

Employee Stock Plan Proposals at the Tech 120

2016 WAS ANOTHER BUSY YEAR for employee stock plan proposals among the 120 largest publicly-traded technology companies primarily headquartered in the San Francisco Bay Area (the “Tech 120”).

This Thoughtful Pay Alert summarizes the results of our review of the Tech 120 stock plan proposals, based on the information disclosed in the companies’ proxy statement filings with the Securities and Exchange Commission.

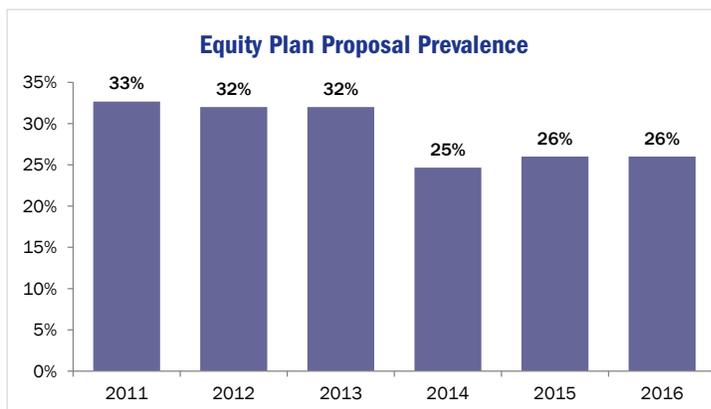
Number of Employee Stock Plan Proposals Remained Constant in 2016

Thirty-one companies in the Tech 120 submitted employee stock plan proposals to their shareholders (based on a review of proxy statements filed for companies with fiscal year ends during the period from June 1, 2015 through May 31, 2016). This number is consistent with Tech 120 practices in 2015 and 2014.

As in each of those years, 36 companies (29%) of the Tech 120 have an active “evergreen” feature in their current plan which provides for the annual replenishment of shares to the plan share reserve without shareholder approval for up to 10 years following an IPO. Only two of those companies (Twitter and Yelp) submitted employee stock plan proposals to shareholders in 2016. 29 of the remaining companies in the Tech 120 (34%) submitted stock plan proposals to shareholders in 2016.

This pattern reflects the typical life cycle for many employee stock plans where mature public companies generally seek to replenish their employee stock plan share reserve, or adopt a new plan, approximately every two to three years (although, as discussed in the next paragraph, this practice may be about to change). This pattern also reflects, in part, the dilution policies of the major proxy advisory firms, such as Institutional Shareholder Services (“ISS”), and certain institutional investors, which typically limit the number of shares that they will approve for issuance at any given time for purposes of making equity awards.

As has been well-publicized, ISS made significant changes to its employee stock plan voting guidelines in advance of the 2015 proxy season and has continued to refine (and tighten) these guidelines in its 2016 and 2017 annual updates to require additional changes in both the stock plan provisions and/or company grant practices “pillars” to garner a favorable vote recommendation. Given the importance of obtaining shareholder approval of a new plan or share reserve increase, we have seen a number of companies make changes to the features in their plan in response to these refinements. In particular, we note that 13 of the 31 companies (42%) seeking shareholder approval in 2016 added one-year minimum vesting requirements for awards to the features in their plans. We have also seen a distinct compression in the size of the ISS-compliant share requests, which, we believe, may lead to a reduction in the share pool replenishment cycle in the competitive market (for example, from every two to three years to every one to two years).



Employee Stock Purchase Plan Proposals

We also note that 15 companies (13%) in the Tech 120 submitted employee stock purchase plan proposals to their shareholders during the past 12 months (compared to 19 and 21 companies during the 2015 and 2014 proxy seasons, respectively).

Employee Stock Plan Proposals at the Tech 120 (continued)

Director Compensation Limits

In response to the recent focus on director compensation, we saw 22 of the 31 companies (71%) seeking shareholder approval in 2016 include an express annual limit on the compensation that may be paid to the non-employee members of their board of directors in their stock plan provisions. These limits were split equally between limiting both cash and equity compensation and equity compensation only. Further, these limits were expressed as a dollar amount at 18 companies (82%) and as a specific number of shares at four companies (18%). For those annual limits stated as a dollar amount, the limit ranged from \$775,000 to \$1 million at the 50th to 75th percentiles.

