

CHAPTER 16**Compensation Committees**

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§ 16.06 Chart of Relevant Independent Director Requirements

§ 16.01 Introduction

The compensation committee is today one of the most visible, active and important committees of a board of directors. This was not always the case.

The role of the compensation committee has significantly expanded and evolved over the past two decades. Prior to that time, compensation committees were utilized only to the extent technically required or by a limited number of companies that were historically particularly sensitive to corporate governance matters. Rather than fully utilizing the compensation committee, many companies' executive compensation issues were addressed, as a practical matter, by the company's human resources staff, the chief executive officer or other members of management, a special committee chosen by the company's chairman or the entire board of directors. Depending upon the size and nature of the company, the compensation committee was used only on a limited basis and typically took a relatively passive role in the review and approval of executive compensation. Meetings were formalities and the members infrequently received public attention. Those days are long over and that approach has been largely abandoned by virtually all public companies.

As further explained below, the initial changes in the role of the compensation committee focused predominantly on executive compensation and all types of equity-based award plans and programs, largely as a result of certain court cases in the executive compensation arena, statutory changes, regulatory developments from the Securities and Exchange Commission ("SEC"), guidance from certain self-regulatory organizations (notably, the New York Stock Exchange ("NYSE") and Nasdaq Stock Market ("Nasdaq")), the growing influence of proxy advisory firms (such as Institutional Shareholder Services Inc. ("ISS") and Glass, Lewis & Co. ("Glass Lewis")), and public, media and workforce scrutiny. More recently, the expansion and evolution of the role of the compensation committee has further accelerated as the committee's role now includes areas of focus in addition to executive compensation and

equity-based awards. Many compensation committees now have oversight of, and responsibility for, a wide variety of workforce-related issues, including human capital management, employee engagement, talent development, succession planning (often in conjunction with the nominating and governance committee), diversity, equity and inclusion (“DEI”) matters, and components of the environmental, social and governance (“ESG”) function that relate to executive compensation and workforce matters. Reflecting this expanded role, many compensation committees have revised their charters and have changed their names to the Management Development and Compensation Committee, Human Capital and Compensation Committee, Human Resources Committee, Management Compensation, Development and Human Capital Committee, and other variations. More recently, due to certain governmental pressures and stakeholder perspectives, many companies are revisiting, reframing, discontinuing or, in more limited instances, reaffirming, their DEI and ESG programs, policies and goals, which has caused compensation committees to reevaluate the use of DEI and ESG-related metrics in executive compensation plans and arrangements. Nonetheless, this development has not necessarily caused a retreat to the name “compensation committee” for committees that changed their name and, as a general matter, DEI and ESG-related considerations remain in the purview of compensation committees, although the approach may have changed.

The initial evolution with compensation committees began in the wake of corporate scandals that erupted in the early-2000s, beginning most notably with the bankruptcy of Enron in 2003 and the subsequent stock option backdating controversies. This evolution continued with the global financial crisis that began in 2008 and 2009, which triggered an intensified focus on the compensation of senior executives and the release of additional statutory and regulatory requirements. Increasing pressure mounted on companies to demonstrate that the compensation and perquisites awarded to their senior executives had been fully and knowingly reviewed, considered and approved by the outside, independent directors who made up the compensation committee. Executive compensation also became a political issue.

In response to the actual and perceived abuses concerning executive compensation, certain court cases (largely beginning with the courts in

the *Ovitz* cases¹ and extending more recently to *Tornetta v. Musk*,² the SEC, NYSE and Nasdaq have increased their focus on the procedures taken to review and approve compensation arrangements, the composition and internal workings of the compensation committee and, more recently, on the actual size of compensation packages and specific awards. Some of these cases have called into question whether the business judgment rule or entire fairness standard applies to the decision-making of the compensation committee. This increased scrutiny has affected not only all types of executive compensation, but also non-employee director compensation.

The SEC's proxy disclosure rules focus on expansive and transparent disclosure of compensation arrangements covering named executive officers and the process by which compensation is awarded and decisions are made.³ In an SEC report that reviewed initial disclosures of 350 public companies, and in public comments by its officials and rules it has issued since then, the SEC made explicit its view that companies need to provide clear and meaningful analysis of how and why compensation decisions were made.⁴ The SEC has constantly reinforced that position and companies have responded to it with lengthier and more detailed disclosure, as well as summaries advocating the accomplishments during the year and highlighting the good-governance-favorable features of their compensation programs. Compliance with these disclosure requirements has required public company compensation committees to formalize their compensation philosophies and to carefully consider their processes for making decisions.

Various controversies over the years have prompted changes in the role of the compensation committee. For example, the stock option

¹ In re The Walt Disney Co. Derivative Litigation (“*Ovitz III*”), 906 A.2d 27 (Del. 2006); In re The Walt Disney Co. Derivative Litigation (“*Ovitz II*”), 907 A.2d 693 (Del. Ch. 2005); In re The Walt Disney Co. Derivative Litigation (“*Ovitz*”), 825 A.2d 275 (Del. Ch. 2003).

² *Tornetta v. Musk* (“*Tornetta II*”) No. 2024 WL 4930635 (Del. Ch. Dec. 2, 2024); *Tornetta v. Musk* (*Tornetta I*”), 310 A.3d 430 (Del. Ch. 2024), No. 2018-0408-KSJM, 2024 Del. Ch. LEXIS 27 (Del. Ch. Jan. 30, 2024); *Tornetta v. Musk*, 2019 Del. Ch. LEXIS 999 (Sept. 20, 2019).

³ See, e.g.: “Proxy Disclosure Enhancements,” 74 Fed. Reg. 68334, 74 Fed. Reg. 68334, 68337 (Dec. 23, 2009) (“new” Item 402(s) of Regulation S-K); SEC Release Nos. 33-9089, 34-61175, IC-29092 (Dec. 16, 2009), available at <http://www.sec.gov/rules/final/2009/33-9089.pdf> (last visited Aug. 21, 2025).

⁴ SEC, “Staff Observations in the Review of Executive Compensation Disclosure,” available at <http://www.sec.gov/divisions/corpfin/guidance/excecompdisclosure.htm> (last modified October 9, 2007 and last visited Aug. 21, 2025).

“backdating” controversy⁵ emphasized the need to create procedures concerning the granting of equity-based awards and to ensure that they are followed. Many companies found that even though they did not “backdate” stock options, sloppy administrative procedures caused backdating and, in certain instances, triggered accounting restatements, tax issues, securities reporting and registration concerns, employee claims and other issues. Although many companies improved their grant practices over the past two decades, the SEC continues to focus on stock option granting practices as demonstrated by its issuance of new Item 402(x) of Regulation S-K in December 2022,⁶ which requires narrative disclosure of a company’s policies and practices on the timing of option and option-like awards as well as tabular disclosure of options and option-like awards in relation to the disclosure of material non-public information. Another example involves the focus by the SEC and others (such as shareholders) on the failure to adequately identify and disclose perquisites as compensation in the proxy statement.⁷ The SEC’s enforcement actions and certain court cases have encouraged compensation

⁵ The stock option “backdating” controversy stemmed from an increase of government investigations in 2005 and 2006 into companies suspected of misleading shareholders as to the value of stock option grants they were approving and issuing at a lower exercise price than current fair market value by engaging in the practice of “backdating,” e.g., dating stock options retroactively as of a date when the stock price was lower than the date the stock options were actually granted.

⁶ SEC Release Nos. 33-11138; 34-96492; File No. S7-20-21 (Dec. 14, 2022), available at <https://www.sec.gov/files/rules/final/2022/33-11138.pdf> (last visited July 16, 2025).

⁷ For example, the SEC and Dow Chemical Company (“Dow”) entered into a settlement in July 2018 relating to the SEC’s enforcement action claiming that Dow did not follow the SEC perk disclosure standard from 2011 to 2015 as a result of its failure to adequately identify and disclose approximately \$3 million in perks provided to the chief executive officer (which included personal aircraft use, sporting events, travel to non-Dow board meetings, club memberships, personal assistance time and charities). There was no allegation of executive misconduct, but the SEC determined that Dow used a “business purpose” standard and did not adequately train employees regarding proper perk disclosure. The settlement included a civil penalty of \$1.75 million, use of an independent consultant to recommend changes to company policies and procedures regarding perk disclosure and the adoption and implementation of the recommendations. *Dow Chemical Corp.*, Exchange Act Release No. 83581, 2018 SEC LEXIS 1621 (July 2, 2018). Other examples include: *Stanley Black & Decker, Inc.*, Exchange Act Release No. 97761 (June 20, 2023) (regarding failure to disclose certain perquisites and personal benefits related to corporate aircraft use paid to, or on behalf of, four of its executive officers and one of its directors for a period of three years); *National Beverage Corp.*, Exchange Act Release No. 92560 (Aug. 4, 2021) (regarding failure to disclose company-paid trips for the chief executive officer that were not integrally and directly related to the CEO’s job duties); *Gulfport Energy Corp.*, Exchange Act Release No. 91196 (Feb. 24, 2021) (relating to executive’s expenses

committees (and, in certain cases, audit committees) to take a closer look at perk practices and the disclosure of such perks. This has resulted in improved and enhanced procedures, including bolstering internal controls, creating comprehensive guidelines and training programs for all employees involved in analyzing, administering and reporting perks, and tracking perks in a manner that facilitates compliance and proper disclosure.

Broader proxy disclosure requirements and the potential for SEC review have not, by themselves, dictated the decisions made by the compensation committees. However, in practice, the disclosure requirements and the potential for scrutiny have greatly influenced compensation committee process as well as the substance of compensation decisions, particularly as norms and best practices evolve.

Historic legislation in response to economic turmoil in 2008 and 2009, and shareholder activism generally, have become relevant to the decision of what and how to pay public company executives. The Emergency Economic Stabilization Act of 2008, which established the Troubled Asset Relief Program (“TARP”),⁸ and the American Recovery and Reinvestment Act of 2009 (“ARRA”),⁹ provided governmental aid aimed at stabilizing financial institutions, and contained substantive limits on executive pay of financial institutions participating in the program (including, for example, limiting incentives for excessive risk taking, and clawbacks where compensation was paid based on inaccurate statements of earnings or other goals). ARRA also contained a “say-on-pay” shareholder requirement for participating financial institutions. TARP and ARRA were the harbinger of sweeping legislation that would apply new executive compensation requirements to most public companies regardless of industry and would affect not only compensation committee processes, but also the substance of the decisions made by compensation committees.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”),¹⁰ continued the trends of broadening the disclosure of executive compensation and imposing additional corporate

incurred related to traveling on aircrafts for reasons “not integrally and directly related” to the executive’s duties); *Hilton Worldwide Holdings, Inc.*, Exchange Act Release No. 90052 (Sept. 30, 2020) (regarding use of the wrong legal standard for determining perk disclosure).

⁸ 12 U.S.C. § 5211.

⁹ Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009) (codified as amended in scattered sections of the U.S.C.).

¹⁰ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010); 12 U.S.C. §§ 5301 *et seq.*

governance requirements on companies, both of which affect compensation committees of most public companies. Among other things, the Dodd-Frank Act requires public companies to provide shareholders with an advisory vote to approve executive compensation disclosed in their proxy statements at least once every three years (commonly referred to as a “say-on-pay” vote, with the vote on the timing of the vote being commonly referred to as a “say-on frequency” vote), and to provide shareholders with an advisory vote to approve compensation (including deferred and contingent compensation) based on or otherwise related to an acquisition, merger, sale or other similar transaction (commonly referred to as a “say-on-parachute” vote). Most companies have adopted an annual say-on-pay vote.

The Dodd-Frank Act also sets forth standards regarding the independence of compensation committee members, the independence of the compensation committee’s consultants and other advisers and the authority of, and funding for, the compensation committee to retain consultants and advisers. Further, it directs the SEC to adopt rules regarding the disclosure of the ratio of the chief executive officer’s total compensation to the median compensation of the company’s employees, which rules have been finalized by the SEC (commonly referred to as the “CEO pay ratio” rules). It also directs the SEC to issue rules regarding the adoption and disclosure of clawback policies to recover incentive compensation paid to executive officers if an accounting restatement is required due to material noncompliance with applicable financial reporting requirements and rules regarding the relationship between the compensation paid to a company’s named executive officers and the company’s financial performance (commonly referred to as “pay-versus-performance” disclosure), both of which have also been finalized.

Although companies were awaiting further guidance on certain aspects of the Dodd-Frank Act for well over a decade, compensation committees have already addressed certain aspects of the law for quite some time and need to continue to monitor developments and guidance promulgated under the Dodd-Frank Act. For example, as the 2011 proxy season was the first year of a mandated say-on-pay vote, many compensation committees took a fresh look at the compensation arrangements covering their named executive officers and, in certain cases, made changes to those arrangements. In order to obtain a favorable say-on-pay vote, compensation committees, typically with the input and guidance of their advisers as well as management, also revisited their proxy disclosures, often with a view toward providing clearer explanations regarding the company’s executive compensation arrangements and the process and rationale behind their executive compensation decisions.

This trend continues today, as most companies are subject to an annual say-on-pay vote and need to explain in future proxy statements whether and how they considered the results of the most recent say-on-pay vote in determining compensation policies. The proxy disclosures in the Compensation Disclosure and Analysis (“CD&A”) have become far more extensive and developed as a result of experience, market practice, SEC scrutiny, shareholder reaction and potential litigation claims.

The legislative and regulatory landscapes continue to evolve and compensation committees need to continue to review and monitor these developments. For example, in 2020, the SEC introduced under Regulation S-K¹¹ a requirement that public companies disclose in Form 10-K a description of their human capital resources that are material to the business, including the number of employees and any human capital measure or objectives that the company focuses on in managing the business. The SEC has indicated that, depending on the nature of the company’s business and workforce, the disclosure may address measures or objectives that address the development, attraction and retention of the workforce. These developments have triggered higher levels of scrutiny on human capital, governance and compensation-related matters and have contributed to the expansion of the role and responsibilities of the compensation committee.

The regulatory landscape further evolved in 2022 and 2023 with the SEC’s release of its final Dodd-Frank Act rules on pay versus performance disclosure and on the clawback of erroneously paid incentive compensation.¹² The SEC’s final rule on pay versus performance became effective on October 8, 2022 and requires specified pay versus performance disclosures for annual proxy statements for fiscal years ending on or after December 16, 2022. The pay versus performance rules implement the Dodd-Frank Act requirement mentioned above that public companies disclose a “clear description” of compensation paid to their top executives, including information “showing the relationship between executive compensation *actually paid* and the financial

¹¹ The SEC adopted amendments to Items 101, 103 and 105 of Regulations S-K, which became effective as of November 9, 2020. 17 C.F.R. §§ 229.101, 229.103 and 229.105.

¹² “Pay Versus Performance,” 87 Fed. Reg. 55197 (Sept. 8, 2022); 17 C.F.R. § 229.402 (“new” Item 402 of Regulation S-K) (Sept. 8, 2022); SEC Release No. 34-95607, available at <https://www.sec.gov/rules/final/2022/34-95607.pdf> (last visited Aug. 21, 2025); “Listing Standards for Recovery of Erroneously Award Compensation,” 87 Fed. Reg. 73076; SEC Release Nos. 43-96159, IC-34732 (Nov. 28, 2022), available at <https://www.sec.gov/rules/final/2022/33-11126.pdf> (last visited Aug. 21, 2025).

performance of the issuer.” The SEC also released Compliance & Disclosure Interpretations (“CD&Is”) interpreting its final pay versus performance rule.¹³ With respect to clawback guidance, the SEC published its final rules on October 26, 2022, which tasked the national securities exchanges with adopting formal listing standards that, in turn, require publicly listed companies to establish and disclose clawback policies that meet the standards prescribed in the rules. Both NYSE and Nasdaq released new listing standards in late February 2023, requiring issuers to develop and implement a policy providing for the recovery of erroneously awarded incentive-based compensation received by current or former executive officers.¹⁴ The NYSE and Nasdaq’s clawback listing standards became effective on October 2, 2023.¹⁵ In order to comply with these listing standards, most issuers (subject to very limited exceptions) were required to adopt compliant clawback policies no later than December 1, 2023.

More recently, in June 2025, the SEC hosted a roundtable discussion on various executive compensation topics with a view for the SEC “to engage in retrospective review of its rules to ensure that they continue to be cost-effective and result in disclosure of material information without an overload of immaterial information.”¹⁶ The roundtable addressed many topics, including evaluating CEO pay ratio and pay-versus-performance disclosures as well as clawbacks, discussing the length and complexity of executive compensation disclosures, and addressing perquisite disclosure and, in particular, the treatment of executive security expenses.¹⁷ The SEC requested that interested parties submit comments,

¹³ SEC, “Section 128D. Item 402(v) – Pay Versus Performance,” (Feb. 10, 2023), available at <https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp> (last visited Aug. 21, 2025).

¹⁴ New York Stock Exchange, “Proposed Rule Change,” available at <https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2023/SR-NYSE-2023-12.pdf> (last visited Aug. 21, 2025); NASDAQ, “Proposed Rule Change,” available at <https://listingcenter.nasdaq.com/assets/rulebook/NASDAQ/filings/SR-NASDAQ-2023-005.pdf> (last visited Aug. 21, 2025).

¹⁵ SEC, Release No. 34-97688, available at <https://www.sec.gov/rules/sro/nyse/2023/34-97688.pdf> (last visited Aug. 21, 2025).

¹⁶ SEC Statement on the Upcoming Executive Compensation Roundtable, available at <https://www.sec.gov/newsroom/speeches-statements/statement-upcoming-executive-compensation-roundtable> (last visited Aug. 20, 2025).

¹⁷ SEC Roundtable on Executive Compensation Disclosure Requirements, available at <https://www.sec.gov/newsroom/meetings-events/sec-roundtable-executive-compensation-disclosure-requirements>; Links available to Webcasts (Parts 1, 2 and 3) (last visited Aug. 20, 2025).

which may inform the SEC's next steps and perhaps a revised approach to the disclosure rules.

With respect to tax-related compensation matters, in January 2025, the IRS and the Department of the Treasury published proposed regulations relating to Section 162(m) of the Internal Revenue Code.¹⁸ The proposed regulations implement the amendments made to the section as part of the American Rescue Plan Act of 2021 ("ARPA"). Beginning with the first taxable year following December 31, 2026, the definition of "covered employees" subject to the \$1 million compensation deduction limit under Section 162(m) of the Internal Revenue Code, as amended by the ARPA, will include the five highest compensated employees—not limited to executive officers—in addition to those currently required to be covered employees, i.e., current and former named executive officers.

In addition, proxy advisory companies (such as Institutional Shareholder Services Inc.¹⁹ and Glass, Lewis & Co.²⁰), which influence institutional voting by institutional investors, as well as some of the large institutional investors, focus extensively on executive compensation and the actions of the compensation committee. Historically, they had exerted their influence by withholding votes for, or voting against, reelection to the board of committee members if they did not approve of the committee's actions. With the enactment of the Dodd-Frank Act's say-on-pay requirement, their focus shifted toward recommending whether to support a company's say-on-pay proposal. This focused attention has caused the board members serving on compensation committees to closely review the guidelines of proxy advisory companies and institutional investors (which are generally updated annually) and to determine whether any changes to the executive compensation programs are necessary or appropriate.

The influence of the proxy advisory firms on executive compensation continues with their periodic updates. For example, as a result of the Covid-19 pandemic, ISS released guidance relating to compensation decisions arising out of the pandemic and, in particular, actions taken by companies and their compensation committees under both long-term and

¹⁸ REG-118988-22, 90 Fed. Reg. 4691 "Certain Employee Remuneration in Excess of \$1,000,000 under Internal Revenue Code Section 162(m)" (Jan. 16, 2025), available at <https://www.federalregister.gov/documents/2025/01/16/2025-00728/certain-employee-remuneration-in-excess-of-1000000-under-internal-revenue-code-section-162m> (last visited Aug. 20, 2025).

¹⁹ See <http://www.issgovernance.com/> (last visited Aug. 21, 2025).

²⁰ See <http://www.glasslewis.com/> (last visited Aug. 26, 2024).

short-term incentive programs.²¹ They continue to be focused on the use and structure of performance-based compensation (continuing to favor a pay mix weighted toward performance-vesting awards over time-vesting awards) and the connection between pay and performance, disclosure and communication with shareholders, and the elimination of what they view as poor pay practices. More recently, the proxy advisory firms have focused on the adequacy of companies' clawback policies. Both ISS and Glass Lewis do not view as "robust" clawback policies that do not cover time-vesting equity awards. Additionally, Glass Lewis expects companies to adopt clawback policies that extend beyond the NYSE and Nasdaq listing requirements pursuant to the Dodd-Frank Act and authorize recoupment of incentive-based compensation when problematic decisions or actions occur, such as material misconduct, a material reputational failure, a material risk management failure, or a material operational failure.²² Starting in 2025, Glass Lewis is also requesting companies that maintain change in control provisions allowing compensation committee discretion over the treatment of unvested awards, to clearly disclose the rationale for the compensation committee's decision should a change in control occur.

More than ever before, serving on a board's compensation committee has become a serious responsibility with extensive public scrutiny and directors are treating it accordingly. To facilitate and enhance legal compliance and improve overall corporate governance, companies are looking at the following issues, among others, with regard to their compensation committees: the appropriate composition of the committee; the qualifications and independence of the members of the compensation committee; the number of meetings of the committee; the duties and responsibilities of the committee; the scope and depth of the review and analysis of compensation arrangements and other human capital-related matters; the timing of presentation of issues to the compensation committee; updating and educating the committee members, and the involvement and independence of compensation consultants and lawyers in the process. Generally, companies are taking a proactive approach to their compensation philosophy, strategy and process, as well as to the adoption and implementation of their compensation arrangements. No longer are (or should) compensation committees acting as a "rubber stamp" of management's compensation proposals. Rather, they are taking a fresh and harder look at their compensation arrangements and the related issues (still with the appropriate assistance and impact of

²¹ See § 16.05[4] *infra*.

