

Best Practices: Conducting the Compensation Committee Meeting

Presentation for:
Executive Compensation Webinar Series
April 11, 2019

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About Anthony “Tony” Eppert



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- Tony practices in the areas of executive compensation and employee benefits

- Before entering private practice, Tony:
 - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
 - Obtained his LL.M. (Taxation) from New York University
 - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
 - Editor-in-Chief, Journal of Medicine and Law
 - President, Tax and Estate Planning Society

Upcoming 2018 and 2019 Webinars

- Upcoming 2019 webinars:
 - Anatomy of ISS (5/9/2019)
 - Tips to Increase the Longevity of the Equity Plan's Share Reserve (6/13/2019)
 - Multi-Disciplinary Facets to Net Withholding: It Ain't Boring (7/11/2019)
 - Everything Perquisites: The 101 Training Course (8/8/2019)
 - Preparing for Proxy Season: Start Now (Annual Program) (9/12/2019)
 - Stock Ownership Policies & Clawback Policies: Design Pointers (10/10/2019)
 - Employee Stock Purchase Plans: The Introductory Course (11/14/2019)
 - How to Design Restrictive Covenants & Economic Forfeitures (12/12/2019)

- Sign up here: <https://www.huntonak.com/en/insights/2018-executive-compensation-webinar-schedule.html>

Our Compensation Practice – What Sets Us Apart

- Compensation issues are complex, especially for publicly-traded issuers, and involve substantive areas of:
 - Tax,
 - Securities,
 - Accounting,
 - Governance,
 - Surveys, and
 - Human resources

- Historically, compensation issues were addressed using multiple service providers, including:
 - Tax lawyers,
 - Securities/corporate lawyers,
 - Labor & employment lawyers,
 - Accountants, and
 - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation



Our Compensation Practice – What Sets Us Apart (cont.)

- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement “best practices”
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

Intro and Overview of Legal Standards (Del. Law)

- There are two primary legal standards under Delaware law that are applicable to members of the Compensation Committee (the “**Committee**”)
 - Duty of Care, and
 - Duty of Loyalty

- Duty of Care
 - The duty of care requires Committee members to make informed decisions, based upon all material information, and only after critically assessing such information
 - The Committee is permitted to rely upon professionals, but only if such professionals were chosen by the Committee with reasonable care (*i.e.*, after verification the professional possesses the requisite expertise)

- Duty of Loyalty
 - Each member of the Committee must put the best interests of the Company and its shareholders first and not apply the personal interests of the Committee member
 - In instances where a Committee member has a conflict of interest (which is not typical given that the Committee members are independent and deliberate on compensation matters), such member has a duty to make FULL disclosure to the other members of the Committee, and depending upon the facts, make full disclosure to the full Board of Directors

General Duties and Responsibilities

- The duties and responsibilities of the Committee are those that were delegated to it by the Board of Directors pursuant to the Compensation Committee Charter
 - Compensation philosophy
 - A primary responsibility of the Committee is to have oversight of compensation decisions with respect to the Company’s executive officers, including the design of a compensation philosophy
 - Such compensation philosophy should motivate executives and align the interests of the executive officers with those of the Company’s long-term shareholders
 - Typically such alignment is effectuated through performance-based compensation
 - At least annually (or more frequently), the Committee should review and approve the compensation goals and objectives that cover the executive team, such goals and objectives to include:
 - Balance between short-term and long-term compensation,
 - The performance of each member of the executive team, and
 - The compensation levels of each member of the executive team
 - Be sure to provide the Committee with tally sheets and wealth accumulation tables so the Committee is “informed” when deciding the above
 - Proving that the Committee was informed in making a decision bolsters the business judgment rule defense

General Duties and Responsibilities (cont.)

- [Continued from the prior slide]
 - Succession planning
 - Often the Nominating and Governance Committee will be charged with the responsibility of implementing succession planning
 - But to the extent the Committee is charged with such responsibility, the Committee then needs to ensure that the Company has appropriate succession planning for its executive officers and at the Board of Director level
 - With respect to the CEO, such succession planning should include both long-term planning and cover planning for emergency situations
 - The succession plan should be regularly monitored (at least annually) and revised (as needed) to eliminate gaps within the talent pool
 - Such planning should include the development of short-term and long-term talent
 - To ensure that the Committee is informed in making decisions surrounding succession planning, consider having the CEO report to the Committee on the performance of his or her direct reports. And too, consider providing the Committee with an opportunity to engage the various direct reports
 - At least annually, the Charter should be reviewed and reassessed by the Committee
 - Any proposed changes to the Charter must be submitted to the full Board for their approval

General Duties and Responsibilities (cont.)

- [Continued from the prior slide]
 - With the help of HR, legal and possibly finance, the Committee should oversee the process of determining whether any of its compensation policies and practices (for any group of employees, not just the NEOs) create material risk
 - If a compensation policy is “reasonably likely to have a material adverse effect” on the Company, then a stand-alone discussion of this risk must be presented within the proxy
 - If required, this discussion should be outside of the CD&A because it covers more than just the NEOs (*i.e.*, consider placement within the governance section)
 - Many companies provide affirmative disclosure even when there is no required disclosure (*i.e.*, positive disclosure is good!). The most prevalent type of affirmative disclosure is disclosure of the “process” for evaluating risk within the Company’s compensation programs, including:
 - The Committee’s (or Board’s) role in risk management, and
 - An overview of the programs and elements reviewed in the process, including an overview of the parties conducting the review
 - HR/legal must develop a process to determine the above by:
 - Identifying all plans,
 - Assessing risk, and
 - Making a determination
 - Most important to the foregoing is the “process”

General Duties and Responsibilities (cont.)

