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Key Trends in Executive Compensation, Employment Law and Compensation Committee Practices

On January 29, 2020, Skadden hosted the webinar "Key Trends in Executive Compensation, Employment Law and Compensation Committee Practices" presented by panelists **Michael Bergmann**, Executive Compensation and Benefits counsel; **Young Park**, Executive Compensation and Benefits counsel; and **Anne Villanueva**, Labor and Employment associate. The main takeaways are summarized below.

Recent Trends in Executive and Director Compensation

Executive Perquisites

Ms. Park began by discussing the heightened scrutiny that companies are receiving from the Securities and Exchange Commission (SEC), proxy advisory firms and activist shareholders regarding the provision and disclosure of executive perquisites. She surveyed some recent, high-profile examples, including an SEC action regarding perquisites that did not hinge on proxy disclosure but nonetheless reinforces the SEC's focus on ensuring that companies disclose how — and how much — they pay their top executives.

Pay Ratio

Ms. Park then turned to CEO pay ratio disclosures. Mr. Bergmann noted that while few notable developments in this area arose over the past year, pay ratio remains a key shareholder concern. Ms. Park explained that an important compliance matter for companies in 2020 is to evaluate the identity of the median employee in light of any changes in workforce composition, compensation arrangements or the last year's median employee's circumstances. She specified that if a company intends to use the same median employee profile in this year's proxy statement, the company should describe the basis for the reasonable belief that no change in relevant circumstances occurred that would result in a significant change to pay ratio disclosure.

Recent Litigation Developments

Ms. Park next addressed recent Delaware case law regarding nonemployee director compensation. One case involved a company that attempted to qualify for the deferential business judgment standard of review by including in its compensation plan a provision stating that the directors could not be held liable for actions taken in "good faith" with

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respect to the plan or any awards granted pursuant to the plan. While the court found this provision insufficient to bind the company's stockholders or to operate as a waiver of their rights, the case demonstrates both some steps that can insulate nonemployee director compensation decisions from challenge and that process and a good record are important in that regard.

Another case stands as a repudiation of a technique used by some members of the plaintiffs' bar to sidestep the need under Delaware law to either make a demand that a company's board of directors investigate a claim or plead with particularity the reason that making a demand would have been futile. In this case, the plaintiff sent a letter "suggesting" that the board consider taking action but stating that the letter did not constitute a demand. The board, however, treated it as such, conducted an investigation into the allegations and concluded that the board should not pursue them. The court sided with the company and concluded that the letter was in fact a presuit demand and deferred to the board's decision.

Proxy Advisor Compensation Policies Update

Mr. Bergmann discussed the 2020 changes to the compensation policies of advisory firms Institutional Shareholder Services (ISS) and Glass Lewis (GL). Calling the ISS changes relatively modest, Mr. Bergmann reviewed new guidance regarding severance payment disclosure and confirmation that evergreen provisions in equity incentive plans likely will be considered a negative overriding factor for purposes of the Equity Plan Scorecard. Mr. Bergmann then presented factors that GL had made clear could lead to a negative say-on-pay vote recommendation (including, for example, excessively broad change-in-control triggers, inappropriate severance entitlements, inadequately explained or excessive sign-on arrangements and guaranteed bonuses), and he noted that GL had indicated that the failure to appropriately respond to low (80% or less) shareholder support for a prior say-on-pay proposal could cause a negative recommendation for a current proposal.

Employment Law Developments

Ms. Villanueva began by covering the origins and broad reach of the #MeToo movement, which has brought additional focus and attention to sex- and gender-based discrimination.

The Gender Pay Gap and Pay Transparency Laws

Ms. Villanueva explained that federal, state and local governments are making changes, including enacting laws regarding equal pay, salary history bans and pay transparency. In particular, Ms. Villanueva specified that 49 states have equal pay acts, and some — such as California, New York, New Jersey and Massachusetts — have more expansive protections that include new forums for filing claims, longer statutes of limitation, different standards for equity, higher burdens for employers and increased damages for violations.

Ms. Villanueva also described the increase in salary history bans and pay transparency laws. The former are designed to prohibit inquiries into salary history by employers when making hiring decisions or decisions about an applicant's pay, with the goal of breaking the cycle of potential prior wage discrimination. Currently, 13 states and over 20 localities have enacted salary history bans. Ms. Villanueva explained that in the context of mergers and acquisitions, buyers are inheriting seller compensation structures, and as such, buyers should consider undertaking enhanced due diligence to determine if gaps in pay equity exist. Pay transparency, on the other hand, enables employees to discuss their pay without fear of retribution. Ms. Villanueva stated that pay secrecy contributes to the gender pay gap because women cannot challenge wage gaps that they do not know exist. Ms. Villanueva noted that 16 states have enacted pay transparency laws, but currently no federal equivalent exists.

Employment Agreements, Merger Agreement Representations and SEC Disclosures

Next, Ms. Villanueva discussed how we are beginning to see changes in employment agreement representations, cause definitions, and merger agreement representations and warranties in connection with the #MeToo movement. Some companies are adjusting individual compensation arrangements, incorporating sexual harassment into cause definitions, and updating compensation recovery policies to provide for clawbacks or forfeiture of previously paid compensation for sexual misconduct in the workplace.

Companies increasingly are also adding to employment agreements affirmative representations that executives have not engaged in sexual harassment or misconduct, or that executives have not been the subject of any alleged harassment or misconduct. Finally, companies may choose to empower compensation committees to consult with company management to periodically review and update policies on sexual misconduct, including training and reporting procedures.

Ms. Villanueva further discussed ways in which companies may face disclosure of sexual harassment obligations, whether under newly proposed amendments to certain SEC rules or to protect against shareholder derivative and securities law class actions based on executives' and directors' purported responses to underlying harassment allegations. Ms. Villanueva recommended next steps and considerations for companies in light of such allegations, including the severity of the allegations, whether the allegations implicate the company's processes and procedures for protecting against and handling sexual harassment in the workplace, and the timing of the allegations (*e.g.*, in certain situations, disclosure may make sense to preemptively shape the narrative). In sum, Ms. Villanueva stated, companies must weigh a variety of factors in deciding whether to disclose allegations of sexual harassment or investigations, and companies should work with outside counsel to carefully consider disclosure obligations over time.

New Internal Revenue Code Section 162(m) Guidance

Mr. Bergmann ended the presentation by examining the proposed Section 162(m) regulations issued by the Internal Revenue Service (IRS) in late December 2019, noting that the regulations would expand the scope of 162(m) beyond what many had anticipated, including by extending the deduction limitation to a corporation's allocable portion of a subsidiary partnership deduction (*e.g.*, in an "up-C" structure), eliminating transition relief for companies that become publicly held and extending coverage to publicly traded partnerships treated as a corporation. Mr. Bergmann highlighted substantial additional guidance on the "grandfathered" treatment of certain compensation arrangements in effect before the statutory changes — including a welcome clarification that accelerated vesting of grandfathered compensation is not a material modification — but he noted that the proposed regulations largely track prior IRS guidance on grandfathering. In closing, Mr. Bergmann emphasized that taxpayers need to pay particular attention to the various effective dates under the proposed regulations because, while the new rules generally will first apply to taxable years beginning on or after the date of publication of the final regulations, many special and important different (and earlier) dates apply.

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