²² See § 16.05[2][b][ii] *infra*.

management). Further, as the DEI, human capital and ESG landscape continues to shift, and companies face increasing pressure from the government, shareholders and other stakeholders to either strengthen or pull back from a commitment to ESG and DEI (depending on their perspective), the compensation committee continues to absorb additional responsibilities and rise in importance—not only in the executive compensation area, but also in areas relating to management and broader workforce issues impacting the business.

§ 16.02 The Business Judgment Rule: Executive and Non-Employee Director Compensation Case Law Developments; ISS Policy on Director Compensation

The business judgment rule protects officers and directors of companies from liability if they act in good faith and on an informed basis, using sound business judgment and reasonable care. The actions of members of a board's compensation committee are generally held to the same business judgment standard that applies to other directors. Courts (particularly those in Delaware) are traditionally reluctant to second guess good faith corporate decision-making by informed officers and directors, particularly directors who are disinterested and independent. Accordingly, the business judgment rule has largely served as a protective shield for members of compensation committees, enabling them to act in good faith, using their business judgment. But some decisions by Delaware courts have shown a change in the court's handling of the business judgment rule, and, in certain cases, a shift in the legal standard from the business judgment rule to the entire fairness standard (as further discussed below).

One of the first cases that addressed the application of the business judgment rule to executive compensation packages was the *Ovitz* case in 2003.¹ *Ovitz* involved the hiring and termination of Michael Ovitz as president of the Walt Disney Company in the mid-1990s. The company's shareholders alleged that Disney's board of directors and compensation committee blindly approved Ovitz's employment agreement and failed to consider that the terms of his without-cause termination were negotiated in large part by Ovitz's close friend, Michael Eisner, Disney's chief executive officer. In so doing, the shareholders claimed that the board of directors and compensation committee knowingly or intentionally abdicated their responsibility to exercise sound business judgment and to make a good faith attempt to fulfill their fiduciary duties to the company and its shareholders.²

Throughout the various stages of litigation, the defendant directors argued that both Ovitz's hiring and termination were reasonable exercises of business judgment; the lucrative terms under the contract were necessary to lure him to the job and the without-cause termination was

¹ In re The Walt Disney Co. Derivative Litigation, 825 A.2d 275 (Del. Ch. 2003) ("*Ovitz*").

² *Id.*, 825 A.2d at 277. Ovitz allegedly received severance in an amount exceeding \$140,000,000 after barely one year of employment. *Id.* at 279. The final severance package was valued at approximately \$130,000,000. In re The Walt Disney Co. Derivative Litigation ("*Ovitz III*"), 906 A.2d 27, 35 (Del. 2006).

reasonable to avoid protracted litigation.³ Ultimately, the courts concluded that while the compensation committee certainly did not follow best practices, it did not violate any of its fiduciary duties.

The *Ovitz* cases emphasized the necessity for procedures, including appropriate deliberation, full disclosure, full understanding of all ramifications of compensation arrangements and obtaining the advice of advisors when appropriate. Legislation, notably the Dodd-Frank Act, and shareholder activism underscore the importance of many of these concepts as they are designed to increase accountability and transparency relating to executive compensation decisions. Shareholder derivative lawsuits stemming from negative shareholder advisory votes on executive compensation required under the Dodd-Frank Act continue to shape and shed light on the role of compensation committees and the business judgment rule developed by the *Ovitz* cases. These cases alerted compensation committee members to the importance of following and documenting procedures and process, as well as the potential individual exposure of the compensation committee members.

The *Ovitz* cases demonstrated that compensation committee decisions will be protected by the business judgment rule if certain procedural safeguards are followed; if they are not followed, the court may closely scrutinize those decisions. These safeguards may include, depending on the circumstances, all or some of the following: (1) an analysis of the cost and related financial implications (e.g., economic, accounting or tax impact) of the proposed arrangement; (2) an analysis of industry standards and appropriate comparables; (3) the retention of appropriate advisors given the type of proposed arrangement (e.g., compensation consultants, lawyers, accountants and/or actuaries), which, depending upon the circumstances, may or may not serve as advisors to the company; (4) the review of appropriate documentation including actual versions of the proposed arrangement (not merely summaries) and final versions, all of which should ideally be given to directors prior to the meeting at which binding decisions will be made; (5) full and meaningful disclosure of all relevant facts concerning the proposed arrangement and deliberation; and (6) the involvement of disinterested, non-conflicted persons not just in the approval process, but also in the negotiation process. It must also be emphasized that *Ovitz* reinforced that the ultimate decision of the committee is not the core issue in reviewing fiduciary duty (although fairness to the company does become a method of avoiding liability if good faith is violated), but, rather, what is important are the procedures taken by each and every member of the

³ *Ovitz*, N. 1 *supra*, 825 A.2d 275, 286-287.

ecutive Compensation

committee in reaching that decision. Furthermore, it is clear that the more information the committee has before it when making decisions, the less likely that the members' fiduciary role will be challenged.

One post-*Ovitz* example of a compensation committee's process successfully leading to a dismissal is *In re Goldman Sachs*.⁴ In that case, after Goldman Sachs suffered financial loss following the housing crisis in 2008, plaintiff shareholders took issue with the compensation structure that Goldman's directors approved for management, which they claimed incentivized management to engage in "overly-risky business decisions."⁵ The plaintiffs alleged that the directors failed to properly analyze and rationally set compensation levels, which resulted in the directors breaching their fiduciary duties.⁶

The Delaware Chancery Court disagreed and dismissed the case. Goldman's charter included an exculpatory provision that required plaintiffs to show that there was an intentional dereliction of duty or that the directors acted with a conscious disregard for their responsibilities, which amounted to bad faith.⁷ Citing the *Ovitz* case, the court noted that an intentional dereliction of duty is "more culpable than simple inattention or failure to be informed of all facts material to the decision."⁸ Choosing one metric for setting compensation levels over another does not necessarily demonstrate that the board did not act in good faith.⁹ The court went on to state that the plaintiffs failed to show that the compensation committee's decision to approve the compensation structure was uninformed—the compensation committee received information from management regarding Goldman's net revenues compared to compensation and benefits expenses and reviewed compensation practices at Goldman's core competitors.¹⁰ The court noted that the business judgment rule "only requires the board to reasonably inform itself; it does not require perfection or the consideration of every conceivable alternative."¹¹

In 2019, the Delaware Chancery Court considered a board's approval

⁴ *In re Goldman Sachs Group, Inc. Shareholder Litigation*, 2011 Del. Ch. LEXIS 151 (Del. Ch. Oct. 12, 2011).

⁵ *Id.* at *4.

⁶ *Id.* at *14.

⁷ *Id.* at *40-41.

⁸ *Id.* at *43.

⁹ *Id.* at *47.

¹⁰ *Id.* at *49.

¹¹ *Id.* at *50.

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of excessive executive compensation in a case of first impression. In *Tornetta v. Musk*, the court considered which standard—the business judgment rule or entire fairness—applies when shareholders approve compensation for a controlling shareholder.¹² In that case, Tesla Inc.’s board approved incentive compensation for Elon Musk, the company’s chief executive officer, giving Musk the potential to earn stock options with a value upwards of \$55.8 billion.¹³ The compensation committee retained outside counsel, engaged a compensation consultant, and solicited advice from other Tesla directors (excluding Musk’s brother, Kimbal).¹⁴ A majority of Tesla’s outstanding disinterested shareholders entitled to vote were present at a special meeting, and a majority of those disinterested shares were voted in favor of the award.¹⁵ The court denied Tesla’s motion to dismiss, noting that because the “board level review was not divorced from Musk’s influence” as a controlling shareholder, the entire fairness standard applies.¹⁶

On January 30, 2024, the Delaware Chancery Court issued its post-trial ruling in *Tornetta v. Musk* (“*Tornetta I*”) that Musk, Tesla, and six members of the Tesla board failed to meet their burden to prove that its \$55.8 billion grant was “entirely fair” under Delaware law.^{16.1} The court’s decision was largely based on its determination that Musk was a “controlling shareholder”^{16.2} who dominated the grant process and enjoyed “thick ties”^{16.3} with the compensation committee members who negotiated the grant. The court ordered the full rescission of the grant and eliminated all compensation earned by Musk under the grant through the date of the decision.^{16.4}

¹² *Tornetta v. Musk*, 2019 Del. Ch. LEXIS 999 (Sept. 20, 2019).

¹³ *Id.* at *2.

¹⁴ *Id.* at *14.

¹⁵ *Id.* at *22.

¹⁶ *Id.* at *30. The court also stated that had the board ensured from the beginning of negotiations with Musk over the award details that an independent, fully functioning compensation committee and the minority stakeholders had an opportunity to engage in an informed review of the award prior to a meaningful approval, the court would have been less concerned over Musk’s coercive influence. *Id.*

^{16.1} *Tornetta v. Musk*, No. 2018-0408-KSJM, 2024 Del. Ch. LEXIS 27 (Del. Ch. Jan. 30, 2024).

^{16.2} *Id.* at *98.

^{16.3} *Id.* at *2.

^{16.4} *Id.* at *192.

As the court noted, Delaware law allows defendants to shift the burden of proof to the plaintiffs under the entire fairness standard where a transaction is approved by a fully informed vote of the majority of the minority stockholders.^{16.5} Here, however, the court determined that the stockholder vote which approved Musk's grant was not done on a fully informed basis for two key reasons: (1) Tesla's proxy did not accurately describe the independence of key directors involved in the grant process^{16.6} and (2) Tesla's proxy omitted key details related to the grant process which included Musk's conversations with the chairman of the compensation committee and his role in facilitating the terms of the grant and the timeline to approve the grant.^{16.7} Additionally, while Delaware courts have largely focused on the process surrounding compensation decisions (rather than the result), the court also focused on the quantum of the grant. The court noted the "extraordinary nature of the grant"^{16.8} and that Tesla's compensation committee had seemingly never inquired whether a \$55.8 billion grant was necessary to retain Musk or whether a grant of that magnitude to retain Musk was in the best interest of the company.^{16.9} In particular, the court noted that: (1) Musk already owned 21.9% of Tesla (which would incentivize his continued commitment to the company^{16.10}); (2) there was seemingly no evidence that Musk intended to leave the company if the grant was not authorized;^{16.11} and (3) the conditions to achieve the grant were not ambitious or difficult to achieve.^{16.12}

Following *Tornetta I*, Tesla sought to reinstate Musk's compensation package by retroactively seeking stockholder approval. Tesla provided to the stockholders additional disclosure about the compensation plan and the court's decision, and in June 2024, the stockholders unaffiliated with Musk approved the compensation plan for a second time in the form of ratification. Tesla and the defendants filed a "motion to revise," requesting that, in light of the stockholders' ratification, the court reverse its prior decision under *Tornetta I* to rescind the compensation

^{16.5} *Id.* at *2.

^{16.6} *Id.* at *123-127.

^{16.7} *Tornetta v. Musk*, No. 2018-0408-KSJM, 2024 Del. Ch. LEXIS 27 at *154 (Del. Ch. Jan. 30, 2024) ("*Tornetta I*").

^{16.8} *Id.* at *143.

^{16.9} *Id.* at *6.

^{16.10} *Id.* at *6.

^{16.11} *Id.* at *38.

^{16.12} *Id.* at *187.

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plan. In the most recent decision in the case (“*Tornetta II*”), the court rejected the request to revise its decision rescinding the plan, finding that stockholder ratification was insufficient to cure the breaches of fiduciary duty committed by the board in approving Musk’s \$55.8 billion compensation package.^{16.13} The court cited four reasons, each of which independently provided a sufficient basis for not revising its prior decision to rescind the plan: (i) there is no procedural basis on which the outcome of an adverse post-trial opinion can be undone by a stockholder vote; (ii) common-law stockholder ratification is an affirmative defense, which was not timely raised as such defense cannot be raised for the first time after a post-trial opinion; (iii) a stockholder vote standing alone cannot ratify a conflicted-controller transaction; and (iv) the stockholders were not fully informed with respect to the ratification vote as the proxy statement contained inaccuracies.

The decision to void Musk’s grant is the latest in a string of high-profile court cases involving executive compensation and may impact the way compensation committees operate when making determinations for the compensation of its key executives. In particular, the focus on process and the scrutiny in which courts view independent directors involved in negotiating such pay packages will need to be carefully observed going forward.

After the *Ovitz* events, the SEC adopted proxy rules that require in the proxy a significant amount of detailed compensation information as to the value of severance arrangements that is likely to make full information much more available to the compensation committee on an ongoing basis, will strongly encourage the use of compensation consultants and will require detailed explanations and analyses of how compensation decisions are made. The Dodd-Frank Act requirement that public companies obtain advisory votes from shareholders on executive compensation further highlights the importance of procedure and documentation when determining executive compensation to mitigate the possibility of a company receiving negative “say-on-pay” advisory votes from shareholders. Additionally, the focus by Institutional Shareholder Services Inc. (“ISS”)¹⁷ on what it considers “problematic pay practices” and its potential negative say-on-pay recommendation or potential recommendation to withhold votes from, or vote against, compensation committee members has also resulted in compensation committees becoming more sensitive to both procedure and substance. Indeed, one of

^{16.13} *Tornetta v. Musk*, No. 2018-0408-KSJM, 2024 WL 4930635 (Del. Ch. Dec. 2, 2024) (“*Tornetta II*”).

¹⁷ See § 16.05[2][b][i] *infra*.

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the most common discussions at compensation committee meetings regards how ISS and Glass, Lewis & Co. will react to the actions.¹⁸

Other Delaware Chancery Court decisions following the *Ovitz* case further examined the good faith standard in the context of stock options. They raised the issue of bad faith of directors in, respectively, issuing back dated options (*Maxim Integrated*) and spring-loading (*Tyson Foods*).

In *Maxim Integrated*,¹⁹ the court noted in connection with the defendant's dismissal motion that it was "difficult to conceive of a context in which a director may simultaneously lie to his shareholders (regarding his violation of a shareholder approved plan, no less) and yet satisfy his duty of loyalty."²⁰ It found that backdating options qualified as one of those rare cases in which a transaction may be so egregious on its face that the board approval cannot meet the test of business judgment.²¹

In *Tyson Foods*,²² which involved spring-loading, *i.e.*, the granting of options right before releasing a positive corporate announcement, the court found that "granting spring-loaded options, without explicit authorization from shareholders clearly involved an indirect deception."²³ It then noted that "[a] director who intentionally uses inside knowledge not available to shareholders in order to enrich employees while avoiding shareholder imposed requirements cannot, in my opinion, be said to be acting loyally and in good faith as a fiduciary."²⁴

These Delaware Chancery Court level decisions on motion emphasize the burden on directors to be very prudent in awarding executive compensation. The *Tyson* decision is particularly interesting because it adds an additional issue (apparently not even asserted by the plaintiff) to the spring-loading debate. It has generally been viewed, even by an SEC Commissioner,²⁵ that, if the board is knowledgeable of all facts,

¹⁸ See: Glass Lewis Policy Guidelines, available at <http://www.glasslewis.com/guidelines/> (last visited Aug. 21, 2025); Institutional Shareholder Services Inc., available at <http://www.issgovernance.com/about/about-iss/> (last visited Aug. 21, 2025).

¹⁹ *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007).

²⁰ *Id.*, 918 A.2d 341, 355.

²¹ *Id.*, 918 A.2d at 356.

²² *In re Tyson Foods, Inc. Consolidated Shareholders Litigation*, 919 A.2d 563 (Del. Ch. 2007).

²³ *Id.*, 919 A.2d 563, 592.

²⁴ *Id.*, 919 A.2d at 593.

²⁵ *Id.*, 919 A.2d at 597.

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there is no insider trading and, hence, no illegal action. The *Tyson* court has indicated that, notwithstanding no insider trading, there may have been bad faith that removes the grants from the business judgment rule and to a fairness criterion.

Subsequent to the passage of the Dodd-Frank Act, a number of derivative lawsuits have been filed after failed say-on-pay votes, despite the advisory and non-binding nature of the votes and specific language in the Dodd-Frank Act stating that such votes are not intended to change or increase director fiduciary duties.²⁶ Two 2011 decisions present an interesting contrast with respect to their treatment of the business judgment rule and may prove instructive to compensation committees with respect to their role and the processes for determining executive compensation.

In *Beazer Homes*,²⁷ which involved a negative say-on-pay-advisory shareholder vote, the court granted defendant's motion to dismiss a derivative shareholder suit holding that the plaintiff's allegations did not rebut the presumption of valid business judgments.²⁸ In this case, the company's board of directors approved pay increases for its four top executives in 2010, while that same year the company suffered a new loss of \$34 million and a decline in annual share price of more than 17%.²⁹ The court noted that because the say-on-pay vote had not yet been held when the challenged decisions were initially made, the outcome of the vote could not be evidence that the directors had not acted properly.³⁰

In *Raul v. Rand*,³¹ which was dismissed because of the plaintiffs' failure to make a demand, the Delaware District Court emphasized that say-on-pay votes are advisory, do not bind the board, and do not create additional fiduciary duties for the board.³²

By contrast, in *Cincinnati Bell*,³³ which also involved a negative say-

²⁶ Dodd-Frank Act § 951; Exchange Act § 14A(c).

²⁷ Teamsters Local 237 Additional Security Fund, derivatively on behalf of Beazer Homes USA, Inc. v. McCarthy, 2011 BL 272332 (Ga. Super. Sept. 15, 2011), available at <http://www.sec.gov/news/press/2011/2011-61.htm> (last visited Aug. 21, 2025).

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Raul v. Rynd*, 929 F. Supp.2d 333 (D. Del. 2013).

³² *Id.*, 929 F. Supp.2d 333, 345-348. Compare, *Friedman v. Khosrowshahi*, 2014 Del. Ch. LEXIS 121 at *34-38 (Del. Ch. July 16, 2014) (shareholder failed to plead particularized facts for purposes of demand futility regarding CEO's compensation constituted unjust enrichment).

³³ NECA-IBEW Pension Fund, derivatively on behalf of Cincinnati Bell, Inc. v.

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on-pay advisory shareholder vote, the court denied defendant's motion to dismiss a derivative suit filed by a union pension plan on behalf of shareholders of Cincinnati Bell, Inc. In this case, the company's board of directors approved significant increases in total annual compensation for its top three executives of 71.1%, 80.3%, and 54.3% for 2010, while that same year the company suffered a \$61 million decline in net income (which represented a negative shareholder return of almost 19%).³⁴ While noting that the Ohio courts follow the business judgment rule and "will not inquire into the wisdom of actions taken by a director in the absence of fraud, bad faith, or abuse of discretion," the court nevertheless found that the plaintiff made adequate pleadings that the Cincinnati Bell directors were not entitled to business judgment protection for the 2010 executive compensation decisions in light of the company's declining financial performance.³⁵ The decision in this case is interesting in that it showed a willingness on the part of the court to second-guess director decisions, which is contrary to the business judgment rule. The case was thereafter settled and few courts in deciding these cases appear to have followed the approach in *Cincinnati Bell*.³⁶

Plaintiffs have also tried to argue corporate waste for not structuring compensation to obtain tax deductions. In *Freedman v. Adams*,³⁷ the plaintiff alleged waste based on a board's decision to pay executives without taking advantage of qualifying the compensation as performance-based under Section 162(m) of the Internal Revenue Code.³⁸ Citing the definition of waste under *Ovitz*, the court reasoned that the board's decision to forego the tax advantage in favor of flexibility in structuring executive compensation arrangements was not so unreasonable that a business person of ordinary, sound judgment would not make it.³⁹ The court found that the board, which was disinterested, knew what it was doing and, indeed, disclosed its decision to shareholders in the proxy statement.⁴⁰

Cox, 2011 U.S. Dist. LEXIS 106161 (S.D. Ohio Sept. 26, 2011).

³⁴ *Id.*

³⁵ *Id.*

³⁶ See, e.g.: *Dennis v. Hart*, 724 F.3d 1249 (9th Cir. 2013); *Plumbers Local No. 137 Pension Fund v. Davis*, 2012 U.S. Dist. LEXIS 5053 (D. Ore. Jan. 11, 2012); *Assad v. Hart*, 2012 U.S. Dist. LEXIS 2366 (S.D. Cal. Jan. 6, 2012).

³⁷ *Freedman v. Adams*, 58 A.3d 414 (Del. 2013).

³⁸ 26 U.S.C. § 162(m). However, as discussed in later sections, the Tax Cuts and Jobs Act of 2017 moots this decision in most cases.

³⁹ *Freedman v. Adams*, N. 37 *supra*, 58 A.3d 414, 417.

⁴⁰ *Id.*

Directors have also been sued in cases alleging inadequate disclosure for say-on-pay advisory vote requirements. These shareholders often try to delay the annual meeting to pressure the company to settle for payment of legal fees and agreement to make additional disclosures;⁴¹ some of these cases have proceeded to trial.⁴² Although generally the courts have favored the company and board in inadequate disclosure cases, it is still important to assure that all material information is described in the proxy because plaintiff lawyers will try to take advantage of any oversights.

The business judgment rule has also been challenged with respect to directors' decisions about their own compensation. The business judgment rule generally protects directors' decisions that were made in a loyal and informed manner; however, self-interested decisions, such as those regarding directors' own compensation, are "inherently likely to be disloyal."⁴³ The plaintiffs in several cases have challenged the use of

⁴¹ See, e.g., *Stephen Knee v. Brocade Communications*, No. 1-12-CV-220249 (Cal. Super. Sept. 28, 2012) (applying Delaware law) (settling for additional disclosures and \$625,000 in legal fees); see *Brocade Communications Systems, Inc. Form 8-K*, available at <https://www.sec.gov/Archives/edgar/data/1009626/000100962612000030/brcd-8kx2012x10x05.htm> (last visited Aug. 21, 2025).

⁴² *Seventh Circuit: Noble v. AAR Corp.*, 2013 U.S. Dist. LEXIS 48075 (N.D. Ill. April 3, 2012) (plaintiff did not show that board's failure to disclose information regarding the "say on pay" vote impaired shareholder rights).

