Cooley

Comp Talks

Key Takeaways:
Director Compensation Trends and Litigation Developments

At the Comp Talks session on September 29, 2021, **Director Compensation Trends and Litigation Developments**, our panelists – Cooley partners Peter Adams and Alessandra Murata – discussed the latest developments surrounding the director compensation-setting process for public companies' boards, including policy and design considerations, as well as the recent landscape of breach of fiduciary dutyclaims. Here are some of the key takeaways summarized by Cooley lawyer Dani Nazemian:

Director compensation is more complex than ever and continues to evolve. The convergence of apandemic, increasing director responsibilities and the need to attract candidates with specialized expertise and diverse backgrounds has resulted in unprecedented competition for qualified director candidates and more directors are negotiating compensation including special sign-on and one-time awards.

Although there has been a decrease recently in litigation activity surrounding director compensation, director pay is still routinely scrutinized by plaintiffs. As a precursor to filing a derivative lawsuit, shareholders (and their counsel) often challenge director compensation by sending a "books and records" demand. Companies who receive such a demand, or any other challenge to directorcompensation (including a derivative complaint), should reach out to their counsel to determine the appropriate way to proceed.

The best indicator of whether a company's director compensation program is likely to be challenged is where its director pay falls relative to the company's peers. The panelists stressed theneed for companies to closely examine their peer group and to consider how the peers were selected – and whether they are comparable to the company. The use of aspirational peer groups can be especially problematic. Additional factors to consider are company performance, industry and public disclosures.

Including a limit in a shareholder-approved plan is recommended to mitigate litigation risk. Although shareholder approval of a discretionary plan with a "meaningful limit" on director compensation no longer results in automatic application of the more deferential business judgment rule, the panelists recommended including and obtaining shareholder approval of such a limit, which is helpful if a company's director pay program is challenged. The key is to ensure the limit provides discretion and flexibility, but also sets a reasonable upper boundary on compensation. The panelists suggested that, alternatively, companies could consider adopting a formula plan, which eliminates flexibility and is not theprevailing practice, but ensures protection of the business judgment rule.

Process is key when implementing a director compensation program. The panelists discussed the importance of checking the relevant universe of company documents for limitations on the type and termsof director pay. Attention should be paid to properly identifying the body approving compensation and to the selection of the company's compensation consultant. A director compensation program may take the form of a policy or, alternatively, may be approved on an annual basis. Although the determination of director compensation on an annual basis preserves discretion, it is important to consider:

- Optics
- The associated litigation risk
- Timing issues in connection with the board's possession of material nonpublic information
- The time commitment associated with annual iterations of director compensation

A company's pay philosophy will drive decisions that impact director compensation policies, which shouldaddress the form of pay and treatment in the event of a change in control.

Director compensation is not "set it and forget it." The panelists stressed that best practice is to review director compensation each year before the annual meeting, even if the structure is not changing. This is especially important if a company provides for fixed share grants within a director compensation policy and if the company has experienced stock price volatility. The panelists noted that it is crucial for companies to closely monitor their director compensation programs, particularly given the growing complexity of the director compensation landscape, the increased demands on and for directors, and special requests by new and current directors.

Mistakes happen – don't panic! In the event that a director compensation limit is inadvertently exceeded or if other errors are made in connection with the implementation of a company's director compensation program, the panelists encouraged companies to connect with their counsel to address possible remedies and next steps. The panelists also provided disclosure examples in an appendix to the presentation.

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