
Preparing for Proxy Season: Start Now (Annual Program)

Presentation for:
Executive Compensation Webinar Series
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About Anthony “Tony” Eppert



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- Tony practices in the areas of executive compensation and employee benefits

- Before entering private practice, Tony:
 - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
 - Obtained his LL.M. (Taxation) from New York University
 - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
 - Editor-in-Chief, Journal of Medicine and Law
 - President, Tax and Estate Planning Society

Upcoming 2021 Webinars

- 2021 webinars:
 - How to Properly Hire and Fire an Executive Officer (10/14/21)
 - A Review of Unique Non-Employee Director Compensation Arrangements (11/11/21)
 - Thoughts on Maximizing the Deductibility of Compensatory Arrangements (12/9/21)

Sign up here: <https://www.huntonak.com/en/insights/executive-compensation-webinar-schedule.html>

Our Compensation Practice – What Sets Us Apart

- Compensation issues are complex, especially for publicly-traded issuers, and involve substantive areas of:
 - Tax,
 - Securities,
 - Accounting,
 - Governance,
 - Surveys, and
 - Human Resources

- Historically, compensation issues were addressed using multiple service providers, including:
 - Tax lawyers,
 - Securities/corporate lawyers,
 - Labor & employment lawyers,
 - Accountants, and
 - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation



Our Compensation Practice – What Sets Us Apart (cont.)

- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement “best practices”
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

Compensatory Snap Shot of 2021 Proxy Season

- Through June 2021:
 - Approximately 90% of the companies passed their say-on-pay vote (slightly up from prior year during same period)
 - Approximately 6.5% of the companies received less than 70% say-on-pay support
 - If less than 70% support is received, then next proxy season ISS will perform a qualitative review to determine the Compensation Committee’s responsiveness to the low passing rate
 - Approximately 89% of the companies received passing support for their equity incentive plan proposals
 - Approximately 55 companies failed their say-on-pay vote (up from approximately 43 failures last year during the same period)
 - A pay-for-performance disconnect or COVID pay adjustments without a compelling rationale were predominate reasons for such failed votes
 - Approximately 11% of the companies faced ISS opposition to their say-on-pay proposals (slightly down from prior year during same period)
 - Noteworthy is that an “Against” recommendation from ISS creates a drop in the pass rate by approximately 32%
 - Lack of pay-for-performance remains the highest reason for a negative recommendation from ISS
 - For shareholder proposals relating to executive compensation, the highest number of submissions related to ESG metrics and pay disparity

Potential Upcoming Tax Changes

- Increase of the top marginal income tax rate for high earners from 37% to 39.6%
 - Applicable to married taxpayers filing a joint return with income over \$509,300
 - Applicable to individuals with income over \$452,700
- Increase the corporate income tax rates from 21% to 25%-28%
- Increase the long-term capital gains rates to 25%-30% for those with income in excess of \$1mm (though Pres. Biden's proposal is at 39.6%)
 - A 3.8% net investment income tax would apply in addition to the foregoing
- For gains in excess of \$1mm, a possible elimination of any ability of heirs to have a step up in basis for when certain property is transferred to the heirs upon the taxpayer's death
 - Some exceptions may apply
- Expand the payroll tax to 12.4% for earnings above \$400,000
 - Such will create what is called a “donut hole” where wages between \$142,800 and \$400,000 are not taxed

Possible Reactions to Upcoming Tax Changes

- Consider accelerating the payment of income that would otherwise be paid in January 2022. For example:
 - Determine whether it makes sense to exercise non-statutory stock option in 2021
 - Should annual bonuses that would be paid in early 2022 be accelerated and instead paid in 2021
 - If audited financials are required to determine whether performance metrics are satisfied, then consider whether the Board or Compensation Committee could make a preliminary conclusion on the performance metrics so as to pay out in December 2021
 - If such determination is too high after actual performance is calculated, then the executive would owe money to the Company
 - And if such determination is too low after actual performance is calculated, then the executive would be owed the remainder

- Revisit non-qualified deferred compensation elections
 - We suspect there will be an increase in the use of non-qualified deferred compensation arrangements

- Any increase in long-term capital gains rates should not impact decisions on whether to seek grants of ISOs (or exercise an ISO) or whether to make an 83(b) election within 30 days of receiving a grant of restricted stock
 - However, an increase in capital gains rates may impact the timing of when to exercise a non-ISO

Possible Items of Interest for Fall 2022

- Some of the more highlighted points are contained on the following slides
- But overall, Compensation Committee concerns will be very similar to its concerns with respect to compensation decisions for 2021, such including:
 - Volatility of stock price and its impact on compensation arrangements such as conversion ratios, stock ownership policies, relative total shareholder return and similar performance metrics, etc.;
 - Addressing underwater stock options;
 - Addressing long-term performance metrics that likely will not pay out;
 - Addressing retention issues for executives who would otherwise receive a “fresh grant” of equity if he or she took employment with another entity;
 - Planning for an exit strategy;
 - Disclosure; and
 - Etc.