State Courts:

Delaware: Raul v. Astoria Financial Corp., 2014 Del. Ch. LEXIS 103 at *23-26 (Del. Ch. June 20, 2014) (plaintiff failed to establish that the board did not disclose whether and how it considered the results of its say-on-pay vote).

New York: Morrison v. Hain Celestial Group, Inc., 40 Misc.3d 812, 971 N.Y.S.2d 391 (2013) (shareholders failed to establish that officers did not comply with say-on-pay compensation disclosures in proxy statements).

⁴³ *Stein v. Blankfein*, 2019 Del. Ch. LEXIS 199 at *12 (Del. Ch. May 31, 2019). Shareholder plaintiff filed derivative action against Goldman Sachs' directors for, among other things, a breach of fiduciary duties of loyalty based on excessive compensation of non-employee directors, alleging that the compensation was substantially more than non-employee director compensation at its peer companies. The Goldman directors filed a motion to dismiss, which the court denied. Following the Delaware Court of Chancery's refusal to approve a settlement presented in 2018, the Delaware Court of Chancery approved a settlement in 2020 which contained a cap of non-employee director compensation and other provisions, including releases. *Stipulation and Agreement of Compromise, Settlement and Release*, filed February 28, 2020. The approval of this settlement was rejected, reversed and remanded on appeal in August 2022 by the Delaware Supreme Court on the basis of overbroad releases, including releases of future claims. *Griffin v. Stein*, 2022 Del. LEXIS 246 (Aug. 16, 2022). As of this writing, the case has not yet been resolved.

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the business judgment rule and have argued that the appropriate standard for reviewing such decisions is the entire fairness standard.⁴⁴ The entire fairness standard requires directors to demonstrate that a “transaction was the product of both fair dealing and fair price.”⁴⁵ Courts have had multiple opportunities to consider such cases in this context.

In *Seinfeld v Slager*,⁴⁶ the Delaware Court of Chancery found that the directors were not entitled to the benefit of the business judgment rule when granting themselves restricted stock units because the shareholder-approved equity plan did not place a “meaningful limit” on the grants.⁴⁷ The court required the directors to show that the amounts were entirely fair.

Similarly, in a case involving director equity grants at Citrix,⁴⁸ the court took the same position as it had in *Seinfeld*, i.e., requiring that the directors demonstrate entire fairness as to the size of the grant because the “Company did not seek or obtain stockholder approval of any action bearing specifically on the magnitude of compensation to be paid to its non employee directors” when the shareholders approved the plan.⁴⁹ It should be noted that the court in that case dismissed, on the basis of the business judgment rule, a number of claims regarding the compensation committee’s approval of executive-level severance payments or payments beyond those prescribed by plans.⁵⁰

In *Espinoza v. Zuckerberg*, the Delaware Chancery Court again considered process—this time whether a decision made by directors can be ratified by a disinterested controlling stockholder without the formality prescribed by the Delaware General Corporation Law (“DGCL”).⁵¹ In

⁴⁴ *Id.*

⁴⁵ *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del, 1993).

⁴⁶ *Seinfeld v. Slager*, 2012 Del. Ch. LEXIS 139 (Del. Ch. June 29, 2012).

⁴⁷ *Id.* at *41-42.

⁴⁸ *Calma v. Templeton*, 114 A.3d 563 (Del. Ch. 2015).

⁴⁹ *Id.*, 114 A.3d 563, 569, 588 (holding that upfront stockholder approval by stockholders of generic limits on compensation for all beneficiaries does not establish a ratification defense because, when the board sought stockholder approval of the plan, stockholders were not asked to approve any *action specific to director compensation*). (Emphasis in original.)

⁵⁰ *Id.*, 114 A.3d at 589-590 (plaintiff raised meaningful questions as to whether certain companies with considerably higher market capitalizations [. . .] should be included in the peer group . . . Count I states a claim for breach of fiduciary duty).

⁵¹ *Espinoza v. Zuckerberg*, 124 A.3d 47, 49; 2015 Del. Ch. LEXIS 273 at *1 (Del. Ch. Oct. 28, 2015).

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that case, Facebook directors approved compensation increases for certain committee members and annual restricted stock unit grants for non-employee directors.⁵² Mark Zuckerberg, Facebook's chief executive officer and a controlling stockholder at the time, testified that had he been presented an opportunity to formally approve the compensation, he would have done so. The defendants sought application of the business judgment rule. However, the court held that the entire fairness standard applies when stockholder action does not comply with the statutory formalities in the DGCL.⁵³

In 2017, the Supreme Court of Delaware considered stockholder ratification with respect to equity awards made by directors to themselves under the general parameters of an equity incentive plan.⁵⁴ In *In re Investors Bancorp*, an equity incentive plan created a pool of equity awards from which directors could later award to themselves in amounts and on terms they decided.⁵⁵ Generally, when company directors grant themselves equity incentive awards, "the directors must prove that the awards are entirely fair to the corporation."⁵⁶ The stockholder ratification defense may apply when the stockholders have previously approved the equity incentive plan.⁵⁷ Stockholder ratification generally means that "a majority of fully informed, uncoerced, and disinterested stockholders approved board action."⁵⁸ However, "the mere approval by stockholders of a request by directors . . . to take action within broad parameters does not insulate all future" board action.⁵⁹ The benefit of the stockholders ratification defense is that, if successfully used, the deferential business judgment standard will apply instead of the more rigorous entire fairness standard.⁶⁰

The Investors Bancorp equity incentive plan, as approved by the stockholders, allowed "directors to allocate up to 30% of all option or

⁵² *Id.*, 124 A.3d at 51.

⁵³ *Id.*, 124 A.3d at 47.

⁵⁴ *In re Investors Bancorp, Inc. Stockholder Litigation*, 177 A.3d 1208 (Del. Dec. 13, 2017).

⁵⁵ *Id.*, 177 A.3d at 1211.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*, 177 A.3d at 1220.

⁶⁰ *In re Investors Bancorp, Inc. Stockholder Litigation*, 177 A.3d 1208, 1220 (Del. Dec. 13, 2017).

restricted stock shares available as awards to themselves.”⁶¹ The board considered awards to themselves under the plan and awarded themselves 7.8 million shares, in a combination of options and restricted shares, with a total fair market value of \$51,653,997.⁶² The court found that the equity incentive plan had not been ratified because the number, types, and terms of awards were left to the compensation committee’s discretion and would not be determined until subsequent stockholder approval.⁶³ However, the information subsequently provided to the stockholders indicated awards would be made for future performance, when in reality the awards, as presented by the plaintiffs, rewarded past performance, which had already been approved.⁶⁴ Thus, the defendants were not able to avail themselves of the stockholder ratification defense and the stringent entire fairness standard applied.

Generally, when shareholders wish to challenge board decisions in a derivative action they are required to first demand that the directors take action with respect to such decision.⁶⁵ However, there is an exception to the rule where demand would be futile—that is, where the “board is deemed incapable of making an impartial decision regarding the pursuit of the litigation.”⁶⁶ New York’s Supreme Court, in 2018, considered which standard applies when a shareholder actually makes a demand.⁶⁷

In *Solak v. Fundaro*, a shareholder filed a complaint against the directors of Intercept Pharmaceuticals, Inc., alleging that the non-employee director compensation policy adopted by the board was excessive and had not been approved by the shareholders.⁶⁸ The plaintiff sent a demand letter to the board demanding that the board revise and cancel stock option and restricted stock awards until a new plan could be approved by shareholders.⁶⁹ The board did not take action, and the court had to determine whether the board’s refusal was wrongful.⁷⁰

⁶¹ *Id.*, 177 A.3d at 1212.

⁶² *Id.*, 177 A.3d at 1215-1216.

⁶³ *Id.*, 177 A.3d at 1224.

⁶⁴ *Id.*

⁶⁵ *In re Goldman Sachs Group, Inc. Shareholder Litigation*, 2011 Del. Ch. LEXIS 151 at *20 (Del. Ch. Oct. 12, 2011).

⁶⁶ *Id.*

⁶⁷ *Solak v. Fundaro*, 2018 N.Y. Misc. LEXIS 964, 2018 N.Y. Slip Op. 30478(U) (March 19, 2018).

⁶⁸ *Id.* at *3.

⁶⁹ *Id.*

⁷⁰ *Id.* at *8.

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However, the court first had to determine which standard applied: the business judgment rule (as the defendants claimed) or the entire fairness standard (as the plaintiff claimed).⁷¹

Generally, when directors fix their own compensation the decision may be viewed as self-interested, since the directors are conferring benefits upon themselves.⁷² Under *Solak*, absent any other factors, such conduct would ordinarily trigger the entire fairness standard.⁷³ In *Solak*, however, there was another factor—the plaintiff sent a demand letter to the board demanding that it cancel awards pending a new compensation scheme to be presented to and approved by the shareholders.⁷⁴ The directors sought protection from the business judgment rule for their decision to not take action on the demand letter.

A plaintiff arguing against application of the business judgment rule bears the burden of showing that “the board breached its duty of care or loyalty, or acted in bad faith.”⁷⁵ If the plaintiff is successful, the burden shifts to the board to show that “the challenged act or transaction was entirely fair to the corporation and its shareholders.”⁷⁶ However, when a shareholder sends a demand letter to a board, the test is modified because, in making the demand, the shareholder concedes that the board is “disinterested and independent for the purpose of responding to the demand.”⁷⁷ Thus, with respect to the board’s decision not to take action pursuant to the demand letter, the business judgment rule applied.

The New York Supreme Court dismissed the case because it found that, based on the facts alleged by the plaintiff, the board did not breach its duty of care in deciding to not take the action the plaintiff demanded.⁷⁸ The court found that the board sought counsel from a law

⁷¹ *Id.*

⁷² *In re Investors Bancorp, Inc. Stockholder Litigation*, 177 A.3d 1208, 1217 (Del. Dec. 13, 2017).

⁷³ *Id.*

⁷⁴ *Solak v. Fundaro*, 2018 N.Y. Misc. LEXIS 964 at *4; 2018 N.Y. Slip Op. 30478(U) (March 19, 2018).

⁷⁵ *Id.* at *10.

⁷⁶ *Id.*

⁷⁷ *Solak v. Fundaro*, N. 74 *supra*, at *11. See also, *Anderson v. Mattel, Inc.*, 2017 Del. Ch. LEXIS 12 at *8 (Del. Ch. Jan. 19, 2017) (citing *Ironworkers District Council v. Andretti*, 2015 Del. Ch. LEXIS 135 at *24 (Del. Ch. May 8, 2015): “By making a demand, a stockholder tacitly acknowledges the absence of facts to support a finding of futility.”).

⁷⁸ *Solak v. Fundaro*, N.74 *supra* at *11.

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firm and held several discussions on how to respond, engaged a compensation expert, reviewed pertinent documents, and studied director compensation of peer group companies.⁷⁹ The court further noted that the fact that the plaintiff would have used a different peer group “was not sufficient . . . to determine that the board’s investigation was so inadequate that gross negligence could reasonably be inferred.”⁸⁰ While the *Solak* case did not directly address the issue of whether the compensation policy for the non-employee directors was excessive, it did demonstrate that when a shareholder plaintiff wishes to challenge director compensation, a demand letter may result in the challenge being dismissed owing to application of the business judgment rule.

The *Solak* court pointed out that boards are not necessarily required to act in the same manner, or use the same information, that a particular shareholder would have.⁸¹ Although the *Solak* case did not raise a question of best practices, the concept of following best practices had been addressed in earlier cases, including in one of the *Ovitz* cases. In that case, the court discussed many ways in which the Disney board failed to act in accordance with best practices, but also made a clear distinction between best practices and fiduciary duties.⁸² The court noted that:

“Unlike ideals of corporate governance, a fiduciary’s duties do not change over time. How we understand those duties may evolve and become refined, but the duties themselves have not changed, except to the extent that fulfilling a fiduciary duty requires obedience to other positive law. *This Court strongly encourages directors and officers to employ best practices, as those practices are understood at the time a corporate decision is taken.* But Delaware law does not—indeed, the common law cannot—hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices, any more than a common-law court deciding a medical malpractice dispute can impose a standard of liability based on ideal—rather than competent or

⁷⁹ *Id.* at *13-14.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² In re Walt Disney Co. Derivative Litigation, 907 A.2d 693, 697 (Del. Ch. Aug. 9, 2005) (“*Ovitz II*”) (“[T]he best practices of corporate governance include compliance with fiduciary duties. Compliance with fiduciary duties, however, is not always enough to meet or satisfy what is expected by the best practices of corporate governance.”).

standard-medical treatment practices, lest the average medical practitioner be found inevitably derelict.”⁸³

While the courts have considered a myriad of questions in the context of the business judgment rule and entire fairness standard when it comes to executive and director compensation, the foregoing decisions continue to demonstrate the importance of process when evaluating and setting compensation. More recently, as demonstrated by the court’s decisions in *Tornetta I* and *Tornetta II*, courts have also begun to evaluate the quantum of the compensation paid or granted within the context of the process taken by the compensation committee and the surrounding facts and circumstances.

These case developments dovetail with ISS’ policy on director compensation. ISS looks for reasonable practices that adequately align the directors’ interests with shareholder interests while preserving director independence. ISS has stated that it may issue an adverse vote recommendation for members of the board of directors or compensation committee who approve or set director compensation where there is a recurring pattern (generally, two or more consecutive years) of excessive director compensation without disclosing a compelling rationale or without disclosing mitigating factors for such levels of director pay.⁸⁴ These mitigating factors may include onboarding type equity-based grants for new directors that are identified as one-time grants, payments made in connection with corporate transactions or special circumstances (such as special committee service, requirements related to extraordinary need, or transition payments made to a former executive for a limited period), or payments made in consideration of specialized scientific expertise (as may be necessary in certain industries such as biotech/pharma). ISS has specified circumstances that will not mitigate concern around high director pay. These include payments made to reward general performance/service, payments made under separate consulting/service agreements with an indefinite or prolonged period or where payments appear to be for services that are within the scope of the director’s responsibilities or problematic payments for directors such as performance-conditioned incentives, perks or retirement benefits. Accordingly, compensation committees should carefully evaluate director

⁸³ *Id.*

⁸⁴ United States Procedures & Policies (Non-Compensation) Frequently Asked Questions (Updated Feb. 25, 2025), available at <https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf> (last visited July 16, 2025).

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pay in light of these cases and ISS' policy on director compensation.

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§ 16.03 The Role of the Compensation Committee and Corporate Governance

Historically, many public companies formed compensation committees to assist their boards of directors with the responsibilities and duties relating to executive and employee compensation. The role of the compensation committee has grown significantly both in its scope and in its importance in setting the overall compensation philosophy of a company and in making compensation recommendations to directors and shareholders. The role has further expanded into governance and succession planning in certain cases and, most recently, has expanded into human capital and workplace-related matters.

Compensation committees of public companies must abide by the strictures of legislation, as well as the related regulations and securities exchange listing rules. To comply with SEC rules enacted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”),¹ both the New York Stock Exchange (“NYSE”) and The Nasdaq Stock Market (“Nasdaq”) amended their respective listed-company rules to require that listed companies establish and maintain independent compensation committees operating under a written charter with certain rights and responsibilities to retain and seek advice of consultants, independent legal counsel and other advisers after considering certain independence factors. Further, companies and compensation committees awaited SEC rulemaking under Dodd-Frank for many years following the enactment of Dodd-Frank, and following the recent issuance of guidance, compensation committees have been diligently reviewing the impact of the recent guidance on their public companies, which includes final rules on CEO pay-ratio disclosure, pay versus performance disclosure and the clawback of erroneously paid incentive-based compensation and the related disclosure requirements.

Today, however, public companies also face external pressure when it comes to governance and compensation matters, which has affected the role of compensation committees. For instance, the influence of proxy advisory firms such as Institutional Shareholder Services Inc. (“ISS”) and Glass, Lewis & Co. (“Glass Lewis”) has surged over the past two decades. These firms provide proxy-voting research and recommendations to their institutional investor clients.² On an annual basis

¹ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010); 12 U.S.C. § 5301 note.

² See About ISS, available at <https://www.issgovernance.com/about/about-iss/> (last visited Aug. 26, 2024), and Glass Lewis Company Overview, available at <https://www.glasslewis.com/company-overview/> (last visited Aug. 26, 2024).

these firms issue proxy voting guidelines in a variety of governance areas such as board matters (including board elections, board diversity and composition, board independence, declassified boards and the role and performance of committees); risk management; the role of the chairman and chief executive officer; proxy access; financial reporting; environmental, social and governance matters; bylaws and other governing documents; shareholder proposals; and, of course, compensation matters. In the compensation arena, the proxy advisory firms identify problematic pay practices, help investors evaluate the link between executive pay and company performance and advise shareholders whether to vote in favor of or against executive and director compensation proposals (such as on a say-on-pay vote or the approval of a company's equity incentive plan). In addition to proxy advisory firms, large institutional shareholders, including prominent investment firms such as BlackRock, Inc. and pension plans such as CalSTRS, have begun implementing their own proxy-voting guidelines and/or subscribing to the stewardship principles established by the Investor Stewardship Group.³ Accordingly, increased legislation and regulation coupled with the increased input and, in some cases, demands from proxy advisory firms and institutional investors, have influenced the role of the compensation committee and the scope of the duties and responsibilities undertaken by the committee.

More recently, the role and responsibilities of the compensation committee have further expanded well beyond executive compensation and broad-based equity-based awards. With an overall increased focus and scrutiny on workplace-related considerations as well as various developments relating to human capital disclosures, pay equity and a host of social and governance issues, the compensation committee's areas of responsibilities and duties now often include oversight of, and responsibility for, human capital management, employee engagement, talent development, succession planning (which is not completely new for some committees and is often addressed in conjunction with the nominating and governance committee), diversity, equity and inclusion ("DEI") matters, and components of the environment, social and governance ("ESG") function that relate to executive compensation and workforce matters. This change in role and responsibilities has led to a change in the name of many compensation committees. Some committee names have been changed to the Management Development and

³ See Investor Stewardship Group Corporate Governance Principles for US Listed companies, available at <https://isgframework.org/corporate-governance-principles/> (last visited Aug. 26, 2024).

Compensation Committee, Human Capital and Compensation Committee, Human Resources Committee, Management Compensation, Development and Human Capital Committee, Leadership Development, Inclusion and Compensation Committee and other variations.

However, the focus of compensation committees continues to evolve based on changing governmental pressures and various stakeholder perspectives. For example, more recently, due to these changing pressures and perspectives, many companies are revisiting, reframing, discontinuing or, in more limited instances, reaffirming their DEI and ESG programs, policies and goals. This has caused compensation committees to reevaluate the use of DEI and ESG-related metrics in executive compensation plans and arrangements. Nonetheless, this change in focus has not necessarily resulted in a retreat to the name “compensation committee” for committees that changed their name, as described above. Also, while the approach to the use of DEI and ESG metrics in executive compensation may (or may not) have changed, as a general matter, DEI and ESG-related considerations remain in the purview of compensation committees.

[1]—The Role and Functions of the Compensation Committee

Compensation committees perform many functions and have many duties and responsibilities with respect to executive, employee and director compensation, including:

- establishing the company’s general compensation philosophy, reviewing trends in executive and management compensation, overseeing the development of new compensation plans and arrangements, and in certain cases, making recommendations to the board of directors on executive compensation practices and policies;
- selecting, retaining, monitoring and terminating the employment of consultants and advisers, including reviewing and determining the independence of such advisers;
- reviewing and recommending to the board of directors (or, in many cases, acting in lieu of the board of directors) actions affecting salaries, bonuses, stock options, restricted stock, restricted stock units, performance stock units and other forms of equity, benefits and other compensation arrangements for executive officers, including reviewing the timing of equity grants and any equity grant policies;

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- reviewing and approving (or making recommendations to the full board for determining) compensation packages for new corporate officers and termination packages for corporate officers;
- determining and reviewing a peer group for benchmarking compensation for executives (and, in certain cases, for directors);
- reviewing the competitiveness of the company's executive compensation programs to ensure the attraction and retention of corporate officers and the motivation of corporate officers to achieve the company's business objectives;
- reviewing corporate goals and objectives relevant to the compensation of the company's chief executive officer (the "CEO"), evaluating the performance of the CEO in light of those goals and objectives, and setting the CEO's compensation level based on this evaluation;
- reviewing and approving (or making recommendations to the full board for determining) the compensation of all other officers of the company;
- reviewing non-employee director compensation and making recommendations to the board (unless the board delegated such responsibility to the compensation committee; this responsibility may have been delegated to a separate corporate governance committee, such as the nominating and governance committee, to either approve non-employee director compensation or review non-employee director compensation and make recommendations to the board);
- assisting the board of directors in the development of standards and qualifications for potential candidates for executive positions and the examination of such potential candidates, (unless there is a separate corporate governance committee with that function, such as the nominating and governance committee, and in some instances in conjunction with such other committee);
- overseeing the development of executive succession plans, (unless there is a separate corporate governance committee with that function, such as the nominating and governance committee, and in some instances in conjunction with such other committee);

- reviewing the company's incentive compensation and other stock-based plans, overseeing the activities of the individuals (and committees) responsible for administering such plans, and recommending changes in such plans;
- overseeing regulatory compliance with respect to the company's compensation arrangements and overseeing the company's policies on structuring compensation programs to preserve tax deductibility and, when required, reviewing and approving performance goals and overseeing the attainment of performance goals for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), solely to the extent applicable to grandfathered awards and agreements (i.e., those in effect prior to November 2, 2017, and that have not been materially modified on or after such date) in light of the repeal of the performance-based exception to Code Section 162(m) pursuant to the Tax Cuts and Jobs Act of 2017;
- reviewing and approving the Compensation Discussion and Analysis ("CD&A") and publishing an annual executive compensation report for inclusion in the company's proxy statement and/or annual report;
- reviewing additional portions of the company's proxy statement and/or annual report that relate to executive compensation and other matters within the purview of the compensation committee's responsibility as may be determined by the committee, including CEO pay ratio disclosure and pay versus performance disclosure;
- making and approving equity grants to officers and other executives and, in certain cases, all employees;
- reviewing, amending and enforcing (in certain cases with the board of directors or the audit committee), as needed, the company's clawback policy or policies allowing for recoupment of compensation paid to current and former executives and, in certain cases, other employees;
- establishing, reviewing, and monitoring compliance with stock ownership guidelines for executives and non-employee directors (in consultation with the nominating and governance committee, or other appropriate committee, if any); and
- evaluating the overall risk profile of the company's compensation arrangements and determining if they encourage undue risk.