- [Continued from the prior slide]
 - The Committee must conduct a self-evaluation of itself on an annual basis. If such self-evaluation occurs pursuant to a discussion at a meeting of the Committee, be careful when drafting the minutes so as to not create litigation risk

Committee Books and Records

- Increasingly, shareholders are requesting a copy of a Company's books and records with respect to executive compensation matters.
- Books-and-records requests (Delaware law)
 - Shareholders may seek to receive related corporate records through a simple (and inexpensive) books-and-records request. Litigation may follow
 - Newsworthy payouts (*i.e.*, high executive severance) may trigger a books-and-records request for related documents
 - By way of example, in one case payment of \$57mm in severance triggered a claim of excessive compensation, and the result was a books-and-records request for related documents.
 - Keep in mind that the standard for requiring a Company to produce compensation-related documents in response to a books-and-records request is low. Only a “credible basis” from which the Court could infer “possible mismanagement” is required
 - As noted by the above Court, directors who “choose not to ask questions” regarding executive compensation “take the risk that they may have to provide explanations later, or at least produce explanatory books and records” as part of a books-and-records investigation
 - In order to help prove that the directors satisfied their fiduciary duties of care and loyalty when approving executive compensation (especially large dollar amounts), the records of the meeting should be heavily documented and include tally sheets. Additionally, minutes should reflect appropriate deliberations in person or by a telephonic meeting

Meetings and Written Materials

- The Committee should meet as frequently necessary
 - Just remember that the number of meetings held in the prior fiscal year will be disclosed in the proxy statement
- The CEO and other executives (if applicable) should not be present for a portion of the meeting so that the Committee can deliberate on their compensation packages
 - Consider having the beginning of the Committee meeting without the CEO and any executives so that the Chair of the Committee can set the stage for what he or she wants to accomplish in the meeting
- Written materials such as minutes are critical to proving that the Committee members were informed and that their decisions were deliberative
 - Written materials should be provided to the Committee in advance of the meeting (as far in advance as is feasible)
 - Consider whether it makes sense for the record to show that the Committee deliberated on a topic more than 1x (*i.e.*, first, when the executive officers raised the topic with the Committee, followed by the executive officers later implementing the Committee's direction to develop the point, and second, to bring the matter back to the Committee for its action)

Meetings and Written Materials (cont.)

- [Continued from prior slide]
 - In the minutes, be sure to record the time and date, where the meeting took place, any and all compliance with the notice procedures, the date in advance of the meeting on which the written materials were provided to the Committee members, and those in attendance (including those who were invited to attend such as experts)
 - A purpose of recording which Committee members were in attendance (physically or via phone or video) is to document that the meeting satisfied the quorum requirement
 - Absent a quorum, actions taken by the Committee are voidable
 - The minutes should also record the discussion points (both pros and cons) of an issue, along with the action taken by the Committee
 - Any abstentions or objections should be recorded in order to show a possible Court that the issue was not missed, and that the positions were fully discussed
 - The minutes should include the advice of any experts, and if a report was provided by the expert, consider attaching such to the minutes
 - In advance of the next meeting of the Committee, the minutes from the prior meeting should be circulated and then approved at such next Committee meeting

Tally Sheets

- If the business judgment rule is applied:
 - Then the decisions of a director will be presumed to have been informed, made in good faith, and accomplished with the belief that such was in the best interests of the Company
 - The presumption makes it more difficult for a plaintiff to prove the director breached his/her fiduciary duties

- Tally sheets (a.k.a. a “placemat”)
 - Tally sheets are important for a director to help preserve the defense of the business judgment rule because tally sheets are facially proof that the director made an “informed” decision, even if in retrospect the wrong decision
 - A tally sheet lists each component of an executive’s compensation and tallies it up
 - Committees should require a tally sheet showing the range of potential payments in alternative scenarios
 - It should be prepared and explained by a compensation expert
 - It should be attached to the minutes

- Amounts to tally include:
 - Income for the year,
 - Projected values under different performance and termination scenarios,
 - Realized option and stock gains (last 5 years), and
 - Total wealth accumulation

Wealth Accumulation Tables

- Wealth accumulation analyses focus on how much wealth the executive will accumulate at various career points
 - Such includes realized and unrealized equity value, plus deferred income (e.g., retirement plans)

- Wealth accumulation tables are used to help determine:
 - Wealth accumulation targets,
 - A reasonable minimum guaranteed wealth and from what sources,
 - How performance metrics figure into the analyses,
 - Whether accumulation is appropriate in the context of his or her overall compensation,
 - Whether, from a shareholder's perspective, the shareholders should fund the level of accumulation, and
 - Whether improved long-term incentive plans could create better alignment with shareholders

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Kellililienstern@HuntonAK.com

Committee Advisors

- Under NYSE listing standards, the Committee has discretion to hire independent advisors such as independent legal counsel, compensation consultants, etc.
 - The Company MUST provide applicable funding for reasonable fees

- In considering whether an advisor is independent, the Committee must assess the advisor's independence, including following 6 factors PRIOR to the Committee hiring such advisor:
 - Whether other services are provided by the advisor's company to the Company,
 - If yes, the amount of fees the advisor's company receives from the Company for such other services relative to the fees the advisor receives for advising the Committee,
 - Whether the advisor has a personal or business relationship with a member of the Committee or with any executive officer of the Company,
 - Any conflict-of-interest policies of the advisor's company, and
 - Whether the advisor owns stock in the Company

Don't Forget Next Month's Webinar

- Title:
 - Anatomy of ISS

- When:
 - 10:00 am to 11:00 am Central
 - May 9, 2019