Cooley

Comp Talks

Key takeaways

Director Compensation

At our Comp Talks session on February 21, 2024 – **Director Compensation** – Cooley partners Peter Adams, Ariane Andrade and Ali Murata discussed various topics and developments relating to director compensation. Below are some key takeaways summarized by Cooley associate Nathaniel Hearn.

Director compensation remains a target of stockholder litigation. Despite a recent decrease in stockholder challenges to director compensation, director pay is still heavily scrutinized by plaintiffs' attorneys. Delaware law empowers directors to set their own compensation, and without a stockholder-approved director compensation program meeting certain requirements, these self-interested decisions are subject to the most stringent level of judicial review under Delaware law (the "entire fairness" standard).

Comprehensive director compensation limits remain good governance. Following the Delaware Supreme Court's 2017 decision in *Investors Bancorp*, "meaningful" director compensation limits in stockholder-approved equity incentive plans are no longer sufficient – on their own – to confer the protection of the more deferential "business judgment rule" with respect to director compensation decisions. However, the use of meaningful limits in equity plans, applied to both cash and equity compensation paid or granted to nonemployee directors, continues to be the prevailing practice in good corporate governance.

Avoid being an outlier. When designing nonemployee director compensation programs, the board of directors should work with outside advisers and undertake a market analysis to ensure that the proposed compensation levels are within range for the company's industry and specific peer group. Companies at the greatest risk for unwanted attention from stockholders looking to challenge director compensation decisions frequently maintain director compensation programs providing for compensation that is significantly higher than the median of their peers.

Don't "set it and forget it." Given the growing complexity of the director compensation landscape, it is crucial for boards and compensation committees to regularly reevaluate and closely monitor director compensation programs, along with ensuring that a rigorous process for setting director compensation is in place. Nonemployee director compensation design should be reviewed periodically and compared against then-current market and peer data to ensure that total compensation levels and components remain appropriate and within the norm.

Know your documents. For administrative ease, consider memorializing the details of the director compensation program – including cash and equity compensation, vesting schedules, timing for payment and any applicable limits on director compensation – in a formal director compensation policy that provides for automatic equity grants to nonemployee directors without further board or committee action after the policy is adopted. Ensure that all relevant parties, including stock plan administrators, have up-to-date copies of the nonemployee director compensation policy and are aware of the form and amounts of compensation, as well as the schedules for vesting and payment, to avoid foot faults.

Special director compensation is on the rise. The competition for director talent has never been stronger, and increasingly, prospective directors are negotiating special awards outside of the standard director compensation packages. These awards should be approved by the disinterested board or committee members before the new director joins the board to ensure that the decision receives the protection of the business judgment rule. Directors also may receive one-time awards in consideration of their performance of significant additional duties, such as work related to an M&A transaction. In either case of a special or one-time award, don't forget that any limits on director compensation in the company's equity incentive plan will apply.

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