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Some committees with expanded duties and responsibilities beyond compensation-related and certain governance matters may have duties and responsibilities for any of the following:

- reviewing training, education and development programs; and
- periodically reviewing and discussing with management the development, implementation and effectiveness of the company's policies and strategies related to its human capital function, which may include those policies and strategies regarding: the development, attraction and retention of company personnel; diversity, equity and inclusion; workplace environment and culture; and internal communications programs.

While these duties and responsibilities almost always cover compensation decisions affecting executive officers and the grant of all equity awards and may include certain additional non-compensation related duties and responsibilities relating to human capital, DEI, ESG and other matters, the scope of these duties and responsibilities may vary by company. For instance, a company may wish to have its compensation committee address the compensation and benefit arrangements covering employees who are key members of management even if they are not necessarily executive officers (e.g., all employees with the title of vice president and above or key executives employed at subsidiaries or divisions). Notwithstanding the roles and responsibilities identified above, which generally are found in compensation committee charters, compensation committees typically consider proxy advisory firm guidelines, best practices, legal requirements and accounting ramifications when evaluating and determining executive compensation.

In certain cases, rather than having the compensation committee make equity grants to all eligible employees and make other key compensation decisions affecting all eligible employees, compensation committees may wish to delegate certain matters to the CEO or the most senior-level human resources executive. However, any such delegation should not apply to members of management who are subject to short-swing profit recovery rules under Rule 16b-3 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or who are reasonably expected to become executive officers under the securities laws. If delegation is used for employees below the level of executive officer or some lower employee level, at the time delegation is contemplated, compensation committees may wish to establish parameters

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surrounding the delegation, including the maximum aggregate annual share pool, maximum individual annual share award, grant timing under the delegation, type of permitted equity grants and minimum vesting schedules. Sometimes companies establish a matrix that sets ranges of equity grants per employee title or “band.”

In addition, in order to facilitate compliance with Rule 16b-3 under the Exchange Act and have the authority relating to all compensation matters vested in a single committee familiar with such matters, many compensation committees are granted the authority to review and approve the compensation and equity arrangements paid to directors. Alternatively, certain companies vest this authority in the full board of directors, have the compensation committee recommend non-employee director compensation matters to the full board of directors for ultimate approval or utilize a committee of all independent directors. Other variations include having the nominating and governance committee of the board of directors review and approve non-employee director compensation or review it and recommend it to the board for ultimate approval, or having the compensation committee and nominating and governance committee make joint recommendations to the board.

There has been some disagreement as to whether it is preferable to let independent directors (on the compensation committee or nominating and governance committee) set the directors’ own compensation⁴ or to have it set by the full board, which includes management directors whose compensation is set by the compensation committee. Each alternative has different pros and cons, but the only other possible (although unusual) alternative would be to have it fixed by shareholder vote. This would be cumbersome and, indeed, would still require a proposal by the board or compensation committee.

Generally, good governance involves having the compensation committee, the nominating and governance committee or another committee of independent directors review and analyze director compensation. Having some level of compensation committee involvement often makes sense because that committee is already well versed in compensation matters from its work on executive compensation and typically

⁴ In 2018 ISS implemented a policy by which it may recommend voting against board members responsible for approving non-employee director compensation when such pay is excessive without a compelling rationale for two or more consecutive years. See U.S. Procedures & Policies (Non-Compensation) Frequently Asked Questions (Feb. 25, 2025), available at <https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf> (last visited July 17, 2025).

works closely with an independent compensation consultant on executive compensation matters. Following such review and analysis, the compensation committee would make recommendations regarding non-employee director compensation to the full board with the full board making the final decision.⁵

The SEC proxy rules require enhanced disclosure of director compensation similar to executive compensation disclosure set forth in the proxy's summary compensation table, but with general narrative (rather than the extensive narrative required in the CD&A in the proxy).⁶ The proxy would also describe whether a committee or the full board determines director pay.

One issue that has arisen is the practice of activists paying persons amounts beyond standard director's pay to serve on boards. A number of corporations have tried to pass governance rules limiting such practices. ISS has opposed such actions without shareholder approval and will review such payments on a case-by-case basis.⁷ ISS does, however, support disclosure of any such compensation arrangements.⁸

When performing the duties and operations described above, many compensation committees seek the advice of compensation consultants, outside legal counsel and other advisers. Both the NYSE and Nasdaq amended their respective listed company rules to require compensation committees of listed companies to have a written charter with the express authority to retain such advisers and the responsibility to consider certain independence factors before selecting such advisers.⁹

[2]—Compensation Committee Charters

The role and responsibilities of compensation committees are often laid out in a company's "Compensation Committee Charter," which can range from the very specific and detailed to the very broad. Publicly

⁵ See, e.g., Council of Institutional Investors (CII), Policies on Corporate Governance, "Role of the Compensation Committee in Director Compensation," Section 6.2 (last updated Sept. 17, 2019), available at http://www.cii.org/corp_gov_policies (last visited Aug. 26, 2024).

⁶ "Proxy Disclosure Enhancements," 74 Fed. Reg. 68334, 74 Fed. Reg. 68337 (Dec. 23, 2009) ("new" Item 402(s) of Regulation S-K), SEC Release Nos. 33-9089, 34-61175, IC-29092 (Dec. 16, 2009), available at <http://www.sec.gov/rules/final/2009/33-9089.pdf> (last visited Aug. 26, 2024).

⁷ ISS, "ISS Director Qualification/Compensation Bylaw FAQs" (Jan. 13, 2014), available at <https://www.issgovernance.com/file/files/directorqualificationcompensationbylaws.pdf> (last visited Aug. 26, 2024).

⁸ *Id.*

⁹ See § 16.04[2][b] *infra*.

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traded companies whose shares are traded on the NYSE and Nasdaq are required to adopt charters for their compensation committees in accordance with the corporate governance rules set forth in their respective listing standards.

The NYSE rules generally require that the compensation committee of a listed company have a written charter that addresses the committee's purpose and responsibilities and the annual performance evaluation of the compensation committee. Also, the charter must give the committee the authority, in its sole discretion, to retain and terminate the employment of consultants, outside legal counsel and other advisers, as well as the responsibility to consider certain enumerated factors relating to such adviser's independence from the listed company. At a minimum, in addressing the committee's purpose and responsibilities, the charter must address the committee's direct responsibility to:

- review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives (either as a committee or with other independent directors, as directed by the board), and determine and approve CEO compensation based on this evaluation;
- make recommendations to the board with respect to non-CEO compensation, incentive compensation and equity-based plans;¹⁰
- prepare a compensation committee report on executive compensation to be included in the proxy or Form 10-K and
- an annual performance evaluation of the compensation committee.¹¹

The commentary to the NYSE rules states that a compensation committee charter should also address procedural matters such as member qualifications, appointment and removal, committee structure and operations (including delegation authority) and the committee's reporting relationship with the board. The NYSE commentary also states that nothing should be construed as precluding discussion of CEO compensation with the board generally.

¹⁰ Informally, the NYSE has confirmed that these are minimum requirements and, in fact, the compensation committee could approve the non-CEO executives' compensation, incentive compensation and equity-based plans.

¹¹ NYSE 303A.05.

The Nasdaq rules likewise generally require a listed company's compensation committee to maintain a charter. The Nasdaq rules require the charter to specify: (i) the scope of the compensation committee's responsibilities and how it carries out such responsibilities (including structure, processes and membership requirements); (ii) the compensation committee's responsibility for determining, or recommending to the board of directors for determination, the compensation of the CEO and other executive officers; (iii) that the CEO may not be present during voting or deliberations on his or her own compensation; and (iv) the specific authority, in its sole discretion, to retain and terminate consultants, outside legal counsel and other advisers, as well as the responsibility to consider, when selecting such adviser, certain enumerated factors relating to the adviser's independence from the company.¹² In addition, unlike the NYSE rules, the Nasdaq rules require a listed company to certify that it has adopted such a charter and that it will continue to review and reassess the adequacy of the charter on an annual basis.¹³

Given the expanded role and responsibilities of compensation committees, including matters relating to human capital and other workforce-related issues, many charters have been expanded to incorporate these additional functions.

[3]—Compensation Committee Procedural Action Items

Compensation committees are tasked with significant responsibility. The cornerstone of the compensation committee's responsibility is setting its pay philosophy and determining compensation arrangements. In discharging its corporate fiduciary duties, there are several procedural "action items" that compensation committee members should consider:

- Periodically review and reconsider the committee's role and responsibilities as they relate to executive compensation, director compensation, governance matters (e.g., clawbacks, stock ownership guidelines and succession issues) and areas of shifting focus such as human capital, DEI, ESG and other workplace matters.
- Review director independence and governance structure for compensation purposes (e.g., "independent director" status for stock exchange purposes under the Dodd-Frank Act and

¹² Nasdaq 5605(d)(1).

¹³ *Id.*

“non-employee director” status for purposes of Section 16(b) of the Exchange Act).¹⁴

- Hire committee advisers and review and assess the independence of such advisers.
- Review annually and update, as needed, committee charters.
- Actively engage shareholders and seek to understand their expectations with respect to “say-on-pay” and address shareholder concerns regarding compensation.
- Review proxy guidelines from proxy advisory firms, such as ISS and Glass Lewis, as well as those of any relevant institutional investors, such as BlackRock or Vanguard.
- Review proxy filings, including the compensation committee report, the CD&A and, as appropriate, disclosures surrounding CEO pay ratio, pay versus performance and clawback policies and the implementation of such policies.
- Be aware of, and demonstrate an understanding of, the current business and economic climate’s implications for executive compensation and seek ways to appropriately respond.
- Continually assess risk and adopt risk-mitigation measures if and as needed.
- In setting compensation, review and consider pay mix (e.g., fixed vs. variable, short-term vs. long-term, cash vs. stock, and formula vs. discretionary), form of stock awards (full value vs. appreciation, performance-vesting vs. time-vesting), pay caps, performance metrics, recoupment features and share ownership or retention requirements.
- In setting compensation, review and set the peer group and review and consider benchmarking analysis.
- Engage in good governance practices, such as having an annual agenda, taking appropriate minutes, conducting executive sessions and ensuring directors have the requisite education to assist them in serving on the compensation committee.

[4]—Compensation Committee Interlocks and Proxy Reporting Requirements

¹⁴ See § 16.04[2][b] *infra*. Note that an analysis of whether a director is an “outside director” for purposes of Section 162(m) of the Code should be done solely to the extent necessary to address grandfathered arrangements. See § 16.04[1] *infra*.

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To the extent that the members of a company's compensation committee are part of an "inter-locking directorship" with the board of another company, such "compensation committee interlocks" must be disclosed in the company's proxy statement. Such interlocks occur when:

- an executive officer of the company serves as a member of the compensation committee of another entity, one of whose executive officers serves on the compensation committee of the company;
- an executive officer of the company serves as a director of another entity, one of whose executive officers serves on the compensation committee of the company; or
- an executive officer of the company serves as a member of the compensation committee of another entity, one of whose executive officers serves as a director of the company.

In addition to its rules relating to listing standards for compensation committees, the SEC also amended Item 407 of Regulation S-K (Corporate Governance) to require that, to the extent that its compensation committee identifies compensation consultants pursuant to Item 407(e)(iii) of Regulation S-K whose work has raised any conflict of interest, the registrant must provide narrative disclosure of the nature of the conflict and how the conflict is being addressed. In doing so, Item 407 requires the registrant to take into account the compensation committee adviser independence factors listed in Exchange Act Rule 10C-1(b)(2). The amended listed company rules of NYSE and Nasdaq do not alter these proxy disclosure requirements.¹⁵

¹⁵ Existing provisions under Item 407(e) of Regulation S-K require that public companies make various proxy disclosures regarding the role of compensation consultants in determining executive and director compensation, including whether the compensation committee (or another board committee performing a similar function) engaged its own compensation consultant to provide advice regarding the compensation of executives or directors, the nature and scope of their work and the material instructions or directions given to the consultants. In certain cases, disclosure of the fees paid to compensation consultants is required. Under these rules, if a compensation consultant (or its affiliates) provided other services to the company for fees in excess of \$120,000 in the company's last completed fiscal year, the company must disclose the fees paid to the compensation consultant for executive and director compensation consulting, as well as the aggregate fees paid to the compensation consultant and its affiliates for all other services. The company also must disclose whether the decision to engage the compensation consultant or its affiliates for these other services was made or recommended by management and whether the board or a board committee approved the engagements for these other services. Similar disclosure regarding fees is required

[5]—Other Corporate Governance Considerations

In defining the role of the compensation committee and formulating the overall compensation philosophy of a company, the board of directors of a public company and compensation committee members must be cognizant of the requirements under the Dodd-Frank Act regulating executive compensation, as well as consideration of overall organizational risk and whether a company's compensation plans, programs and arrangements are reasonably likely to have a material adverse impact on the company. The Dodd-Frank Act, which requires say-on-pay advisory votes on executive compensation¹⁶ and independence requirements for compensation committee members and advisers,¹⁷ also requires new pay-for-performance disclosure requirements in a company's proxy materials that relate executive compensation to a company's overall compensation and financial performance.

[a]—Executive Compensation Disclosure Requirements

The Dodd-Frank Act imposes two additional executive compensation disclosure requirements for proxy and other materials filed by companies subject to the executive compensation proxy disclosure requirements: namely, the pay ratio disclosure rules under Section 953(b) of the Dodd-Frank Act and the "pay for performance" disclosure rules under Section 953(a) of the Dodd-Frank Act. The Dodd-Frank Act requires the SEC to establish rules requiring clear "pay-for-performance" disclosures showing the relationship between compensation for a company's named executive officers that was actually paid and the company's financial performance (taking into account any change in the value of the stock and any dividends or distributions), and may include a requirement to include performance graphics.¹⁸

Dodd-Frank directs the SEC to adopt rules requiring disclosure of the ratio of total compensation of the chief executive officer to the median compensation of the company's employees.¹⁹ For this purpose, total compensation includes all components of compensation disclosed

if a compensation consultant is engaged by company management.

¹⁶ See § 16.05 *infra*.

¹⁷ See § 16.04[2][b] *infra*.

¹⁸ Dodd-Frank Act § 953(b); Exchange Act § 14(i). See also, 80 Fed. Reg. 26330 (proposed May 7, 2015).

¹⁹ Dodd Frank Act § 953(b)(1); Exchange Act § 14(i)(b)(1); 15 U.S.C. § 78l. See also, Pub. L. No. 112-106, Title I, § 102(a)(3), 126 Stat. 309 (April 5, 2012) ("JOBS Act") ("new" Exchange Act § 14(i)).

in the Summary Compensation Table of a company's proxy statement.²⁰ The SEC issued a final pay ratio rule that generally requires disclosure of the median total annual compensation of all employees other than its chief executive officer, the total annual compensation of its chief executive officer and the ratio of such amounts (the "Pay Ratio Rule").²¹ Typically, the compensation committee would work closely with its advisers and management to review the methodology and disclosure under the Pay Ratio Rule.

The Pay Ratio Rule does not apply to smaller reporting companies, foreign private issuers, U.S.-Canadian Multijurisdictional Disclosure System filers, and emerging growth companies.²² In addition, the Pay Ratio Rule provides a transition period for companies that are new registrants so that they are not required to disclose their pay ratio until after their first full fiscal year has been completed.²³

Under the Pay Ratio Rule, companies are required to consider all U.S. and non-U.S. employees, as well as part-time and seasonal employees, employed by the company or any of its consolidated subsidiaries.²⁴ A company's median employee need only be determined once every three years, so long as there are no changes in the company's employee population or employee compensation arrangements that the company reasonably believes would significantly affect its pay ratio disclosure.²⁵ The Pay Ratio Rule does offer some flexibility to companies in determining the median employee and calculating total annual compensation of the median employee. For one, companies are able to choose the date for determining the median employee and calculating his or her compensation, so long as it is a day within three months of the company's last completed fiscal year.²⁶ Companies also have flexibility in determining the methodology they use to identify the median employee.²⁷

²⁰ Dodd Frank Act § 953(b)(2); Exchange Act § 14(i)(b)(2).

²¹ 17 C.F.R. § 229.402(u)(1) (2015). See 80 Fed. Reg. 50104 (Aug. 18, 2015).

²² Preamble, 80 Fed. Reg. 50104, 50114 (Aug. 18, 2015) ("*Preamble*").

²³ Instruction 7 to Item 402(u), 17 C.F.R. § 229.402(u) (2015). A new registrant is not required to make a pay ratio disclosure until it has (i) been subject to the requirements of Sections 13(a) or 15(d) of the Exchange Act for at least twelve calendar months and (ii) filed at least one annual report. *Preamble*, N. 22 *supra*, at 50147.

²⁴ 17 C.F.R. § 229.402(u)(3) (2015).

²⁵ Instruction 2 to Item 402(u), 17 C.F.R. § 229.402(u) (2015). The Pay Ratio Rule permits companies to use reasonable estimates in identifying median employees. *Preamble*, N. 22 *supra*, at 50130.

²⁶ *Preamble* at 50119. Once a company selects a date for determining the median employee, it must provide an explanation for any changes to such date. *Id.*

²⁷ Instruction 4 to Item 402(u), 17 C.F.R. § 229.402(u) (2015). Companies may

With respect to multinational companies, two exemptions for non-U.S. employees are available.²⁸ The first exemption, the foreign data privacy law exemption, permits a company to exclude employees in jurisdictions with data privacy restrictions that the company cannot comply with in providing personnel data necessary for determining and reporting the median employee compensation.²⁹ The second exception is the *de minimis* exception, which permits companies to exclude non-U.S. employees that make up 5% or less of the company's total employees.³⁰ In addition, companies may choose to make cost-of-living adjustments for employees in jurisdictions other than the jurisdiction in which the chief executive officer resides. However, any cost-of-living adjustments must be made with respect to the cost of living in the jurisdiction where the chief executive officer resides and must also be used when calculating the median employee's compensation.³¹ Companies also have some flexibility for situations in which a company has more than one chief executive officer serving during the fiscal year.³² Such companies may either take the total compensation for each chief executive officer that served during the year or they may choose to annualize the compensation of the chief executive officer serving in that role at the time the median employee is determined.³³ Annualization is also permissible when calculating median employee compensation, but it may only be used for permanent employees.³⁴ Thus, while the Pay Ratio

identify the median employee by using the total compensation for each employee under Item 402(c)(2)(x), statistical sampling, reasonable estimates, or any consistently applied compensation measures, such as tax and payroll records. *Preamble*, N. 22 *supra*, at 50130-50136.

²⁸ 17 C.F.R. § 229.402(u)(4) (2015).

²⁹ *Id.*

³⁰ *Id.* If a company uses the *de minimis* exception for a particular jurisdiction, it must exclude all employees from the jurisdiction and include additional disclosure. A company may choose to use both the foreign data privacy exception and the *de minimis* exception; however, any employees excluded for data privacy reasons will count against the 5% *de minimis* threshold. *Id.*

³¹ Instruction 4 to Item 402(u), 17 C.F.R. § 229.402(u) (2015). If a company chooses not to use a cost-of-living adjustment for determining its median employee, it may not use an adjustment for calculating the compensation of the median employee. Additional disclosure is required if a cost-of-living adjustment is used. *Preamble*, N. 22 *supra*, at 50125.

³² *Preamble*, N. 22 *supra*, at 50128.

³³ Instruction 10 to Item 402(u), 17 C.F.R. § 229.402(u) (2015). The company is required to disclose which option it chose and how the CEO's total annual compensation was calculated. *Id.*

³⁴ Instruction 5 to Item 402(u), 17 C.F.R. § 229.402(u) (2015). Annualization, which takes an employee's actual compensation and projects such compensation as if the employee had worked for an entire fiscal year, may be used for both part-time and full-

Rule mandates additional disclosure requirements, it also provides companies with some latitude in meeting those requirements.

When the Pay Ratio Rule was enacted, there was a general expectation that there would be intense scrutiny and confusion over significant gaps between the pay of many companies' chief executive officers and their median employees and concern surrounding the disclosure of the median employee compensation. As CEO pay had been known for decades, the disclosure of the CEO pay ratio over the past few years has garnered some attention, but nothing particularly significant.

In response to Dodd-Frank, the SEC proposed rules that would generally require that executive compensation disclosures in proxy and other information statements include a table, covering up to five years, that sets forth compensation actually paid to the chief executive officer and an average of the compensation actually paid to other named executive officers, along with the corresponding total compensation amounts, and the cumulative total shareholder return ("TSR") of the company and its peers, each over the prior five-year period.³⁵ In addition to tabular disclosure, the proposed rule requires companies to clearly describe the relationship between compensation actually paid and the company's TSR, as well as the relationship between the company's TSR and that of its peers.³⁶

These pay versus performance requirements were finalized by the SEC on September 8, 2022 and have become effective for companies as of October 11, 2022.³⁷ The final rule applies to companies registered under Section 12 of the Securities Exchange Act of 1934 and subject to the federal proxy rules.³⁸ Foreign private issuers, companies only subject to Section 15(d) reporting obligations and emerging growth companies are not impacted by the SEC's final rule.³⁹ The rule also applies to Business Development Companies ("BDCs") and Smaller Reporting Companies ("SRCs") but the final rule's requirements are

time employees who did not work an entire full fiscal year (for example, owing to leave under the Family Medical Leave Act or other leave or being newly hired). The rule prohibits full-time equivalent adjustments under all circumstances. *Preamble*, N. 22 *supra*, at 50129.

³⁵ See *Preamble*, 80 Fed. Reg. 26330, 26331-26332 (proposed May 7, 2015).