Size of Share Reserve Requests in 2016

Among the companies that sought shareholder approval of a new or amended employee stock plan in 2016 (30 companies excluding Yelp, which with a dual class of common stock structure and a significant post-request share pool is a market outlier), the share requests (as a percentage of the company’s outstanding shares) ranged as shown below.

Continued Decline in Prevalence of Fungible Share Provisions

In 2016, less than half of the employee stock plan proposals submitted to shareholders (45%) included a “fungible share” provision that limits the number of shares that may be granted from the share reserve under full-value equity awards (such as restricted stock unit and performance share awards). This prevalence level continued the sharp decline in such provisions seen between 2015 (65%) and 2014 (83%), which is the likely result of the continued shift from broad-based stock options to full-value awards at Tech 120 companies.

“Fungible share” provisions provide companies with a greater number of shares in their employee stock plan share reserve for the grant of stock options, but are neutral with respect to the number of shares available for the grant of full-value awards under the reserve. (For example, where a company has 10 million shares in its plan share reserve and a 2:1 fungible share ratio for full-value awards, it may grant stock options covering up to 10 million shares or full-value awards covering up to five million shares.) Where a company has dropped stock options from its annual equity strategy, the use of a fungible ratio to maxi-

Equity Plan Reserves								
	June 2014 to May 2015 (n=31)				June 2015 to May 2016 (n=30)			
	New Shares as %	Current Shares as %	Total Shares as %	Plan Fungible Ratio	New Shares as %	Current Shares as %	Total Shares as %	Plan Fungible Ratio
Market 75th	5.58%	6.00%	10.25%	2.00	6.34%	5.56%	11.11%	1.71
Market 50th	3.77%	4.94%	8.49%	1.50	4.33%	3.36%	9.20%	1.00
Average	4.92%	4.75%	9.67%	1.50	4.75%	4.17%	8.92%	1.54
Market 25th	2.26%	2.59%	6.73%	1.00	2.49%	2.04%	6.12%	1.00

All Proposals Approved in 2016

As has been the case in each of the last four years (2012 through 2015), each of the 31 companies submitting an employee stock plan proposal to its shareholders in 2016 saw its proposal approved by shareholders. The average level of support was 86% of the votes cast, and 71% of the shares outstanding.

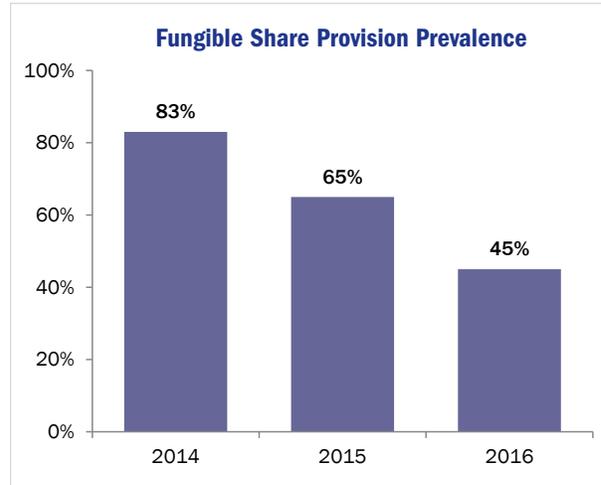
mize the utility of the share reserve is no longer necessary. (In the previous example, the company could seek approval of a reserve of only five million shares and still grant full-value award shares covering five million shares (such awards would be counted on a 1:1 basis for shares reserve accounting purposes).) Since a plan share reserve of only five million shares represents a smaller percentage of a company’s outstanding shares, this approach (including the absence of a fungible share provision) is likely to be favored by certain shareholders.

Employee Stock Plan Proposals at the Tech 120 (continued)

In 2016, the fungible share ratios ranged between 1.36:1 to 2.17:1 (with a median of 1.74:1) and, in most cases, were specifically derived for each company from the relative fair value of a full-value award compared to the fair value of an appreciation-based award (based, in many cases, on ISS' notion of "fair value").

Need Assistance?

Compensia has extensive experience in assisting companies in formulating employee stock plan proposals and developing effective strategies for obtaining shareholder approval of such proposals. If you would like assistance in analyzing your equity compensation strategy or negotiating the various pressure points in implementing an employee stock plan or a share reserve increase, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Jason Borrevik at 408.876.4035 or Mark A. Borges at 415.462.2995. ■



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