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Compensation Season 2016

Boards of directors and their compensation committees will soon shift attention to the 2016 compensation season. Key considerations in the year ahead include the following:

1. Say-on-Pay. If a company anticipates a challenging say-on-pay vote with respect to 2015 compensation, it should proactively reach out to large investors, communicate the rationale for the company's compensation programs and give investors an opportunity to voice any concerns. Shareholder outreach efforts, and any changes made to the compensation program in response to such efforts, should be highlighted in the proxy's Compensation Disclosure and Analysis. ISS FAQs indicate that one possible way to reverse a negative say-on-pay recommendation is to impose more onerous performance goals on existing compensation awards and to disclose publicly such changes on Form 8-K, though the FAQs further note that such action will not ensure a change in recommendation. Disclosure of prospective changes to the compensation program will demonstrate responsiveness to compensation-related concerns raised by shareholders.

2. ISS. Management and compensation committees should understand the potential consequences of their decisions under applicable ISS policies, but should not waiver in their commitment to create a culture that attracts and retains talented personnel who will contribute to the long-term success of the company. The ISS position on a particular issue does not always serve the best interests of shareholders, and many large institutional shareholders have disclaimed ISS as a primary source of influence in favor of their own, internally generated policies. The most recent ISS pronouncements regarding executive compensation matters are summarized in our December 22, 2015 memorandum "ISS Publishes Updated FAQs Regarding 2016 U.S. Compensation Policies."

3. New Dodd-Frank Regulations. Last year the SEC adopted final rules regarding pay ratio disclosure. Registrants must include the pay ratio disclosure for proxy statements filed in respect of the first fiscal year beginning on or after January 1, 2017. We continue to await final regulations regarding clawbacks, disclosure of pay for performance and disclosure of hedging by employees and directors. The SEC may finalize these rules as soon as early 2016.

4. Shareholder Activism and Change in Control Protections. Companies should ensure that they understand how their change in control protections function if an activist obtains a significant stake in the company or control of the board. Appropriate protections ensure that management will remain focused on shareholder interests during a period of significant disruption; inadequate protections can result in management departures at a time when stability is crucial. The best time to review these protections and ensure their adequacy is before an activist surfaces.

5. Equity Compensation Plan Matters. Companies should determine whether a share increase or new plan needs to be submitted to shareholders at this year's annual meeting or whether the performance goals under their incentive plans require re-approval in order to preserve the plan's exemption from tax code Section 162(m) and the continued deductibility of performance-based compensation. When seeking shareholder approval of an equity plan, companies should understand the likely voting recommendations of the proxy advisory firms, and consider whether additional plan changes or other steps will be required to ensure plan approval.

6. Compensation-Related Litigation. Set forth below are the principal categories of compensation-related litigation in recent years and some suggestions that may mitigate the likelihood of such actions.

- *Disclosure Regarding New or Amended Equity Plans.* A robust description of the determination of the number of shares covered by a new or amended equity plan and the dilutive impact of the plan shares may reduce the likelihood of a lawsuit alleging inadequate disclosure.

- *Compliance with Plan Terms and/or Section 162(m).* Care should be taken to administer plans in accordance with their terms, including applicable limits on share grants and cash incentive payments. Plans should be drafted to provide flexibility to grant non-deductible awards and should not commit to the preservation of deductibility, including when exercising administrative discretion. Proxy statements should include disclosure that highlights that flexibility and the possibility that even awards intended to be deductible may not be.

- *Director Equity Grant Limitations.* Consider including in new or amended omnibus equity plans provisions specifying the precise amount and form of individual grants to directors or a meaningful director-specific individual award limit. These limits may help to avoid claims challenging the level of director compensation.

7. Excise Tax Exposure in M&A Transactions. M&A transactions may expose company employees to punitive taxes, including the 20% excise tax on golden parachute payments (Section 280G), the 15% excise tax on equity compensation awards in inversion transactions (Section 4985) and the 20% penalty tax on non-compliant deferred compensation (Section 409A). By planning ahead, companies may be able to mitigate or eliminate these tax exposures. Properly implemented non-compete arrangements and acceleration of taxable compensation into the year prior to a transaction closing may mitigate the 280G excise tax. An equity award cash out may avoid the application of the inversion excise tax. And there is a robust corrections framework that allows companies to fix certain broken arrangements under Section 409A. Finally, where mitigation or remediation are impractical solutions to the application of one of these punitive taxes, make-whole arrangements may be appropriate.

8. Executive Succession. During the last twelve months, we have continued to witness a number of high profile CEO turnovers. Planning for succession of the CEO and other senior executives is critical for the long-term success and stability of any public corporation. The board should evaluate annually the status of future generations of company leadership, and the new year is a good time to highlight this priority item.

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