³⁶ *Id.*

³⁷ "Pay Versus Performance," 87 Fed. Reg. 55197 (Sept. 8, 2022); 17 C.F.R. § 229.402 ("new" Item 402 of Regulation S-K) (Sept. 8, 2022); SEC Release No. 34-95607, available at <https://www.sec.gov/rules/final/2022/34-95607.pdf> (last visited Aug. 26, 2024).

³⁸ *Id.*

³⁹ *Id.*

generally less burdensome in comparison.⁴⁰

The final rule requires a new table in a proxy statement (or other information statement) that shows the named executive officers' total compensation (as reported in the summary compensation table) and "compensation actually paid" next to the following financial performance metrics:

- TSR for the issuer and the issuer's peer group (weighted according to market capitalization as of the beginning of the fiscal year); TSR is expressed as a dollar value from an investment of \$100. For this purpose, the peer group can be either the peer group (if any) that is specified in the CD&A for compensation benchmarking purposes or the index the issuer uses for the required performance graph in its annual report on Form 10-K. If the peer group is not from the published index, it must be disclosed in a footnote. The peer group can change from year to year, which may create challenges. The TSR disclosures for a changed peer group must be provided for each of the lookback years and the change would need to be explained in a footnote (SRCs are not required to provide peer group information);
- Net income; and
- A metric selected by the issuer (not required for SRCs); this metric must be a financial metric (other than TSR or net income) and referred to in the rule as a "financial performance measure." The issuer is required to identify the most important financial metric to link compensation actually paid to financial performance and provide a list of at least three and up to seven metrics that the issuer determines represent the most important financial performance metrics for this purpose. A financial performance measure (other than stock price and TSR) generally must be determined and presented in accordance with the accounting principles used for financial statements. The list of metrics need not be ranked in order of importance, need not be the same for the CEO and

⁴⁰ For SRCs, the lookback period on the new disclosure table with respect to the final rule is limited to three (3) fiscal years. In the first year of disclosure, only two (2) fiscal years will be required. SRCs need not include peer group TSR or company-selected measurements in the disclosure table. SRCs will not be required to provide the tabular list of three to seven financial and non-financial metrics connecting actual compensation paid and performance. Additionally, executive compensation actually paid need not include amounts related to defined benefit pensions.

the other named executive officers, and may include non-financial metrics (but they are not a substitute for financial metrics and the issuer must still disclose at least three financial metrics used or, if fewer, the number actually taken into account).

Issuers are required to provide a clear description of the relationship between compensation actually paid and each financial metric that is included in the table (*i.e.*, TSR, peer group TSR, net income and the company-selected measure, if applicable). The description may be graphic or narrative (or a combination) and must include a comparison of the issuer's TSR to the peer group's TSR.⁴¹

In preparing the disclosure, it is important to recognize that neither "total compensation" nor "compensation actually paid" is a true reflection of compensation that an executive actually receives. Total compensation is based on the total compensation reported in the issuer's summary compensation table in the proxy statement. Compensation actually paid is defined as total compensation, adjusted for defined benefit pensions, equity awards, and above-market earnings on deferred compensation. Compensation actually paid is a bit of a misnomer as it requires assumptions about the value of equity and vesting that may not actually apply in reality. Although the SEC acknowledged in its release that equity award fair value may necessitate some subjective assumptions, it concluded that compensation actually paid should represent a reasonable measure of a named executive officer's actual pay.

The disclosure requirements are only meant to apply to annual proxies or other information statements where executive compensation disclosure is required (for example, information filed in anticipation of an annual shareholder meeting).

As a practical matter, this SEC rule requires companies to collect new types of compensation information and calculations outside the scope of previous proxy processes, making it imperative that companies prepare to address the new proxy requirements early in the annual proxy process. This includes having the dedicated company officials connecting with compensation consultants, accountants and legal counsel to limit violations or even potential foot-faults in adhering to the final rule. Although the preparation of the pay versus performance disclosure can be complex and time-consuming, companies should be preparing their disclosures and reporting their approach and findings to their compensation committees.

⁴¹ SRCs are not required to show peer group TSR or a company-selected measure.

[b]—Disclosure Requirements Regarding Timing of Option Grants

Compensation committees should also be aware of the risks implicated by the timing of equity grants, including the unintentional appearance of “spring-loading” and “bullet-dodging” when granting option or option-like awards to executives. “Spring-loading” option grants refers to a practice of granting option or option-like awards shortly before announcements that can be expected to increase an issuer’s stock price while “bullet-dodging” refers to practices of granting option or option-like awards shortly after releasing information that can be expected to negatively impact an issuer’s stock price.

In response to public concerns regarding these option and option-like grant timing issues, the SEC finalized new Item 402(x) of Regulation S-K in December 2022.⁴² The regulation requires issuers to describe their policies regarding the timing of option and option-like awards with respect to the disclosure of material non-public information including: (i) how the board determines when to grant such awards; (ii) if the issuer takes material non-public information into account when determining grant timing; and (iii) whether the issuer has timed the disclosure of material non-public information to impact the value of option or option-like awards.⁴³ This rule effectively requires issuers to qualitatively outline the decision-making process to investors regarding the timing of option or option-like awards granted close in time to major disclosure events which may impact an issuer’s stock price.

Issuers are required to comply with these new disclosure requirements under Item 402(x) in their Form 10-K (or their proxy statements incorporated by reference into the Form 10-K) for the first filing period that begins on or after April 1, 2023.⁴⁴ For small reporting companies, this effective date is extended to October 1, 2023.⁴⁵

Ultimately, this requirement is prompting compensation committees to review their option grant policies and the specific timing of grants. Although not required, some companies may choose to review their grant policies for all types of equity grants such as restricted stock units,

⁴² 17 C.F.R. § 229.402(x).

⁴³ 17 C.F.R. § 229.402(x)(1).

⁴⁴ SEC, “Insider Trading Arrangements and Related Disclosures,” Release No. 33-11138, available at <https://www.sec.gov/rules/final/2022/33-11138.pdf> (last visited Aug. 26, 2024).

⁴⁵ SEC, “Compliance and Disclosure Interpretation” Question 120.25 (last updated May 25, 2023), available at [SEC.gov | Exchange Act Rules](https://www.sec.gov/ExchangeActRules) (last visited Aug. 26, 2024).

[c]—SEC Clawback Rule

The SEC also published their final “clawback rule” on October 26, 2022, twelve years after the enactment of Dodd-Frank.⁴⁶ The clawback rule tasks national securities exchanges with adopting new listing standards requiring publicly listed companies to establish compensation clawback policies in accordance with the SEC’s new clawback rule. The rule will require national securities exchanges to develop strict minimum requirements in cases where executive officers are “erroneously awarded” incentive-based compensation.⁴⁷ The NYSE and Nasdaq released their respective versions of rules that implement the SEC’s clawback rule on February 22, 2023.⁴⁸ Both sets of rules became effective as of October 2, 2023.⁴⁹ Both the NYSE and Nasdaq have specified that an issuer will only be required to apply its clawback policy to erroneously provided incentive-based compensation received on or after the effective date.⁵⁰ For this purpose, “received” means when a financial reporting measure is attained (even if payment is made at a later date).

The policy would be triggered by an issuer being required to prepare an accounting restatement due to material non-compliance with any financial reporting requirement under the federal securities laws. The final rule provides that the accounting restatement includes both “Big R” restatements (that is, errors that resulted in a material accounting misstatement in previously issued financials) and “little r” restatements (that is, errors that would result in a material accounting misstatement if the errors were left uncorrected in the current report or if the error correction was recognized in the current period). The policy also must require an issuer to recover the gross amount of excess incentive-based

⁴⁶ “Listing Standards for Recovery of Erroneously Award Compensation,” 87 Fed. Reg. 73076; SEC Release Nos. 43-96159, IC-34732 (Nov. 28, 2022) available at <https://www.sec.gov/rules/final/2022/33-11126.pdf> (last visited Aug. 26, 2024).

⁴⁷ *Id.*

⁴⁸ New York Stock Exchange, “Proposed Rule Change,” available at <https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2023/SR-NYSE-2023-12.pdf> (last visited Aug. 11, 2023); NASDAQ, “Proposed Rule Change,” available at <https://listingcenter.nasdaq.com/assets/rulebook/NASDAQ/filings/SR-NASDAQ-2023-005.pdf> (last visited Aug. 26, 2024).

⁴⁹ SEC, Release No. 34-97688, available at <https://www.sec.gov/rules/sro/nyse/2023/34-97688.pdf> (last visited Aug. 26, 2024).

⁵⁰ *Id.*

compensation (before reductions for withholding and other deductions). This would cover incentive-based compensation received by current and former executive officers during a three-year “recovery period” regardless of whether the officer engaged in any misconduct and regardless of fault.⁵¹ The clawback rule would not implicate (1) salaries, (2) discretionary bonuses, (3) compensation tied to subjective or strategic performance standards or (4) strictly time-based or service-based awards as compensation subject to clawbacks.⁵²

Notably, clawback is not required in cases where an independent compensation committee (or, if none exists, a majority of independent members of the board) has determined that recovery of the “erroneously awarded” compensation would be impractical and if any of the following conditions are met: (1) the cost to enforce the policy would exceed the amount recovered by the company, (2) the recovery of the erroneously awarded compensation would violate a home country law which was in effect prior to the effective date of the clawback rule or (3) where compliance with the policy would result in a company’s tax-qualified retirement plan failing to meet the requirements of the Internal Revenue Code.⁵³ Any decision by an independent compensation committee to not enforce their clawback policy must be publicly disclosed and will need to be subject to the review of the applicable national security exchange.⁵⁴

Companies and compensation committees should continue to focus on implementing clawback policies and satisfying disclosure requirements if a clawback is triggered. Compensation committees should further consider how these SEC rules can impact the way shareholders view both the company’s overall compensation philosophy and the individual compensation of the company’s named executive officers. Additionally, companies should consider how the scope of their clawback policies will be viewed by both shareholders and influential proxy advisory firms.

[d]—State Law Considerations

It is important that compensation committees ensure that they are both following federal and relevant state law principles when designing

⁵¹ See N. 46 *supra*.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

and implementing a clawback policy at their respective companies, particularly with respect to a clawback policy that is not required by Dodd-Frank.⁵⁵ In a recent unpublished decision, the New Jersey district court determined that the company was not able to claw back the compensation of its former CEO following the CEO's resignation from the company in connection with an accounting restatement.⁵⁶ The company's lawsuit sought to recoup the CEO's compensation and claimed that the CEO's behavior violated the company's standards of business conduct and that the company's clawback policies were specifically incorporated into various other agreements with the CEO. The court disagreed, stating that the company's use of general standards of business conduct policies to "enforce provisions containing only broad, aspiration language, but offer[ing] no yardstick by which to ascertain performance"⁵⁷ was unenforceable.⁵⁸ While this case is not binding on other courts and is fact-specific, it outlines the need for companies to keep standard contract principles in mind when thinking about how to structure and enforce non-Dodd-Frank clawback policies and provisions with respect to executives.

[e]—Enforcement Considerations

On March 3, 2023, the U.S. Department of Justice's Criminal Division (the "Division") announced a new three-year Compensation Incentives and Clawbacks Pilot Program which sets forth requirements for companies to implement compliance-related criteria into their compensation and bonus system and imposes certain reporting duties with the Division when entering into criminal resolutions.⁵⁹ To help incentivize voluntary engagement with the program, the program directs

⁵⁵ See, *Hertz Corp. v. Frissora*, No. 19cv08927 (EP) CLW, 2023 U.S. Dist. LEXIS 109846 (D.N.J. June 26, 2023) (in a case relating to a non-Dodd-Frank clawback, the court noted that the company's approval of resolutions outlining general clawback principles and their incorporation into the company's standards of conduct were not, by themselves, an enforceable standalone agreement with respect to the recoupment of compensation.).

⁵⁶ See *Hertz Corp. v. Frissora*, No. 19cv08927 (EP) CLW, 2023 U.S. Dist. LEXIS 109846 at *1 (D.N.J. June 26, 2023).

⁵⁷ *Id.* at *9.

⁵⁸ *Id.*

⁵⁹ U.S. Department of Justice, "The Criminal Division's Pilot Program Regarding Compensation Incentives and Clawbacks," available at [Microsoft Word - 2023.03.03 - Comp & Clawback Pilot Program \(justice.gov\)](https://www.justice.gov/opa/record/2023-03-03-comp-clawback-pilot-program) (last visited Aug. 26, 2024).

prosecutors to consider potential fine reductions in cases “where companies seek to recoup compensation from culpable employees and others who had both (i) supervisory authority over the employees or business area engaged in misconduct and (ii) knew of, or were willfully blind to, the misconduct.”⁶⁰

The guidance further notes that corporate responsibility is not limited to wrongdoing committed by just some few high-level executives and that the implementation of broad clawback policies could be considered alongside strict Dodd-Frank compliant clawback policies. The program is effective as of March 15, 2023.⁶¹

[f]—Risk Management

Compensation committees need to understand a company’s risks, controls and capital at risk and consider them in designing compensation to ensure that executive compensation does not rise to a level of inappropriate risk-taking. This is particularly important because proxy disclosure rules, for example, require a discussion and analysis of the broader compensation policies and overall compensation practices for named executive officers and non-executive officers if the risks arising from those practices or policies are reasonably likely to have a material adverse effect on the company. Thus, assessing whether the compensation programs encourage excessive risk-taking and managing the programs and any attendant risks are extremely important when the compensation committee is formulating the overall compensation philosophy for a company, the individual executive compensation arrangements for named executive officers and its broader compensation programs.

For example, compensation committees should be aware of payment features in executive compensation packages that may be considered risky, such as performance bonus programs without caps or programs that have a high proportion of short-term incentives that may encourage actions to maximize profits of a company over the short term but may be harmful over the longer term. Instead, compensation committees may wish to provide compensation packages that help balance risk with incentives, such as a compensation package that provides for an appropriate mix of short-term, medium-term and long-term incentives.

⁶⁰ *Id.*

⁶¹ *Id.*

§ 16.04 Independence of Compensation Committee Members

Many public companies historically formed compensation committees consisting solely of non-employee directors in order to be able to take advantage of exemptions from short-swing trading liability¹ under Rule 16b-3 promulgated under the Exchange Act and of tax benefits related to the deduction of executive compensation under Section 162(m) of the Code prior to the enactment of the Tax Cuts and Jobs Act of 2017 (“TCJA”). Over the past decade, the NYSE and Nasdaq implemented rules requiring publicly traded companies listed on their exchanges to comply with corporate governance requirements mandating the use of “independent” directors to make executive compensation decisions involving equity and equity-based awards. More recently, the Dodd-Frank Act imposed its own independence requirements on compensation committee members, which were implemented by final rules issued by the SEC relating to compensation committee independence. Pursuant to these SEC rules, the NYSE and Nasdaq revised their respective listing rules in January 2013 to expand the obligations of listed companies with respect to compensation committee independence.

[1]—Requirements Under Section IRC 162(m)

Section 162(m) of the Code limits the ability of a publicly traded corporation to deduct compensation in excess of \$1 million paid to “covered employees” in any tax year. In 2017 Congress passed the TCJA, which, in part, amended and repealed parts of Section 162(m) of the Code. Notably, the TCJA repealed the performance-based compensation exception to the \$1 million limitation under Section 162(m) of the Code. However, the statute and regulations issued pursuant to the TCJA (the “New Section 162(m)”) provide a transition rule that grandfather remuneration arrangements provided under a written binding contract that was in effect on November 2, 2017, so long as they are not materially modified on or after that date. Accordingly, the performance-based compensation exception under pre-TCJA Section 162(m) of the Code may still be applicable in certain circumstances, although most performance periods under grandfathered arrangements have now expired. Because there are certain (albeit limited) circumstances in which the rules regarding the exception for performance-based compensation under pre-TCJA Section 162(m) of the Code may apply, the remainder

¹ Liability for selling or buying securities within six months of an opposite way transaction unless the transaction is exempt from the rules, including by virtue of certain approvals by a board committee satisfying the applicable independence standard.

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of this section discusses compensation committee requirements under those prior rules.

Under pre-TCJA Section 162(m) of the Code, the compensation committee of a publicly held corporation must comprise solely two or more outside directors. In order for compensation to qualify as performance-based, and not be subject to the Section 162(m) deduction limitation, the compensation committee must perform certain functions with regard to establishing the compensation and certifying achievements of goals. The performance goals under which compensation is payable must be established by the compensation committee within certain specified time periods, and, to the extent applicable, grants and awards of stock options, stock appreciation rights, restricted stock and other stock-based compensation must be made by the compensation committee.² In addition, the compensation committee must, except in the case of compensation attributable solely to an increase in stock price, certify in writing the attainment of the relevant performance goals and any other material terms prior to the payment of compensation.³ The certification requirement can be satisfied through the use of approved compensation committee minutes from the meeting at which the certification occurs.⁴

The criteria to qualify as an “outside director” under pre-TCJA Section 162(m) are that the director:

- cannot be a current employee of the publicly held corporation;
- cannot be a former employee of the publicly held corporation who receives compensation for prior services (other

² In Priv. Ltr. Rul. 9811029, the Internal Revenue Service (the “Service”) approved as performance-based compensation a stock option plan approved by a compensation committee of the Board of Directors which included inside directors as well as two outside directors, so long as the inside directors abstained or recused themselves with regard to the performance-based compensation matters. The logic, which may or may not ultimately stand up in other situations, is that from a practical point of view this is no different than a subcommittee. On the other hand, this approach results in a technical violation if a mistake is made and a non-outside director is on the committee and votes, even if the vote is irrelevant and there are a sufficient number of votes from outside directors. Considering the stock exchange listing rules with regard to independence of compensation committees, the use of inside directors on compensation committees is likely to be a very unlikely situation.

³ Treas. Reg. § 1.162-27(e)(5).

⁴ Treas. Reg. § 1.162-27(e)(5).

than benefits under tax-qualified retirement plans) during the applicable tax year;⁵

- has not been an officer of the publicly held corporation; and
- does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services.⁶

Whether a director is an employee or former officer is determined on the basis of the facts and circumstances that exist at the time that the individual is serving on the compensation committee.⁷ It is an ongoing determination. An “officer” is defined as an administrative executive who is or was in regular and continued service. The term excludes those employed for a single or special transaction.⁸ In addition, an individual who merely has or had the title of officer, but not the authority, is not an officer.⁹ A director is not precluded from being an outside director solely because the director is a former officer of a corporation that previously was an affiliated corporation of the publicly held corporation.¹⁰ However, an outside director would no longer qualify as such if a corporation in which the director was previously an officer was acquired by the public corporation.¹¹

For purposes of the remuneration test, “remuneration” includes any

⁵ A director who is currently receiving benefits under a supplemental executive retirement plan (“SERP”) or other nonqualified deferred compensation plan as a former employee of the publicly held corporation (or one of its current affiliates) will not qualify as an outside director. In Priv. Ltr. Rul. 200546012, the Service found that a director qualified as an “outside director” under Treas. Reg. § 1.162-27(e)(3), even though he was receiving accrued benefits under tax qualified retirement plans. The director was a senior partner in a partnership that converted into the corporation. In the conversion he received common stock. The director was not an employee at any time nor did he receive any compensation from the corporation for his prior services to the partnership.

⁶ Treas. Reg. § 1.162-27(e)(3)(i).

⁷ Treas. Reg. § 1.162-27(e)(3)(vi).

⁸ Treas. Reg. § 1.162-27(e)(3)(vii).

⁹ In Priv. Ltr. Rul. 9732011, the Service ruled that the corporate secretary of a publicly held corporation was not an officer for Section 162(m) purposes where the functions of such position were ceremonial and ministerial in nature and the individual otherwise lacked the authority of an officer.

¹⁰ A director of a publicly held corporation that had been spun off from its parent qualified as an outside director of such publicly held corporation even though the director continued to serve as an officer of the former parent. Priv. Ltr. Rul. 9731006.

¹¹ Treas. Reg. § 1.162-27(e)(3)(vi).

payments in exchange for goods or services and is deemed to be received, by a director if:

- the remuneration is paid, directly or indirectly, to the director personally or to an entity¹² in which the director has a beneficial ownership interest of greater than 50%;¹³
- remuneration, other than *de minimis* remuneration, was paid by the publicly held corporation in its preceding taxable year to an entity in which the director has a beneficial ownership interest of at least 5% but not more than 50%;¹⁴
- the remuneration, other than *de minimis* remuneration, (as discussed below), was paid by the publicly held corporation in its preceding taxable year to an entity by which the director is employed or self-employed other than as a director.¹⁵

De minimis remuneration is measured based on the amount paid by the publicly held corporation in its preceding taxable year and may not exceed 5% of the gross revenue of the entity for the entity's taxable year ending with or within the publicly held corporation's preceding taxable year. Remuneration in excess of \$60,000, even if less than 5% of gross revenue, is not *de minimis* if the remuneration is paid to an entity in which the director has a beneficial ownership interest of at least 5% but not more than 50%, or is paid for personal services to an entity by which the director is employed or self-employed other than as a director.¹⁶

Remuneration must satisfy two requirements to be deemed paid for personal services. First, the remuneration must be paid to an entity for

¹² "Entity" means any organization that is a sole proprietorship, trust, estate, partnership (including a limited liability company) or corporation. Treas. Reg. § 1.162-27(e)(3)(v).

¹³ Treas. Reg. § 1.162-27(e)(3)(ii)(A). For purposes of this test, remuneration is considered paid when actually paid (and throughout the remainder of that taxable year) and, if earlier, through the period when a contract or agreement to pay remuneration is outstanding. The examples point out how broadly the Service interprets "indirectly," and in many cases representations will be required to be obtained by the corporation as to the fact that the director does not benefit from amounts paid to an entity employing the director. Note that this test is applied on a current and not on a look-back basis.

¹⁴ Treas. Reg. § 1.162-27(e)(3)(ii)(B). For purposes of this test, remuneration is considered paid when actually paid, or, if earlier, when the publicly held corporation becomes liable to pay it. This test is applied on a look-back basis.

