



Compensation Committee Guide 2014

Posted by Kobi Kastiel, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Monday March 24, 2014

Editor's Note: The following post comes to us from [Michael J. Segal](#), partner in the Executive Compensation and Benefits Department of Wachtell, Lipton, Rosen & Katz, and is based on the introduction to a Wachtell Lipton memorandum by Mr. Segal, [David C. Karp](#), [Jeannemarie O'Brien](#), [Adam J. Shapiro](#), [Jeremy L. Goldstein](#), and [David E. Kahan](#); the complete memorandum is available [here](#).

The past year in executive compensation has been marked by two continuing trends: (1) a continuing refinement of conceptions of so-called “best practices” advocated by certain shareholders and responses to those refinements by compensation committees, most notably in the context of the nonbinding, advisory “say-on-pay” vote required by the Dodd-Frank Act (“Dodd-Frank”) and (2) an increased desire by corporations to engage with shareholders to convince them of the appropriateness of their responses and the corporation’s compensation arrangements generally. Against this backdrop, the key challenge for compensation committee members has been to continue to approve compensation programs that directors believe are right for their corporations while maintaining a sufficient understanding of these emerging shareholder views and communicating the appropriateness of their arrangements to avoid attacks that could undermine directors’ abilities to act in their company’s best interest.

Compensation committees should design compensation programs with great care, focusing first and foremost on the incentives that the programs promote. Directors should also bear in mind the heightened sensitivity to pay packages that could be deemed “excessive.” This is particularly true in today’s environment, which has witnessed a marked increase in litigation on executive compensation matters, a trend we expect will continue at least in the short run. All this said, a compensation committee that follows normal procedures and considers the advice of legal counsel and an independent consultant should not fear being second-guessed by the courts, which continue to respect compensation decisions so long as the directors act on an informed basis, in good faith and not in their personal self-interest. In the final analysis, the ability to recruit and retain highly qualified executives is essential to the long-term success of a company.

Given the ongoing shift in the corporate governance landscape, there is a continuing focus by directors on the proper role of a compensation committee. This Guide describes the duties of compensation committee members and provides information to enable them to function most effectively. This Guide begins with a discussion of the responsibilities of the compensation committee and the fiduciary duties of its members. It then outlines different means of compensating executives and the tax and other rules that apply to compensation arrangements. A discussion of change-in-control arrangements follows the discussion of types of compensation. The next section of this Guide focuses on shareholder proposals, relations and litigation, including a discussion of say-on-pay votes and the ongoing influence of proxy advisory firms. This Guide next examines regulation of compensation at financial institutions. The discussion then shifts to compensation committee composition, compensation committee meetings and compensation committee charters. Finally, this Guide addresses compensation of directors.

This edition of the Guide has been updated to reflect the current environment. Significant updates include:

- an updated discussion of the say-on-pay voting process, including a review of the first three years of actual votes and the increasing role of shareholder engagement; and
- an updated section on significant shareholder litigation in the area of executive compensation.