Perquisites: Background

- The item in question is a perquisite if:
 - The item is NOT “integrally and directly related to the performance of the executive’s duties” AND
 - Note that the foregoing is not a business purpose test
 - Put another way, whether the foregoing qualifies as a “ordinary” and “necessary” business expense for tax purposes is NOT determinative as to whether the item qualifies as a perquisite for SEC rules
 - The item confers a direct or indirect benefit on the executive that is personal in nature, regardless of whether a business purpose exists or if the item was provided for the convenience of the issuer
- Notwithstanding the above, if the item is made available to all employees on a non-discriminatory basis, then the item is not a perquisite
- Proxy disclosure rules surrounding perquisites
 - No disclosure is required if the value of all perquisites provided to the individual is less than \$10,000
 - If perquisites to an individual is greater than \$10,000, then the value of all perquisites must be disclosed in the All Other Compensation column of the SCT and the type of perquisite must be footnoted
 - Additionally, if perquisites to an individual is greater than \$10,000, then the value of any perquisite that exceeds the greater of \$25,000 or 10% of the value of all the perquisites to that individual must be quantified and disclosed in a footnote to the All Other Compensation column of the SCT

Perquisites: SEC Activity

- July 2018: An issuer settled an allegation by the SEC that the issuer failed to properly disclose approximately \$3mm of perquisites over a 4-year period
 - As background, the issuer applied the wrong standard in its determination of whether an item is a perquisite (*i.e.*, it appeared to have applied a business purpose standard to the job of the individual, which is an incorrect standard)
 - The perquisites in question consisted of:
 - Travel to outside board meetings,
 - Sporting events,
 - Club memberships,
 - Use of a personal assistant's time
 - Board membership fees to a charitable organization
 - According to the SEC, the issuer failed:
 - To have adequate processes and procedures in place so as to ensure proper reporting
 - To adequately train employees responsible for drafting the CD&A
 - As a result, the issuer entered into a settlement offer with the SEC that:
 - Fined the issuer \$1.75mm (a high amount relative to the value of \$3mm in perquisites)
 - Ordered the issuer to retain an independent consultant for a 1-year period in order to assess the issuer's policies and procedures for complying with SEC compensatory securities laws (and the issuer must implement any recommended changes)
 - Ordered the issuer to be subject to compliance monitoring for 2 years

Perquisites: SEC Activity (cont.)

- July 2018: The SEC alleges that, over a 5-year period, the former CEO of an issuer failed to properly disclose certain personal loans provided to him by vendors and failed to disclose as perquisites certain reimbursements he received
 - With respect to the loans, the SEC alleges that:
 - Outside vendors provided the CEO with approximately \$7.5mm in personal loans, and the issuer failed to properly report these loans as related party transactions
 - The issuer failed to disclose in a Form 8-K that its CEO was loaned approximately \$3mm by an individual who was a candidate to become a member of the issuer's Board of Directors, and who at that time was also a portfolio manager at the issuer's largest shareholder
 - With respect to the reimbursements, the SEC alleges that such reimbursements were not reasonable, were personal, lacked sufficient documentation and were not properly disclosed as perquisites within the issuer's proxy statement. The reimbursements in question related to:
 - A charitable donation to his child's school in the amount of \$15,000
 - \$323,000 in costs associated with alcohol and cigars to stock a bar at the office for the benefit of the issuer's executives,
 - A highly expensive bottle of wine that was purchased at a charity auction, and
 - First class plane tickets for his wife and child to travel to a meeting of the Board of Directors in London (*i.e.*, spouses were invited)

Perquisites: SEC Activity (cont.)

- Other recent perquisite enforcement activity includes:
 - Failure of Hilton Worldwide Holdings, Inc. to disclose in its proxy statement approximately \$1.7mm of travel-related perquisites and personal benefits paid to its CEO and other executives. A civil fine resulted
 - Failure of Argo Group International Holding, Ltd. to disclose in its proxy statement over \$5.3mm paid to its CEO with respect to a wide range of perquisites and personal benefits. A civil fine resulted
 - Failure of Gulfport Energy Corporation to disclose in its proxy statement of approximately \$800,000 of travel-related perquisites and personal benefits paid to its CEO. A civil fine resulted
 - Failure of RCI Hospitality failed to disclose in its proxy statement approximately \$615,000 of perquisites and personal benefits. A civil fine resulted

Perquisites: Practical Thoughts

- To ensure current and on-going compliance, issuers should self-assess whether sufficient control measures exist

- For example, issuers should consider:
 - Whether advanced approval by the Compensation Committee is required before any perquisites may be provided to executives
 - Whether the folks responsible for tracking perquisites need additional training or whether such folks should have frequent training on what is a perquisite, calculating the aggregate incremental cost of such perquisites, tracking perquisites and disclosing the same
 - Whether to revise D&O questionnaires so that perquisite-orientated questions are written to be over-inclusive (thus allowing the issuer's trained individuals to make the determination of whether an item is a perquisite or not)
 - Whether a pre-clearance procedure should apply before an officer or director is reimbursed for certain items that arguably could be a perquisite
 - Whether executive-only facilities constitute a perquisite

Quick Thoughts on DEI

- Diversity, Equity and Inclusion (“DEI”) is part of the “S” in ESG (Environmental, Social and Governance)
- Should it be included within the annual incentive program, the long-term incentive program or both?
- Should a qualitative or quantitative approach be used in determining the extent the DEI target is achieved?
- Should the DEI metric be used to drive upward payouts, or instead should it be used as a downward modifier?

Don't Forget Next Month's Webinar

- Title:
 - How to Properly Hire and Fire an Executive Officer

- When:
 - 10:00 am to 11:00 am Central
 - October 14, 2021

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