

Director Compensation Litigation – A Mid-Year Update

Since last year's decision in the Delaware Court of Chancery (*Calma v. Templeton et al.*) reaffirming the principle that director compensation may not be protected by the "business judgment" rule because directors are inherently conflicted when setting their own pay (see our Thoughtful Pay Alert, [Protecting Your Director Compensation Decisions from Claims of "Excessive Pay"](#)), much has happened in the area of director compensation litigation. Since the *Calma* court determined that the general plan limit on the size of equity awards was not "meaningful" for purposes of board compensation, we have seen a noticeable increase in the number of companies adding limits for equity awards to directors and then submitting these limits for shareholder approval. This Thoughtful Pay Alert summarizes the latest developments and discusses how companies seeking to minimize the risk of "excessive pay" claims should go about crafting a suitable pay limit for their director compensation program.

Companies Begin to Gain Traction in Defending Lawsuits

While numerous lawsuits alleging breach of fiduciary duty involving "excessive" director compensation await resolution, recently we began to see companies experience some success in defending themselves against these claims. In March, salesforce.com disclosed that it had reached an agreement to have a suit alleging "excessive" director pay dismissed with prejudice. In addition, in April, Unilife Corporation disclosed that it had entered into a non-monetary settlement resolving a similar lawsuit alleging that the Board of Directors had overpaid itself, resulting in dismissal of the action.

A Settlement in the Citrix Systems Matter May be Near

According to a June report in *Agenda*, following its loss in *Calma v. Templeton*, Citrix Systems, Inc. may be near a settlement with plaintiff John Calma. Under the terms of a proposed compromise and settlement filed with the Dela-

ware Court of Chancery, which must still be finalized, the company has agreed to:

- limit annual equity awards to non-employee directors to a value of no more than \$795,000 as of the grant date;
- obtain stockholder approval of this limit at its 2017 Annual Meeting of Stockholders;
- provide disclosure beginning in the proxy statement for its 2017 Annual Meeting of Stockholders describing its compensation philosophy and rationale underlying non-employee director compensation, the process used to determine non-employee director compensation (including the role and analysis of the compensation consultant advising the Compensation Committee), and the specific compensation awarded to non-employee directors in the covered fiscal year; and
- amend the Compensation Committee's charter to expressly state that the committee is responsible for (i) conducting an annual review and evaluation of the cash and equity compensation paid to its non-employee directors, (ii) engaging an independent compensation consultant to analyze competitive market data and advise the committee on its non-employee director pay decisions, and (iii) recommending to the Board of Directors the compensation to be awarded to the non-employee directors.

Setting an Effective Compensation Limit

While, in light of the foregoing developments, the ongoing risk of director compensation litigation may be problematic, we continue to recommend that boards of directors (either through their compensation or nominating and governance committee) review their director compensation program and, where appropriate, take protective steps to minimize their potential exposure. For many companies this will involve establishing a realistic and meaningful limit on the compensation payable to the members of the board of directors in any one year.

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We have reviewed the definitive proxy statements for the Bay Area Tech 120 (which consists of the most prominent technology companies headquartered in the San Francisco Bay Area (primarily in Silicon Valley)) as of the end of June 2016 and determined that, in response to the uncertainty in the area of director compensation, there has been a notable increase in companies adopting a director compensation limit. **Based on our review, we have identified 34 companies (28.3%) that, in either their 2015 or 2016 proxy statement, have disclosed or added a limit for director compensation to their employee stock plan (the “Reviewed Companies”).**¹ In each case, this limit was either included as a feature of a new employee stock plan or being added as an amendment to an existing plan. We did not identify any companies that were amending their existing plan for the sole purpose of adding a director compensation limit.

¹ Our review did not include companies that may have adopted a director compensation limit prior to 2015 or where the Board of Directors may have adopted such a limit without formally seeking shareholder approval.

In setting appropriate limits, we recommend the following:

- **Consider a limit that covers both cash and equity compensation** – While the *Calma* decision and several other recent lawsuits only attacked the equity awards granted to directors, the legal principles articulated by the Delaware Court of Chancery apply equally to cash and equity. Accordingly, we believe it is prudent to establish limits on both pay elements (or an overall limit on how much can be paid in a single year) and seek shareholder approval of director compensation in its entirety.
 - ▶ Seven (20.6%) of the Reviewed Companies have adopted a compensation limit that applies to both cash and equity compensation.
- **Express the limit in dollars** – Regardless of whether you limit the size of annual equity awards or overall compensation for a single year, we believe this limit should be expressed in dollars rather than, in the case of equity awards, a specific number of shares. While among larger public companies the two practices are somewhat evenly split, among technology companies the majority tend to use a dollar-denominated limit. In our view, a dollar-denominated limit is preferable because it is simpler, more transparent, and alleviates the potential problems that may arise from a share-

denominated limit, which may fluctuate significantly based on stock price volatility.

- ▶ Twenty-four (70.6%) of the Reviewed Companies have adopted a compensation limit that is expressed in dollars.
- **Consider establishing a “carve-out” for special situations** – Given that some directors are required to perform additional duties, such as serving as Board Chair or Lead Director, a “carve-out” from the director compensation limit (or a separate, somewhat higher limit) for directors serving in these positions provides a compensation framework which is easy to explain and administer.
 - ▶ Fifteen (44.1%) of the Reviewed Companies have adopted a compensation limit that provides exceptions for either the initial year of service or in recognition of a director performing additional duties.
- **Consider whether to establish separate limits for different equity vehicles** – Given that stock options and full value awards are valued differently for financial reporting and economic purposes, to maintain maximum flexibility for the re-design of your future equity award mix it may be useful to consider separate limits for each award type.
- **Ensure the limit is meaningful** – As noted by the Delaware Court of Chancery, for a limit to be given deference, it must be “meaningful.” Consequently, a limit that represents an arbitrary multiple of current pay levels may be problematic. We believe that the limit should be established only after a thorough review of current market practices, taking into account current – and potential future – director responsibilities and board size, and after making reasonable assumptions about ongoing competitive considerations.
 - ▶ The dollar-based limits established by the Reviewed Companies vary from \$300,000 to \$1,500,000 per year, with a median dollar amount of \$750,000 per year.
- **Ensure the limit-setting process is transparent** – With director compensation squarely in the spotlight, we believe that it is incumbent on companies to clearly and thoroughly explain how they set their director compensation levels. To us, this means disclosing whether (and, if so, how) competitive market data fac-

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tors into determining pay practices and levels, as well as the rationale for the various features of your director compensation program. Examples of such disclosure can be found in the definitive proxy statements of [Alliance Data Systems Corporation](#) and [Piedmont Natural Gas Company, Inc.](#)

the members of the board of directors. If you would like assistance in developing or reviewing your director pay practices, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Mark A. Borges. ■

Need Assistance?

Compensia has extensive experience in helping companies design and implement compensation programs for

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Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

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