¹⁵ Treas. Reg. § 1.162-27(e)(3)(ii)(C). For purposes of this test, remuneration is considered paid when actually paid, or, if earlier, when the publicly held corporation becomes liable to pay it. This test is applied on a look-back basis.

¹⁶ Treas. Reg. § 1.162-27(e)(3)(iii). See also, Priv. Ltr. Rul. 199950021.

personal or professional services, consisting of legal, accounting, investment banking, and management consulting services (and such other services as the Commissioner of Internal Revenue may prescribe) performed for the publicly held corporation, and the remuneration must not be for services that are incidental to the purchase of goods or the purchase of services that are not personal services. Second, the director must perform significant services (whether or not as an employee) for the corporation, division, or similar organization (within the entity) that actually provides the personal services described above to the publicly held corporation, or more than 50% of the entity's gross revenues must be derived from the personal-service-providing organization.¹⁷

This limitation was revised in response to criticism concerning the prior rule's impracticability. In addition, outside directors of the publicly held member of an affiliated group are treated as outside directors of all members of the affiliated group.¹⁸

[2]—Requirements Under the Securities and Exchange Act

The SEC rules and regulations historically have related to the disclosure of a company's compensation committee and corporate governance standards rather than dictating specific requirements with respect to a compensation committee or requiring specific corporate governance standards. For example, companies have to disclose whether they have a compensation committee and the members of any such committee in their annual proxy statements, and whether any of their directors or officers are a part of an interlocking directorship with the board of another company. However, SEC rules and regulations set forth specific requirements regarding the independence of non-employee directors where a public company wishes to utilize a compensation committee to approve equity compensation awards to directors or officers, thus exempting such awards from short-swing trading liability under Section 16(b) of the Exchange Act. Additionally, the Dodd-Frank Act includes independence requirements relating to compensation committees, which required the SEC to implement rules to enforce the new independence requirements. Amendments to each of the NYSE's and Nasdaq's listing standards with respect to compensation committee members and their advisors were approved by the SEC and adopted by the exchanges.

¹⁷ Treas. Reg. § 1.162-27(e)(3)(iv).

¹⁸ Treas. Reg. § 1.162-27(e)(3)(viii).

[a]—SEC Rule 16b-3

Section 16(b) of the Exchange Act provides that a company can recover any profits made by an officer or director who buys and sells a company's stock in any period of less than six months. However, Rule 16b-3 promulgated under Section 16(b) of the Exchange Act exempts the grant of stock options and other stock-based awards to executive officers and directors from short-swing trading liability under Section 16 of the Exchange Act if, among other alternatives, the transaction is approved by the board of directors of the issuer, or a committee of the board of directors that is composed solely of two or more "non-employee" directors.¹⁹

In order to qualify as a "non-employee" director, a director:

- cannot be a current officer or employee of the company or a parent or subsidiary of the company;
- cannot receive compensation in excess of the Item 404(a) dollar limitation disclosure threshold,²⁰ either directly or indirectly, from the company or a parent or subsidiary of the company, for services rendered as a consultant or in any capacity other than as a director; and
- since the beginning of the company's last fiscal year, cannot possess an interest in any related party transactions where the Item 404(a) disclosure would be required.

¹⁹ Exchange Act, Rule 16b-3, Section d. Alternatively, stock option and other stock-based awards to executive officers and directors will be exempted from short-swing trading liability under Section 16(b) of the Exchange Act if:

- the transaction is approved or ratified by either: the affirmative votes of the holders of a majority of the securities of the issuer present, or represented, and entitled to vote at a meeting duly held in accordance with the applicable laws of the state or other jurisdiction in which the issuer is incorporated; or the written consent of the holders of a majority of the securities of the issuer entitled to vote; provided that such ratification occurs no later than the date of the next annual meeting of shareholders; or
- the issuer equity securities so acquired are held by the officer or director for a period of six months following the date of such acquisition, provided that this condition shall be satisfied with respect to a derivative security if at least six months elapse from the date of acquisition of the derivative security to the date of disposition of the derivative security (other than upon exercises or conversion) or its underlying equity security.

²⁰ At the time of this writing, \$120,000.

The rules permit reliance on the disclosure provided under Item 404(a) from the most recent fiscal year's filing and an ability not to consider transactions disclosed which were terminated before the director's proposed service as a non-employee director. Note 4 to Rule 16b-3 also requires that the issuer believe in good faith that any current or contemplated transaction in which the director participates will not be required to be disclosed based on information readily available to the issuer and the director at the time such director proposes to act as a non-employee director. A determination of required disclosure will not result in a retroactive loss of Rule 16b-3 exemptions for previously approved grants.²¹

[b]—The Dodd-Frank Act and the SEC Rules

The Dodd-Frank Act provided for sweeping changes in the regulation of the financial services industry in an effort to enhance enforcement, transparency and accountability. Although the Dodd-Frank Act focused in large part on the financial services industry, it included a number of executive compensation and corporate governance provisions that were not limited to the financial services industry and that, instead, applied broadly to public companies without regard to industry.

[i]—Independence of Compensation Committee Members

Under the SEC rules, the national securities exchanges were required to adopt listing standards pursuant to which each member of a listed company's compensation committee is required to be a member of its board of directors and independent.²² A covered company's failure to have a compensation committee composed only of independent directors will result in the prohibition of the listing of the company's stock on any national securities exchange pursuant to such rules. Under such listing standards, a director's "independence" must be based upon the applicable exchange's consideration of relevant factors, among them the source of the director's compensation, including any consulting, advisory or other compensatory fees, as well as the director's affiliation

²¹ 17 C.F.R. § 240.16b-3, Note (4) (2008).

²² 17 C.F.R. § 240.10C-1(b)(1). The compensation independence requirements do not apply to controlled companies, limited partnerships, companies in bankruptcy proceedings, open-ended management investment companies registered under the Investment Company Act of 1940 or foreign private issuers that disclose to shareholders why they do not have an independent compensation committee. 17 C.F.R. §§ 240.10C-1(b)(1)(iii), (b)(5).

with the company or its subsidiaries and affiliates.²³

In addition to the compensation committee member independence requirements under the Dodd-Frank Act and the related SEC rules, both the NYSE and Nasdaq require that executive compensation be reviewed by a compensation committee composed of “independent directors” as defined under the general director independence provisions of the listed company rules of the respective exchange.

Finally, public companies will also have to consider the independence requirements for securities law purposes under Section 16(b) of the Exchange Act regarding short-swing profit recovery rules²⁴ and, to the extent that public companies have grandfathered arrangements, for purposes of tax deductibility under Section 162(m) of the Code regarding performance-based pay.²⁵

*[ii]—Independence of Compensation Committee Consultants,
Legal Counsel and Other Advisers*

In addition to setting forth independence requirements for compensation committee members, the Dodd-Frank Act also addressed concerns about the independence of compensation consultants, legal counsel and other advisers to compensation committees. The related SEC rules implemented these requirements. While the SEC rules did not mandate the use of such advisers, the rules require listed companies to authorize their compensation committees to engage and oversee the services of compensation consultants, legal counsel and other advisers in their sole discretion. If a compensation committee elects to retain the services of compensation consultants, legal counsel and other advisers, it may only do so after taking into consideration the following factors, as well as any other factors identified by the relevant national securities exchange.

The provisions of other services to the company by the employer of the consultant, legal counsel or adviser:

- The amount of fees received by the employer of the compensation consultant, legal counsel or other adviser, as a percentage of such employer’s total revenues;

²³ 17 C.F.R. § 240.10C-1(b)(1)(ii).

²⁴ See §§ 16.04[1] and [2][a] *supra* for more information regarding these independence requirements.

²⁵ See § 16.04[1] *supra*.

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- The policies and procedures of the employer of the consultant, legal counsel or adviser that are designed to prevent conflicts of interest;
- Any business or personal relationship of the compensation consultant, legal counsel or adviser with a member of the compensation committee;
- Any stock of the company owned by the compensation consultant, legal counsel or other adviser; and
- Any business or personal relationship of the compensation consultant, legal counsel or other adviser or his or her employer with an executive officer of the company.²⁶

The SEC rules also require listed companies to provide for appropriate funding, as determined by the compensation committee in its capacity as a committee of the board of directors, for the payment of reasonable compensation to compensation consultants, legal counsel and other advisers retained by the compensation committee²⁷ and confers upon the compensation committee the direct responsibility for their advisers' appointment, compensation and work.²⁸ The compensation committee need not follow the advice of compensation consultants, legal counsel or other advisers it engages, nor does the retention of such advisers relieve the compensation committee from the requirements to exercise its own judgment in fulfilling its duties.²⁹ Additionally, while the Dodd-Frank Act provides that compensation committees shall have the authority to hire independent legal counsel, the SEC rules make clear that the Act does not require that the committee hires independent legal counsel and that the retention of non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the company is not precluded.³⁰

The foregoing requirements are incorporated into the listed company rules of both the NYSE and Nasdaq.³¹

²⁶ 17 C.F.R. § 240.10C-1(b)(4).

²⁷ 17 C.F.R. § 240.10C-1(b)(3).

²⁸ 17 C.F.R. § 240.10C-1(b)(2).

²⁹ 17 C.F.R. § 240.10C-1(b)(2)(iii).

³⁰ See SEC Release No. 33-9330 (June 20, 2012), available at <http://www.sec.gov/rules/final/2012/33-9330.pdf> (last visited Aug. 21, 2025).

³¹ See §§ 16.04[3][a] and [b] *infra* for more information regarding the NYSE and Nasdaq requirements with respect to compensation committee retention of compensation consultants, independent legal counsel and other advisers.

[3]—NYSE and Nasdaq Requirements

The SEC approved rules filed by the NYSE and the Nasdaq that address corporate governance generally and, more specifically, the process of determining compensation levels of executive officers. The rules require listed companies to maintain compensation committees that are comprised entirely of “independent” directors and that are responsible for executive compensation decisions. The rules require that the compensation committees of publicly traded companies establish and review a written charter governing their operation and responsibilities, including their rights and requirements with respect to the retention of outside advisers. Publicly traded companies that are subject to either the NYSE or Nasdaq rules should review the composition of their compensation committees to ensure compliance with these enhanced compensation committee independence standards, in addition to the “outside director” standard under pre- TCJA Section 162(m) of the Code, to the extent applicable, and the “nonemployee director” standard under Rule 16b-3 under the Exchange Act.

[a]—NYSE Section 303A

The NYSE rules require all NYSE-listed companies to maintain a compensation committee comprised entirely of “independent directors.”³² The compensation committee is required to have a written charter that addresses its purpose and responsibilities, and provides an annual performance evaluation of the compensation committee. The charters must also set forth the rights and responsibilities of the compensation committee with respect to retention and oversight of compensation consultants, independent legal counsel and other advisers. The compensation committee is also required to approve a report on executive compensation, as required by SEC rules, to be included in the company’s annual proxy statement or annual 10-K report. Although the rules allow the boards of these companies to allocate the responsibilities of the compensation committee to committees of their choosing, these committees must also be comprised solely of “independent directors.”

[i]—Director Independence Under the NYSE Rules

³² The NYSE rules permit a listed company’s board to allocate the responsibilities of the compensation committee to committees of their own denomination, provided that the committees are composed entirely of independent directors and have a committee charter.

NYSE Section 303A requires a listed company's board of directors to affirmatively determine that each independent director has no material relationship with the company "either directly or as a partner, shareholder or officer of an organization that has a relationship with the company,"³³ and the company must publicly disclose this determination in its annual proxy statement.

Section 303A further requires that, when making this affirmative determination for a director who will serve on the listed company's compensation committee, the company's board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:

- the source of his or her compensation, including any consulting, advisory or other compensatory fee paid to him or her by the company; and
- whether he or she is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company.

The commentary to the amended rules clarifies that, when considering the sources of a director's compensation in determining his or her independence for purposes of compensation committee service, the board should consider whether he or she receives compensation from any person or entity that would impair his or her ability to make independent judgments about the listed company's executive compensation. Additionally, when considering any affiliate relationship a director has with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company, the board should consider whether the affiliate relationship places the director under the direct or indirect control of the company or its senior management, or creates a direct relationship between the director and members of senior management, which may impair his or her ability to make independent judgments about the company's executive compensation.³⁴

In addition, a director will not be considered "independent" until three years³⁵ after the end of the following relationships, if:

³³ NYSE 303A.02.

³⁴ *Id.*

³⁵ Although Institutional Shareholder Services Inc. does not have its own

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- he or she is employed by, or has an immediate family member (spouse, parents, children, siblings, mothers-in-law and fathers-in-law and sons-in-law and daughters-in-law and anyone (other than domestic employees) who shares such person's home) who is an executive officer, of the listed company;
- he or she or an immediate family member receives more than \$120,000 per year in direct compensation from the listed company in any twelve-month period, "other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service)";
- he or she: (1) is a current partner or employee of the company's internal or external auditor; (2) has an immediate family member who is a current partner of the firm, or is a current employee of the firm and personally works on the company's audit; or (3) was or has an immediate family member who was a partner or employee of the firm (but is no longer) and personally worked on the listed company's audit within the last three years;
- he or she or an immediate family member is employed as an executive officer of another company where any of the listed company's present executives serve on that company's compensation committee; or
- he or she is an executive officer or an employee, or has an immediate family member who is an executive officer, of a company that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million or 2% of such other company's consolidated gross revenues (based on those reported in the last completed fiscal year).

independent director standards, its guidelines generally consider a five-year look-back period in determining director independence. See ISS, "U.S. Corporate Governance Policy 2011 Updates" (Feb. 7, 2023), available at <http://www.issgovernance.com/files/ISS2011USPolicyUpdates20101119.pdf> (last visited Aug. 21, 2025). Glass, Lewis & Co. also uses a five-year look-back period. Glass, Lewis & Co., LLC, 2020 Proxy Paper Guidelines, available at https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf (last visited Aug. 21, 2025).

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When applying the look back rule to any “immediate family member,” listed companies need not consider individuals who are no longer immediate family members as a result of legal separation or divorce, or those who have died or become incapacitated. Also, employment as an interim chairman or CEO would not disqualify a director from being considered independent following that employment for purposes of the NYSE requirements.

The commentary to the NYSE rule makes it clear that any reference to the “listed company” includes any parent or subsidiary in a consolidated group with the company. Also, when assessing whether a relationship is “material,” all relevant facts and circumstances should be considered in the broadest manner, including by looking not merely from the director’s standpoint, but also from the standpoint of persons or organizations with which the director has any affiliation (e.g., commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships). The commentary notes that ownership of “even a significant amount of stock, by itself” is not necessarily a bar to any independence finding because the concern relates to independence from management.

[ii]—Retention of Compensation Consultants, Independent Legal Counsel and Other Advisers

The NYSE rules generally incorporate the requirements set forth in the SEC rules with respect to compensation committee retention of compensation consultants, independent legal counsel and other advisers. However, with respect to the independence test which compensation committees are required to apply when retaining such advisers, the NYSE rules specifically require compensation committees to take into account “all factors relevant to that person’s independence from management,” including the factors enumerated in the SEC rules.³⁶ Thus, while these factors must be considered, the NYSE rules suggest that other relevant factors may, and must, be considered as well.

[iii]—Exemptions

The NYSE exempts any listed company of which more than 50% of the voting power is held by an individual, a group or another company (“Controlled Company”) from the requirement that it have a compensation committee composed entirely of independent directors. A

³⁶ NYSE 303A.05(c)(iv). By contrast, the Nasdaq rules, discussed at § 16.04[3][b] *infra*, only require the six factors specifically enumerated in the SEC rules to be considered.

company that chose to take advantage of this exemption would be required to disclose that it is a Controlled Company, and the basis for such determination in its annual proxy statement or, if the company does not file an annual proxy statement, in its annual 10-K report.

Limited partnerships and companies in bankruptcy proceedings also are exempt from requirements that the board have a compensation committee composed entirely of independent directors.

Closed-end and open-end management investment companies that are registered under the Investment Company Act of 1940 (“Investment Company Act”) are exempt from the requirements of Section 303A.³⁷ Business development companies, a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act that are not registered under the Investment Company Act, are required to comply with all of the provisions of NYSE Section 303A applicable to domestic issuers, except that the directors of such companies are not required to satisfy the independence requirements. A director of a business development company would be considered to be independent if he or she is not an “interested person” of the company, as defined in Section 2(a)(19) of the Investment Company Act.³⁸

The requirements generally do not apply to passive business organizations in the form of trusts (such as royalty trusts) or to derivatives and special purpose securities.³⁹ In addition, the requirements generally do not apply to companies listing only preferred or debt securities on the NYSE.

NYSE-listed companies that are foreign private issuers⁴⁰ are allowed to follow home country practice in lieu of the Section 303A requirements with regard to compensation committees, except that such companies would be required to provide a brief, general summary of the significant ways in which their governance differs from governance

³⁷ Registered closed-end management investment companies (“closed-end funds”) would be required to: (1) have a minimum three-member audit committee that satisfies the requirements of Rule 10A-3; (2) comply with the requirements of the NYSE Audit Committee Charter Provision; and (3) comply with the certification and notification provisions regarding non-compliance. Closed-end funds also would be excluded from the disclosure requirement relating to an audit committee member’s simultaneous service on more than three audit committees, but would be subject to the requirement for the board to determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company’s audit committee.

³⁸ Section 2(a)(19) of the Investment Company Act of 1940, 15 U.S.C. §§ 80a *et al.*

³⁹ Unless otherwise required by Rule 10A-3 of the Exchange Act.

⁴⁰ As defined in Rule 3b-4 under the Exchange Act.

followed by domestic companies under the NYSE listing standards. A foreign private issuer that is required to file an annual report on Form 20-F with the SEC must include such statement of significant differences in that annual report. All other listed foreign private issuers would be permitted to provide this disclosure either on their website⁴¹ (provided it is in the English language and accessible from the United States) and/or in their annual report distributed to shareholders in the United States.

Listed companies that are smaller reporting companies⁴² are not required to comply with the enhanced independence requirements for compensation committee members that were adopted by the NYSE. However, smaller reporting companies must generally comply with all other compensation committee requirements under the NYSE rules, with the exception of the rule requiring compensation committees to conduct an independence review prior to retaining compensation consultants, independent legal counsel and other advisers.⁴³

[b]—Nasdaq Rule 5605

Under the Nasdaq listed company rules, listed companies must have a formal standing compensation committee of at least two independent members, and must certify that they have a formal written compensation committee charter. The charter must specify: (i) the scope of the compensation committee's responsibilities and how it carries out such responsibilities (including structure, processes and membership requirements); (ii) the compensation committee's responsibility for determining, or recommending to the board of directors for determination, the compensation of the CEO and other executive officers; (iii)

⁴¹ If the disclosure is made available only on the website, the annual report would be required to state this and provide the web address at which the information may be obtained.

⁴² As defined in Rule 12b-2 of the Exchange Act.

⁴³ The NYSE rules provide a "phase-in" period for companies that cease to be smaller reporting companies to comply with the additional compensation committee independence rules. Under the NYSE rules, a compensation committee of a listed company that ceases to be a smaller reporting company must have one compensation committee member who satisfies the additional compensation committee independence requirements within six months of the date on which the company ceases to be a smaller reporting company, a majority of members must satisfy such requirements within nine months of such date, and all members must satisfy such requirements within twelve months of such date. In addition, a company that ceases to be a smaller reporting company must comply with the requirements regarding compensation consultants, independent legal counsel and other advisers within six months following the date the company ceases to be a smaller reporting company. NYSE 303A.00.

that the CEO may not be present during voting or deliberations on his or her own compensation; and (iv) the specific responsibilities and authorities of the compensation committee to retain or obtain the advice of compensation consultants, independent legal counsel or other advisers.

However, if the compensation committee has at least three members, one non-independent director (who is not a current officer or employee, or family member of a current officer or employee) may serve on the compensation committee for no more than two years, if: (1) the board, under exceptional and limited circumstances, determines that the inclusion of such director on the compensation committee is required by the best interests of the company and its shareholders; and (2) the board publicly discloses in the next annual meeting proxy statement⁴⁴ the use of such exception, the nature of the individual's relationship to the company and the reasons for the board's determination.⁴⁵

[i]—Director Independence Under the Nasdaq Rules

Nasdaq Rule 5605 places significant limitations on who qualifies as an "independent" director for publicly listed companies' compensation committees. Under the rules, an "independent director" is generally a director who does not have a relationship with the company or its subsidiaries which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of the director.⁴⁶ In addition to the general independence considerations, in making the determination as to whether a director is eligible to serve on the compensation committee, the Nasdaq rules require a listed company's board to also consider whether the director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company to determine whether such affiliation would impair the director's judgment as a member of the compensation committee.⁴⁷

Specifically, Rule 5605 sets forth a list of bright line exclusions whereby a director will not be considered "independent" if he or she:

⁴⁴ If the issuer does not file a proxy, the disclosure should be made in its Form 10-K or 20-F.

⁴⁵ Nasdaq 5605(d)(2)(B).

⁴⁶ Nasdaq 5605(a)(2).

⁴⁷ Nasdaq 5605(d)(2)(A).

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- is, or during the past three years was, employed by the company or by any parent or subsidiary of the company;⁴⁸
- accepted or has a family member (a relative by blood, marriage or adoption or someone who has the same residence) who accepted any payments from the company (or any parent or subsidiary of the company) in excess of \$120,000 during any twelve month period within the last three years preceding the determination of independence, other than: (1) compensation for board or board committee service, (2) payments arising solely from investments in the company's securities, (3) compensation paid to a family member for non-executive employment with the company, other than as an executive officer of the company or a parent or subsidiary of the company, (4) benefits under a tax-qualified retirement plan, (5) non-discretionary compensation, (6) loans or other payments from a financial institution made in the ordinary course of business with substantially the same terms, rates, and risks commercially available and that are not required to be disclosed under SEC Regulation S-K, and (7) loans permitted under Section 13(k) of the Exchange Act;
- is a family member of an individual who is, or during the past three years was, employed by the company or any parent or subsidiary of the company as an executive officer;
- is, or has a family member who is, a partner, controlling shareholder or an executive officer of any organization to which the company made, or from which the company received, payments (other than those arising solely from investments in the company's securities or payments under non-discretionary charitable contribution matching programs) that exceed the greater of; (1) 5% of the recipient's consolidated gross revenues for that year, or (2) \$200,000 in the current or any of the prior three fiscal years;
- is, or has a family member who is, employed as an executive officer of another entity where any of the executive officers of the company serve on the compensation committee of

⁴⁸ Nasdaq has indicated that it will only look to the parent and those subsidiaries that are consolidated with the company's financial statements when determining director independence. Nasdaq has also indicated that service by a director as an interim executive officer for less than one year will not impart independence once the interim service has ceased.

such other entity, or if such relationship existed during the past three years;

- is, or has a family member who is, a partner or employee of the company's outside auditors, or was, or has a family member who was, such a partner or employee who worked on the company's audit engagement, during the past three years; or
- in the case of an investment company, an "interested person" as defined under the Investment Company Act, other than in his or her capacity as a member of the board of directors or any board committee.

[ii]—Retention of Compensation Consultants, Independent Legal Counsel and Other Advisers

As with the NYSE rules, the Nasdaq rules incorporate the requirements set forth in the SEC rules with respect to compensation committee retention of compensation consultants, independent legal counsel and other advisers. However, unlike the NYSE rules, the Nasdaq rules do not specifically require compensation committees to take into account "all factors relevant to that person's independence from management." Rather, the Nasdaq rules only require a compensation committee to consider the six factors specifically enumerated in the Nasdaq rules (which are substantially similar to the SEC rules and the factors identified in the NYSE rules).

[iii]—Exemptions

Like the NYSE rules, certain types of companies are exempted from the Nasdaq rules with respect to compensation committees, including limited partnerships, asset-backed issuers and other passive issuers, cooperative entities (such as agricultural cooperatives), open-end management investment companies registered under the Investment Company Act of 1940, and foreign private issuers that elect to follow their home-country practices and that disclose in their annual reports why they do not have an independent compensation committee.

Smaller reporting companies are required to certify that they have and will continue to have a compensation committee of at least two members, each of whom must be an "independent director" as the term applies in the Nasdaq rules generally (but need not meet the extra independence standards that apply to compensation committee members at other listed companies). In addition, smaller reporting companies must certify that the compensation committee has and will continue to have

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a charter that meets the standards generally applicable to compensation committees of other listed companies, except that such charter need not contain provisions regarding the committee's responsibilities and authority with respect to compensation consultants, independent legal counsel and other advisers.⁴⁹

⁴⁹ Nasdaq 5605(d)(5). As with the NYSE rules, the Nasdaq rules contain a "phase-in" period for smaller reporting companies. The Nasdaq rules require a company that ceases to be a smaller reporting company to have at least one compensation committee member who satisfies the additional compensation committee membership requirements within six months of the date on which it ceases to be a smaller reporting company, a majority of compensation committee members who satisfy such requirements within nine months of such date, and all compensation committee members must satisfy such requirements within twelve months of such date. In addition, such company must certify to Nasdaq that it has met the compensation committee charter requirements with respect to compensation consultants, independent legal counsel, and other advisers within six months of the date on which it ceases to be a smaller reporting company, and must also certify on such date that its compensation committee members meet, or within the "phase-in" period described above will meet, the additional compensation committee membership requirements.

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§ 16.05 Shareholder Advisory Votes on Executive Compensation

Among the most significant provisions of the Dodd-Frank Act which affect compensation committees are those that require public companies to provide shareholders with an advisory vote on executive compensation (“say-on-pay” vote), an advisory vote on the frequency of holding an advisory vote on executive compensation (“say-on-frequency” vote) and an advisory vote on certain compensation arrangements triggered in the event of a merger or similar transaction disposing of all or substantially all of a public company’s assets (“say-on-parachute” vote). The say-on-pay votes required under the Dodd-Frank Act grew out of mandated say-on-pay votes for companies receiving funds under the Troubled Asset Relief Program (“TARP”), as well as say-on-pay voting requirements in certain jurisdictions outside of the United States. Under the Dodd-Frank Act, say-on-pay votes generally became required for public companies beginning with their first shareholder meetings on or after January 21, 2011 (and with respect to smaller reporting companies, for their first shareholder meetings on or after January 21, 2013).¹

While such advisory votes do not bind the compensation committee, the votes are intended to provide shareholder input into the committee’s decision-making and to put pressure on committee members to establish executive compensation programs that, on the whole, will be “approved” by shareholders. Thus, these requirements significantly impact the role and requirements of compensation committees by highlighting the importance of procedure, due diligence and documentation in determining and rationalizing executive compensation recommendations set by compensation committees so that companies receive the support of their shareholders.

What appear to be increasingly important in light of the say-on-pay requirements under the Dodd-Frank Act are the policies of proxy advisory companies (such as Institutional Shareholder Services (“ISS”) and Glass, Lewis & Co. (“Glass Lewis”)) and their recommendations to institutional shareholders with respect to these advisory votes. More than ever, compensation committees must be aware of and consider the guidelines established annually by these proxy advisory companies in order to maximize the likelihood that they will receive positive vote recommendations with respect to their compensation programs and determinations. Many large institutional investors also have their own guidelines that need to be considered.

¹ Exchange Act Rule 14a-21(a).

[1]—Say-on-Pay Proposals

Under the Dodd-Frank Act, public companies must provide shareholders with a “say-on-pay” vote as to the compensation of their named executive officers as disclosed in the executive compensation sections of the companies’ proxy statements at least once every three years.² The Dodd-Frank Act provides that the shareholder vote on executive compensation is not binding on the company or the compensation committee and does not purport to change the legal authority or change or increase the fiduciary duties of public company directors.³ However, the say-on-pay rules provide public company shareholders with a mechanism for supporting or opposing their company’s executive compensation practices and are intended to encourage public company boards (and their compensation committees) to consider and follow the shareholders’ advisory vote on the company’s executive compensation program.

The Dodd-Frank Act also requires companies to submit to their shareholders a “say-on-frequency” vote at least once every six years, which is a vote as to the frequency of the shareholder vote on executive compensation (i.e., whether the say-on-pay vote will occur every one, two or three years). There is strong institutional support for annual voting. Both ISS and Glass Lewis strongly support annual voting. Indeed, if there is not an annual vote, ISS, for example, will express negative views about compensation practices by voting against (or withholding votes on) compensation committee members and, in some cases, the full board. Most board members would prefer a negative say-on-pay vote rather than a vote against them (although they are also not so keen on having their companies fail a say-on pay vote or have a low percentage in favor of the say-on-pay vote). As a practical matter, the number of public companies that do not conduct an annual vote is very limited. The Dodd-Frank Act also requires an advisory “say-on-parachute” vote in proxy materials for a meeting where shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or disposition of all or substantially all of the assets of a public company.⁴ The proxy must disclose:

- Any agreements or understandings with any named executive officer of the company concerning any type of

² Dodd-Frank Act § 951; Exchange Act § 14A(a)(1).

³ Dodd-Frank Act § 951; Exchange Act § 14A(c).

⁴ Dodd-Frank Act § 951; Exchange Act § 14A(b)(1).

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- compensation (including deferred and contingent compensation) that is based on or otherwise relates to the transaction;
- The conditions under which such compensation may be paid or payable; and
 - The aggregate total of all such compensation that may (and the conditions upon which it may) be paid or payable to or on behalf of such officer.⁵

To the extent that the compensatory arrangements for which disclosure is required for a say-on-parachute vote have not been previously subject to a vote by shareholders under the say-on-pay provisions of the Dodd-Frank Act, the proxy materials must include a separate nonbinding shareholder vote to approve such agreements and understandings.⁶ However, even if agreements and understandings were subject to a prior say-on-pay vote, any new golden parachute arrangements and any revisions to previously approved arrangements must be subject to a separate say-on-parachute vote in connection with a future merger, and the merger proxy must include disclosure of all golden parachute compensation, including separate disclosure of both the previously approved arrangements not subject to the vote and the new arrangements or revisions subject to the vote.⁷

[2]—Proxy Advisory Companies

[a]—Influence Generally

Proxy advisory companies, in general, are hired by institutional shareholders of public companies to recommend how to vote on particular proxy proposals, including proposals with respect to executive pay and equity-based and other incentive plans. Although the impact of these advisory firms on a particular public company will depend largely on the company's particular shareholder base and specific compensation program, the role of proxy advisory firms has grown in influence with the advent of the say-on-pay advisory voting requirements under the Dodd-Frank Act and has continued to exert greater influence in recent years.

⁵ *Id.*

⁶ Dodd-Frank Act § 951; Exchange Act § 14A(b)(2); Exchange Act Rule 14a-21(c).

⁷ Exchange Act Rule 14a-21(c); Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Securities Act Release No. 33-9178, Exchange Act Release No. 34-63768, 17 C.F.R. §§ 229, 240 and 249.

Boards are concerned about the recommendations made by these proxy advisory firms. While a negative recommendation from these firms is not a guarantee of a resulting negative shareholder vote, it requires the public company to do extensive shareholder outreach, including additional public disclosure (such as supplemental proxy material) to overcome the negative recommendation and the result often depends on the shareholder makeup and the overall increase or decrease in the company stock price (i.e., whether the stockholders are happy with company results and what management has done). Further, moving toward a favorable vote takes more than ensuring a majority vote by the shareholders. As further explained below, given the proxy advisory firms' policies and the impact on proxy disclosure concerning say-on-pay voting outcomes and subsequent actions taken by the compensation committee, many public companies seek to have significant support by shareholders of the compensation structure and programs, rather than support from merely a majority of shareholders.

[b]—Specific Policies and Guidelines

Proxy advisory companies generally publish and update, at least annually, the specific policies and methodologies from which they base their recommendations to institutional investors with respect to shareholder proxy proposals. The two most prominent proxy advisory firms are ISS and Glass Lewis. Although estimates indicate that ISS and Glass Lewis together have 97% of the proxy advisory market share,⁸ there are a few other proxy firms providing advisory services (including Egan-Jones Proxy Services, Segal Marco Advisors, and ProxyVote Plus). In addition to proxy advisory firms, large institutional shareholders, such as BlackRock, State Street Global Advisors, Fidelity Investments, and Vanguard, as well as some public pension funds, publish their own policies and guidelines on which they vote.⁹ The policies and

⁸ See, e.g., Ackerman, "SEC Takes Action Aimed at Proxy Advisers for Shareholders," Wall Street Journal, updated Aug. 21, 2019, available at <https://www.wsj.com/articles/sec-to-take-action-aimed-at-proxy-advisers-for-shareholders-11566399808> (last visited Feb. 13, 2024).

⁹ BlackRock Investment Stewardship, "Corporate governance and proxy voting guidelines for U.S. securities," available at <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf> (last visited Feb. 13, 2024); Fidelity Investments, "Overview of Proxy Voting," available at <https://www.fidelity.com/about-fidelity/fidelity-by-numbers/fmr/proxy-voting-overview> (last visited Feb. 13, 2024); Vanguard Proxy Voting Guidelines, available at <https://about.vanguard.com/investment-stewardship/portfolio-company->

methodologies used by ISS and Glass Lewis with respect to compensation proxy proposals are summarized below.

[i]—ISS

[A]—U.S. Corporate Governance Policies

ISS annually publishes a series of reports describing its corporate governance policies and proxy voting guidelines in the United States, as well as guidelines for other countries and regions. With respect to compensation programs, these policies and guidelines generally have encompassed five broad categories: executive pay evaluation, equity-based and other incentive plans, other compensation plans, director compensation, and shareholder proposals on compensation.¹⁰ Within these categories, ISS’ recommendations typically stem from its “global principles” with respect to compensation program design and administration. These include maintaining an appropriate pay-for-performance alignment, with an emphasis on long-term shareholder value, to attract, retain and motivate executives; avoiding “pay for failure”; having an independent and effective compensation committee; providing shareholders with clear, informative, comprehensive and timely disclosures; and avoiding inappropriate non-executive director compensation that could compromise their independence and ability to make appropriate judgments.¹¹

Prior to the introduction of the say-on-pay rules under Dodd-Frank, this case-by-case analysis might have led to a recommendation from ISS that shareholders vote against, or withhold their votes in favor of, compensation committee members, or in cases where the full board is deemed responsible, the full board of directors including the chief executive officer.¹² Thus, not only would the problematic compensation arrangements themselves be subject to a negative approval recommendation, but the directors who approved such arrangements could be

[resources/proxy_voting_guidelines.pdf](#) (last visited Feb. 13, 2024).

¹⁰ Institutional Shareholder Services, Inc., “United States Proxy Voting Guidelines -- Benchmark Policy Recommendations” (Jan. 9, 2025), available at <https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf> (last visited July 24, 2025).

¹¹ *Id.* at p. 47.

¹² See ISS, “U.S. Corporate Governance Policy 2011 Updates” (Nov. 19, 2010), available at <http://www.issgovernance.com/files/ISS2011USPolicyUpdates20101119.pdf> (last visited Aug. 21, 2025).

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subject to ISS' recommendation that the directors be voted off of the board. As a general matter, many years ago, arrangements with problematic pay practices that were neither newly adopted nor materially modified were essentially "grandfathered" from adverse voting recommendations except in the most egregious cases.

However, with the effectiveness of Dodd-Frank's shareholder advisory say-on-pay requirements, ISS generally shifted its focus away from voting down specific problematic proposals and the committee and/or board members who proposed them, to one in which the compensation program itself was first subject to a say-on-pay vote before the committee members were at risk of being voted out.¹³ Therefore, Dodd-Frank essentially provided committee members some level of insulation from adverse vote recommendations, so long as they offered shareholders a say on pay vote, responded to concerns voiced in prior votes and avoided a program with significant and material problematic pay practices.¹⁴

Although ISS continues to vote on specific proxy proposals related to executive and director compensation on a case-by-case basis (within the principles and framework described above), ISS generally will issue a negative vote recommendation for a company's say-on-pay proposal if the company has a significant pay for performance misalignment, significant problematic pay practices or a significant level of poor communication and responsiveness to shareholders.¹⁵ In certain noteworthy cases (for example, following repeat negative say-on-pay voting outcomes), ISS will also vote against or withhold votes from members of the compensation committee or potentially the full board. For 2025, ISS recommended shareholders vote against, or withhold their vote from, compensation committee members (or the full board) if there is no say-on-pay proposal (as might be the case, for example, in a company that adopted biennial or triennial say-on-frequency votes) and there is pay-for-performance misalignment, problematic pay practices or lack of board responsiveness; the board fails to respond adequately to a prior say-on-pay proposal that received less than 70% support;¹⁶

¹³ *Id.*

¹⁴ ISS 2025 Guidelines, N. 10 *supra*.

¹⁵ *Id.*, p. 47.

¹⁶ Glass Lewis guidelines provide that boards should engage with shareholders when there is less than 80% support (increased from Glass Lewis' historic 75% threshold), available at <https://resources.glasslewis.com/hubfs/2025%20Guidelines/2025%20US%20Benchmark%20Policy%20Guidelines.pdf> (last visited July 24, 2025).

the company recently practiced or approved problematic pay practices; or where the situation is egregious.¹⁷ Problematic pay practices include (1) re-pricing or re-placing underwater options or stock appreciation rights (“SARs”) without prior shareholder approval, (2) extraordinary perquisites or tax gross-ups (including any related to a secular trust or restricted stock vesting), (3) new or materially amended agreements that provide for: change in control payments exceeding three times base salary and average/target/most recent bonus, severance payments upon a change in control without involuntary job loss or substantial diminution of duties, 280G excise tax gross-ups, or multi-year guaranteed awards that are not at risk due to rigorous performance conditions, (4) aliberal change-in-control definition, particularly when combined with any single trigger change-in-control payments or benefits, (5) insufficient executive compensation disclosure by externally managed issuers in cases where it is difficult to ascertain the reasonableness of pay programs and practices, and (6) severance payments for individuals where the termination is insufficiently disclosed as involuntary (this would encompass terminations without cause or resignations for good reason). These recommendations become effective on or after February 1, 2025.¹⁸ ISS has further noted that this list of problematic pay practices is meant to provide guidance but is in no way meant to be exhaustive.

By implementing a threshold of 70% approval with respect to a prior advisory vote on compensation, ISS has made clear that a mere majority (i.e., greater than 50%) of shareholder support for a compensation program will not insulate the directors from adverse voting recommendations, and instead a super-majority, coupled with sound pay practices, appropriate performance-based incentives and comprehensive disclosure, is necessary to pass the muster of the institutional shareholders it advises. As a result, although Dodd-Frank’s mandated say-on-pay votes are, by statute, non-binding and advisory, public company compensation committees must take them into account and respond accordingly or face the risk of being unseated if specific actions to address issues were not taken or where problems are recurring.¹⁹ As a result, compensation committee members are encouraged to discuss, in proxy and other public disclosure statements, outreach efforts and specific actions taken to address and mitigate the pay practices which resulted in a less-than overwhelming say-on-pay vote.

With respect to say-on-frequency recommendations, ISS continues

¹⁷ ISS 2025 Guidelines, N. 10 *supra*, at pp. 17, 47.

¹⁸ *Id.* at p. 49. See also: 26 U.S.C. § 280G; 26 C.F.R. § 1.280G-1.

¹⁹ *Id.*

to recommend annual advisory votes on compensation on the basis that annual votes provide the most consistent and clear communication channel for shareholder concerns about companies' executive pay programs.²⁰ ISS generally will recommend to vote case-by-case on compensation committee members (or, in exceptional cases, the full board) and the say-on-pay proposal if the board implements a say-on-frequency policy that is different from the frequency that received a majority of the votes cast.²¹

With respect to the say-on-parachute votes, ISS generally will evaluate proposals on a case-by-case basis, consistent with the foregoing principles and policies.²² Of course, problematic change-in-control practices, such as single-trigger payments, walk-away rights, full acceleration of equity awards granted shortly before the change-in-control or of performance awards above the target level of performance without compelling rationale, excise tax gross-ups and excessive severance entitlements, could lead to an adverse vote recommendation with respect to the golden parachute arrangements subject to the vote.²³

With respect to the new disclosures required by the SEC's finalized "pay versus performance" rule, ISS has noted that they will be evaluating certain elements which further outline executive compensation as disclosed in the new pay-versus-performance proxy table. These new disclosures will be considered during ISS' qualitative analysis, especially in cases where companies exhibit pay-for-performance misalignment.²⁴

[B]—ISS Methodology

ISS methodology focuses around a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. There are four measures of alignment: three relative measures in which alignment is evaluated in reference to peer group companies and one absolute, where the evaluation is independent of other companies' performance.²⁵

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.* at p. 50.

²⁴ ISS U.S. Compensation Policies Frequently Asked Questions (Updated Dec. 13, 2025), available at <https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf> (last visited July 24, 2025).

²⁵ Institutional Shareholder Services, Inc., "United States Proxy Voting Guidelines-

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The peer group alignment measures: (i) the degree of alignment between the company's Total Shareholder Return ("TSR") rank and the chief executive officer's annualized total pay rank within a peer group, each measured over a three-year period; (ii) the rankings of CEO total pay and company financial performance within a peer group, each measured over a three-year period; and (iii) the multiple of the CEO's total pay relative to the peer group median in the most recent fiscal year.²⁶ The absolute measure looks at the alignment between the trend in the chief executive pay changes and the company TSR over the prior five fiscal years.²⁷

If this analysis demonstrates significant long-term pay-for-performance alignment, or misaligned pay and performance is otherwise suggested, ISS then looks at additional qualitative factors:

- The ratio of performance to time based incentive awards;
- The overall ratio of performance-based compensation to fixed or discretionary pay;
- The clarity and transparency of disclosure;
- The complexity and risks around pay program design;
- The rigor of performance goals;
- The company's peer group benchmarking practices;
- Actual results of financial/operational returns, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (e.g., bi-annual awards);
- Realizable pay compared to grant pay; and
- Any other factors deemed relevant.

Other factors that ISS may deem relevant may relate to a company's

- Benchmark Policy Recommendations" (Jan. 9, 2025), p. 48, available at <https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf> (last visited July 24, 2025);

ISS U.S. Compensation Policies Frequently Asked Questions ((Updated Dec. 13, 2025), p. 9, available at <https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf> (last visited July 24, 2025).

²⁶ *Id.*

²⁷ *Id.*

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specific facts and circumstances, but may include a review of the compensation committee's use of discretion and any recent pay program changes and/or any forward looking commitments.

In the evaluation ISS looks at egregious pay practices. These include:

- Egregious employment contracts:
 - Contracts containing multi-year guarantees for salary increases, non-performance based bonuses, or equity compensation.
- New CEO with overly generous new-hire package:
 - Sign-on awards that are excessively large or insufficiently performance-based;
 - Problematic termination-related equity vesting provisions.
- Abnormally large bonus or incentive plan payouts without justifiable performance linkage or proper disclosure:
 - Includes performance metrics that are changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance;
 - Payouts made despite failure to achieve pre-established threshold performance criteria.
- Egregious pension/SERP (supplemental executive retirement plan) payouts:
 - Inclusion of additional years of service not worked that result in significant benefits provided in new arrangements;
 - Inclusion of performance-based equity or other long-term awards in the pension calculation.
- Excessive perquisites:
 - Perquisites for former and/or retired executives, such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements;
 - Extraordinary relocation benefits (including home buyouts);
 - Excessive amounts of perquisites compensation.
- Problematic severance and/or change in control provisions:
 - Termination or change-in-control cash payments exceeding 3 times base salary plus target/average/last paid bonus
 - (or that include equity gains or other pay elements into the calculation basis);

(Rel. 58)

- New or materially amended arrangements that provide for change-in-control payments without loss of job or substantial diminution of job duties (such as provided by a problematic “good reason” definition, or by single-triggered or modified single-triggered, where an executive may voluntarily leave for any reason and still receive the change-in-control severance package);
 - New or materially amended employment or severance agreements that provide for an excise tax gross-up. Modified gross-ups would be treated in the same manner as full gross-ups;
 - Excessive payments upon an executive’s termination in connection with performance failure or payments made in connection with an apparent voluntary resignation or retirement;
 - Liberal change in control definitions in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring;
 - A problematic “good reason” termination definition that presents windfall risks, such as definitions triggered by potential performance failures.
- Tax Reimbursements: Excessive reimbursement of income taxes on executive perquisites or other payments (e.g., related to personal use of corporate aircraft, executive life insurance, bonus, restricted stock vesting, secular trusts, etc.; see also excise tax gross-ups above).
 - Dividends or dividend equivalents paid on unvested performance shares or units.
 - Internal pay disparity: Excessive differential between CEO total pay and that of next highest-paid named executive officer (NEO).
 - Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts, option exchanges, and certain voluntary surrender of underwater options where shares surrendered may subsequently be regranted).²⁸
 - Significant qualitative shifts away from performance-based compensation into fixed or discretionary pay elements.

²⁸ See § 16.05[4][a] *infra* for ISS’ guidelines for changing performance metrics in light of the COVID-19 pandemic.

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- Other pay practices that may be deemed problematic in a given circumstance but are not covered in the above categories.²⁹
- With respect to compensation committee communications and responsiveness, there are factors that are reviewed by ISS on a case-by-case basis when evaluating ballot items related to executive pay on board responsiveness to investor input and engagement on compensation issues. These include:
 - Failure to respond to majority-supported shareholder proposals on executive pay;
 - Failure to adequately respond to instances where less than 70% of votes cast on a previous say-on-pay proposal, taking into account:
 - Disclosure of engagement efforts with major institutional investors, including the frequency and timing of engagements and the company participants (including whether independent directors participated);
 - Disclosure of dissenting shareholder views that led to the say-on-pay opposition;
 - Disclosure of specific and meaningful actions taken to address shareholder concerns;
 - Other recent compensation actions taken by the company;
 - Whether the issues raised are recurring or isolated;
 - The company’s ownership structure; and
 - Whether the support level was less than 50%, which would warrant the highest degree of responsiveness.

[ii]—*Glass, Lewis & Company*³⁰

Glass Lewis’ philosophy on executive compensation examines companies based on industry, size, maturity, performance, financial

²⁹ ISS 2025 Compensation Policies Frequently Asked Questions, pp. 19-20, available at <https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf> (last visited July 24, 2025). See § 16.05[4][a] *infra* for ISS’ guidelines for changing performance metrics in light of the COVID-19 pandemic. See § 16.05[4][a] *infra* for ISS’ guidelines with respect to repricing options in light of the COVID-19 pandemic.

³⁰ Glass, Lewis & Co., LLC, 2025 Benchmark Policy Guidelines, available at <https://resources.glasslewis.com/hubfs/2025%20Guidelines/2025%20US%20Benchmark%20Policy%20Guidelines.pdf> (last visited July 24, 2025).

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condition, historic pay-for-performance practices and any other mitigating external or internal factors. It looks at five primary issues (partially to analyze excessive risk-taking as a result of the compensation program):

- Overall compensation program design and structure, including selection and challenging performance metrics;
- Implementation and effectiveness of the programs, including pay mix and use of performance metrics;
- Quality and content of disclosure;
- Compensation amounts;
- The link between pay and performance.

Glass Lewis does not have a specific list of egregious pay practices that are automatic negative vote triggers. However, it does have a list, as follows, of issues that have a strong negative impact on the vote:

- Inappropriate peer group and/or benchmarking issues;
- Egregious or excessive bonuses, equity awards, perquisites or severance payments, including golden handshakes and golden parachutes;
- Insufficient response to low shareholder support;
- Problematic contractual payments, such as guaranteed bonuses;
- Adjustments to performance results that lead to problematic pay outcomes;
- Performance targets not sufficiently challenging, and/or providing for high potential payouts;
- Performance targets lowered without justification;
- Discretionary bonuses paid when short- or long-term incentive plan targets were not met;
- Executive pay high relative to peers not justified by outstanding company performance;
- The terms of the long-term incentive plans are inappropriate.³¹

In 2024, Glass Lewis introduced a new policy recommending that issuers clearly disclose their executive ownership requirements and accordingly, how various types of outstanding equity awards are counted

³¹ *Id.* at p. 51.

or excluded from the ownership level calculation. Glass Lewis further noted that, in determining an executive's level of share ownership, the inclusion of unearned performance-based full value awards and/or unexercised stock options in such disclosure would be inappropriate. Rather, the issuer should provide a cogent rationale for the basis of their executive stock ownership calculations.

Additionally, Glass Lewis also outlined new guidelines related to the implementation of clawback policies that go beyond the Dodd-Frank Act requirements relating to material financial restatements. Glass Lewis recommends the adoption of expansive clawback policies that apply to problematic decisions or actions that provide for the recoupment of incentive-based compensation in the event of material misconduct, a material reputational failure, a material risk management failure, or a material operational failure, the consequences of which have not already been reflected in incentive payments and where recovery is warranted.³² Further, Glass Lewis noted that in the event an issuer does not seek recoupment in the event of any of the above categories related to executive conduct, there will be an expectation that the issuer provide a thorough discussion of the issuer's decision to not pursue recoupment and, if applicable, how the issuer has otherwise rectified the disconnect between executive pay outcomes and the negative impact of their actions on the issuer (included in this broader array of recoupment categories) as well as the shareholder experience.³³ The absence of this thorough disclosure may impact Glass Lewis' overall assessment of the quality of the issuer's disclosure and may further impact the broader Glass Lewis' recommendation for the advisory vote on executive compensation generally.³⁴

Also, Glass Lewis highlighted the potential conflict of interest that is created when large shareholders are permitted to vote on equity awards for themselves. Glass Lewis recommends that issuers require an abstention vote or non-vote from large shareholders on proposals related to such large shareholder's own equity awards to the extent such shareholder's vote can materially impact the passage of the proposal.³⁵

Further, Glass Lewis noted that supplemental quantitative factors such as realized pay levels and the "compensation actually paid" disclosures mandated by the SEC regarding pay versus performance may

³² *Id.* at p. 60.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.* at p. 64.

be considered for its pay-for-performance analysis.³⁶

For 2025, Glass Lewis introduced a new requirement for change-in-control provisions that allow compensation committee discretion over the treatment of unvested awards. In such circumstances, Glass Lewis expects issuers to provide clear disclosure regarding the rationale for the committee's decision should a change-in-control occur.³⁷

[3]—Responding to a Negative (or Less than Overwhelming) Advisory Vote

Both ISS and Glass Lewis have expressly stated that they expect compensation committees to consider and disclose the results of an advisory say-on-pay vote, and address concerns raised by the votes by engaging shareholders and take specific actions to adapt their compensation programs accordingly.³⁸ The Dodd-Frank Act already requires companies to disclose and discuss the results of a shareholder advisory vote on compensation within four business days of the end of the annual or special meeting in which directors were elected (and thus the say-on-pay requirements triggered) using Form 8-K, the “current report” companies must file with the SEC to announce material events.³⁹ Specifically, Item 5.07(b) of Form 8-K requires, in addition to disclosure of the names of directors elected, a brief description of any other matter voted upon at the meeting, including the number of votes cast for, against or withheld as to each such matter. Additionally, the Dodd-Frank Act requires companies to discuss in their Compensation Discussion and Analysis whether and how they have considered and implemented the results of the most recent shareholder advisory vote on executive compensation.⁴⁰ Each of these mandated disclosures presents an opportunity for a company to address concerns elicited by, and to discuss actions and efforts taken to mitigate, negative or less-than-overwhelming say-on-pay results.

[4]—Proxy Advisory Firms' Views of the Impact of COVID-19

³⁶ *Id.* at p. 53.

³⁷ *Id.* at p. 59.

³⁸ See: *id.* at p. 52; ISS, 2025 Guidelines, p. 8, available at <https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf> (last visited July 24, 2025).

³⁹ Exchange Act, Form 8-K; 17 C.F.R. § 240.15d-11 (Current Reports on Form 8-K).

⁴⁰ Exchange Act, Regulation S-K, Item 402; 17 C.F.R. § 229.402.

In early 2020 the global coronavirus pandemic, known as COVID-19, reached the U.S. Recognizing the unprecedented challenges that COVID-19 posed to public companies and shareholders, both ISS and Glass Lewis updated their guidelines and policies with respect to various compensation practices. Given COVID-19's impact on businesses and the economy, particularly stock price volatility and business uncertainty, some public companies are facing the possibility that none of their performance-based awards will ultimately pay out and are considering whether and how to make adjustments to performance goals and the corresponding targets governing annual and multi-year cash and equity-based awards established prior to the pandemic.

Many of these companies have already implemented salary reductions and other compensation and benefits changes as a result of economic conditions, prompting them to also review and reevaluate their performance-based compensation in order to encourage retention and to create new incentives. The current views of ISS and Glass Lewis with respect to such adjustments to performance-based compensation are summarized below; however, as the long-term economic effects of COVID-19 become clearer, such views may change.

[a]—ISS

ISS released policy guidance in April 2020. At the outset, ISS noted that the four pillars of its voting policies—accountability, stewardship, independence and transparency—would continue to allow for appropriate discretion and analysis on a case-by-case basis in response to company, sector and market-specific facts and circumstances.⁴¹ In that guidance, ISS recognized that changes are likely with respect to certain performance-based compensation in light of COVID-19 and market conditions.

With respect to adjustments to performance metrics, the guidance provides that:

- companies that modify short-term performance goals, which were previously approved for 2020, should provide contemporaneous public disclosure describing the rationale for the changes to the performance metrics, and the companies should not wait to disclose any such modifications in next year's proxy statement;

⁴¹ ISS, *Impacts of the COVID-19 Pandemic*, April 8, 2020, p. 3, available at [ISS Policy Guidance for Impacts of the COVID-19 Pandemic \(issgovernance.com\)](https://www.issgovernance.com) (last visited Aug. 21, 2025).

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- for long-term performance awards, ISS discourages changing performance goals mid-cycle because such awards cover multiple years, and mid-cycle changes will be reviewed on a case-by-case basis; and
- any prospective structural changes to long-term compensation plans will be reviewed under ISSs existing benchmark policy frameworks.⁴²

In addition, ISS confirmed its view that repricing options without shareholder approval/ratification is a “problematic pay practice.” For boards that seek such approval at 2020 annual meetings, ISS stated that it will generally recommend against repricing that occurs within one year following a significant drop in share price, but will review the action on a case-by-case basis. Among other factors, it will take into account the following factors: (1) whether repricing is a value-for-value exchange; (2) whether surrendered options will not be added back to a plan’s reserve; (3) whether the replacement awards are subject to vesting conditions (and not immediately vested); and (4) whether executive directors and officers are excluded from the repricing.

In its 2022 guidance, ISS noted that it expects a return to pre-pandemic incentive program structures.⁴³ This would mark a return to the traditional view that any mid-year changes to annual incentive metrics, changes to performance targets or measurements or the implementation of programs heavily emphasizing discretionary payments will be negatively viewed by ISS in its review of a company’s executive compensation structure. To the extent a company makes any continuing COVID-related decisions to compensation programs, those changes should be clearly disclosed to investors.⁴⁴ Further, ISS has taken the position that awards or pay increases meant to offset compensation restrictions implicated by the Coronavirus Aid, Relief and Economic Security Act will similarly be viewed negatively.⁴⁵

[b]—Glass, Lewis & Company

Shortly before ISS released its guidance with respect to COVID-19, Glass Lewis shared its approach.⁴⁶ Thus far, Glass Lewis has not issued

⁴² *Id.* at p. 7.

⁴³ ISS 2025 Compensation Policies N. 38 *supra*.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

official guidance with respect to changes in compensation programs⁴⁷ However, it has commented that it believes changes to compensation programs that are proportional to the pandemic’s impacts on shareholders and employees are more likely to be widely supported than those that do not, and that “trying to make executives whole at even further expense to shareholders and other employees is a certainty for proposals to be rejected.”⁴⁸

Glass Lewis projects a “marked increase” in shareholder concerns about compensation, including repricing, dilution, burn rates, hurdle adjustments, vesting changes, caps and cuts on incentives and disclosure about limits and board discretion.⁴⁹

[5]—Conclusion

The growth and prevalence of proxy advisory firms, institutional investors and “say on pay” requirements are, like executive-pay focused legislation and regulation, indicative of a continuing desire of certain parties, such as the public and shareholder activists, to directly influence the substance of pay decisions. These parties put pressure on compensation committee members to adopt so-called “best pay practices” in order to maximize shareholder value and minimize poor corporate governance and excessive risk taking.

Interestingly, this pressure is expanding to impose a long-term growth approach on companies with a focus on all types of stakeholders, not just the shareholders.⁵⁰ Although this point of view is gaining

⁴⁷ See Everything in Governance is Affected by the Coronavirus Pandemic. This is Glass Lewis’ Approach, available at <https://www.glasslewis.com/everything-in-governance-is-affected-by-the-coronavirus-pandemic/> (last visited Aug. 21, 2025).

⁴⁸ Glass Lewis’ 2020 Proxy Paper Guidelines were updated to include COVID-19’s impact on virtual-only shareholder meetings, but have not been updated to reflect its policy on changes to compensation plans and performance metrics. See Glass Lewis 2020 Proxy Paper Guidelines, available at https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf (last visited Aug. 21, 2025).

⁴⁹ “Everything in Governance is Affected by the Coronavirus Pandemic. This is Glass Lewis’ Approach,” available at <https://www.glasslewis.com/everything-in-governance-is-affected-by-the-coronavirus-pandemic/> (last visited Aug. 21, 2025).

⁵⁰ In 2019 the Business Roundtable issued a policy statement arguing that the purpose of a corporation should go beyond only serving the shareholders. The “Statement on the Purpose of a Corporation” argued that corporate boards should deliver value to customers, invest in employees, deal fairly and ethically with suppliers, support the communities in which the corporation operates, and generate long-term value for shareholders. See <https://opportunity.businessroundtable.org/ourcommitment/> (last visited Aug. 21, 2025). Some institutional investors have begun considering this holistic approach.

traction as a general governance matter, any impact on executive compensation is only at a nascent stage and will likely evolve and develop in the coming years.

While often criticized as inconsistent with the common law evolution of the business judgment rule, it is nonetheless clear that the recommendations and guidelines set forth by proxy advisory firms and institutional investors have had an impact. If the compensation committee's roles and responsibilities are to formulate appropriate compensation packages to attract, incentivize and retain key talent for leadership of public companies, then they must assess the potential risk of say-on-pay litigation, media attention and other potential exposures.

Accordingly, compensation committees are effectively required to understand and analyze the policies and guidelines set forth by proxy advisory firms when formulating executive compensation decisions. Committee members are wise to continue to assess how the compensation programs they establish and the changes to such programs will be viewed by institutional investors. Compensation committee members should keep in mind, however, that they are not required to implement the modifications suggested by ISS and other proxy advisory groups. Instead, committees should evaluate the company's business needs, goals and circumstances and weigh them in the context of the proxy guidelines, and be aware that establishing, maintaining and supporting "poor pay practices" contrary to applicable proxy advisory guidelines could very well result in a recommendation that their own seat on the board of directors could be taken away as a consequence. As a result, compensation committees are well-advised to fully consider and appropriately respond to the concerns voiced by their shareholders, institutional investors and proxy advisory firms, whether such voices come to them by virtue of a shareholder say-on-pay vote, proxy firm published policies and updates or a general disconnect between compensation and performance.

Vanguard's former CEO, Bill McNabb, welcomed the statement, noting that "[b]y taking a broader, more complete view of corporate purpose, boards can focus on creating long-term value, better serving everyone—investors, employees, communities, suppliers and customers." In addition, Larry Fink, BlackRock's CEO, issued a 2020 letter to CEOs urging companies to consider "the needs of a broad range of stakeholders." See BlackRock, *A Fundamental Reshaping of Finance*, available at [Larry Fink CEO Letter | BlackRock](#) (last visited Feb. 13, 2024).

(Rel. 58)

§ 16.06 Chart of Relevant Independent Director Requirements

The Nasdaq and NYSE rules affect the composition of public companies' compensation committees by setting a standard for director independence. The next several pages contain a chart summarizing the requirements for director independence under Section 162(m) of the Internal Revenue Code as in effect prior to the enactment of the Tax Cuts and Jobs Act of 2017 (the "TCJA") and solely to the extent applicable to grandfathered awards and agreements (i.e., those entered into prior to November 2, 2017, and that have not been materially modified on or after that date)), Rule 16b-3 of the Exchange Act, and the Nasdaq and NYSE rules. As may easily be noted, while these rules are similar in the intent and some of the rules themselves are similar, there are distinct differences. Therefore, merely because the committee members satisfy the definitions of "outside director" under pre-TCJA Section 162(m) of the Code and "non-employee director" under Rule 16b-3, does not necessarily mean that they will satisfy the NYSE or Nasdaq rules concerning director independence. Similarly, even if the NYSE or Nasdaq independent director rules are satisfied, it is possible that the director may fail to satisfy the director definitions under pre-TCJA Section 162(m) of the Code or Rule 16b-3 of the Exchange Act.

Given the repeal under the TCJA of the performance-based compensation exception to Section 162(m) of the Code, satisfying the definition of "outside director" has become significantly less relevant for compensation committees in recent years as compared to the years when that performance-based compensation exception was available under Section 162(m). In certain cases, satisfying the definition may be relevant for pre-TCJA performance-based compensation that is grandfathered, although the performance periods for virtually all grandfathered arrangements have expired.

Of course, because of the risks associated with a violation of the listing requirements, it is likely that it is more important for companies to satisfy the NYSE and Nasdaq rules as compared to the rules under Rule 16b-3 of the Exchange Act and certainly as compared to the largely non-applicable rules under Section 162(m) of the Code.

Failure to satisfy the non-employee director rule under Rule 16b-3 can be cured by satisfying holding periods under Rule 16b-3. To the extent even applicable, failure to satisfy Section 162(m) of the Code results only in the loss of tax deductions. Nevertheless, it would be ideal if the committee satisfied all of the various requirements (other than the requirement under Section 162(m) of the Code unless it is necessary for

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grandfathered arrangements). Failure to satisfy the relevant requirements would no doubt require explanation in the proxy.

TABLE: Landscape

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Outside Directors Under Pre-TCJA Section 162(m) Applicable to Grandfathered Plans	Non-Employee Directors Under Rule 16b-3	Independent Directors Under NYSE Section 303A	Independent Directors Under Nasdaq Rule 4200
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<ul style="list-style-type: none"> • Cannot be a current employee of the publicly held corporation (the “Company”). • Cannot be a former employee of the Company who receives compensation for prior services during the taxable year (other than benefits under a tax-qualified retirement plan). • Cannot be a current or former officer of the Company. • Cannot receive remuneration from the Company, either directly or indirectly, in any capacity 	<ul style="list-style-type: none"> • Cannot be a current officer or employee of the issuer (the “Company”) or a parent or subsidiary of the Company. • Cannot receive compensation in excess of \$120,000, either directly or indirectly, from the Company or a parent or subsidiary of the Company, for services rendered as a consultant or in any capacity other than as a director. • Since the beginning of the Company’s last fiscal year, cannot possess an interest in any related party transactions where the amount exceeds 	<ul style="list-style-type: none"> • The board of directors must affirmatively determine that the director has no material relationship with the listed company (the “Company”) either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company. • An individual will not be considered independent until three years after the end of the following relationships: <ul style="list-style-type: none"> – the individual is employed by, or an immediate family member is an executive officer of, the Company 	<ul style="list-style-type: none"> • Cannot be a current officer or employee of the company (the “Company”) or its subsidiaries or any other individual having a relationship, which, in the opinion of the Company’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. • The following individuals cannot be considered independent: <ul style="list-style-type: none"> – is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the Company; – accepted or has a family member who accepted any payments
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(Rel. 55)

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<p>other than as a director.</p>	<p>\$120,000.</p>		<p>from the company or any parent or subsidiary in excess of \$100,000 during the current or any of the past three fiscal years, other than</p> <p>(i) compensation for board or board committee service, (ii) payments arising solely from investments in the company's securities,</p>
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16-06 Compensation Committees
Executive Compensation

		<p>– the individual or an immediate family member receives more than \$120,000 per year in direct compensation from the Company, other than:</p> <p>(i) director and committee fees;</p> <p>(ii) pension or other forms of deferred compensation;</p> <p>(iii) compensation received by a director for former service as an interim Chairman or CEO; or</p>	<p>(iii) compensation paid to a family member who is a non-executive employee of the company or a parent or subsidiary of the company,</p> <p>(iv) benefits under a tax-qualified retirement plan, or non-discretionary compensation or</p> <p>(v) loans permitted under Section 13(k) of the Exchange Act;</p> <ul style="list-style-type: none"> • is a family member of an individual who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company as an executive officer; • is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of any organization to which the company made, or
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16-06 Compensation Committees
Executive Compensation

		<p>(iv) compensation received by an immediate family member for services as a non-executive employee of the listed Company.</p> <ul style="list-style-type: none"> • the individual is affiliated or employed by, or an immediate family member is affiliated with or employed by in a professional capacity by, a present or former internal or external auditor of the Company. • the individual or an immediate family member is employed as an executive officer of another company where any of the Company's present executives serve on that company's compensation committee. 	<ul style="list-style-type: none"> • from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed the greater of 5% of the recipient's consolidated gross revenues for that year, or \$200,000, other than <ul style="list-style-type: none"> (i) payments arising solely from investments in the company's securities or (ii) payments under non-discretionary charitable contribution matching programs; • is or has a family member who is employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the listed company serve on the compensation committee of such other
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16-06 Compensation Committees
Executive Compensation

			entity; or is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during the past three years
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16-06 Compensation Committees
Executive Compensation

		the individual is an executive officer or an employee, or an immediate family member is an executive officer, of a company that makes payments to, or receives payments from, the Company for property or services in an amount which, in any single fiscal year, exceeds the greater of \$1 million or 2% of such other company's gross revenues.	
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