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Director Pay Settlement Results in an Unprecedented "Director Say-on-Pay" Vote

Facebook's new director pay settlement includes many of the same terms as similar cases, but with one key exception: director say-on-pay. Now the question is whether this will set a trend.

On January 25, the parties involved in Espinoza v. Zuckerberg, et al. reached a settlement, which has been submitted to the Delaware Chancery Court for approval. The terms of the deal have since raised eyebrows in the governance community for the unique inclusion of a so-called "Director Say-on-Pay" vote. The settlement is the latest in a wave of litigation in which plaintiff's attorneys are targeting public company boards that have awarded themselves highly valued stock grants. The plaintiffs claim these grants are excessive and awarded out of self-interest with little oversight.

For a review of measures that companies can take to help protect themselves against litigation, please see our recent client alert, *How Boards Can Guard Against Lawsuits Alleging Excessive Stock Awards*.

The proposed settlement includes two main components (in addition to attorneys' fees not to exceed $525,000). Facebook has agreed to implement and maintain these terms for a period of five years.

- Amend the Compensation & Governance Committee Charter to specify that the Committee should conduct an annual review and assessment of all director compensation, including cash and equity, and use an independent compensation consultant in connection with this review. The Committee will also be responsible for recommending to the board whether to make any changes in director compensation.

- Submit separate proposals (on which Non-Employee Directors must abstain from voting) to stockholders at the 2016 annual meeting for approval of (i) Facebook's 2013 director equity grants and (ii) the go-forward Annual Compensation Program for Non-Employee Directors, which delineates the specific level of directors' annual equity grants and annual retainer fees.

While it seems obvious that the five-year compliance period would not apply to the vote on 2013 director equity grants, it's not clear whether there will be five years of voting on the annual compensation program for non-employee directors. Another term of the settlement that is not specified is whether the vote on director pay is binding. Since the settlement doesn't specify the vote is nonbinding, we can assume the vote will have a binding component. Nonetheless, with CEO Mark Zuckerberg holding a majority of the voting rights, the vote outcome becomes almost guaranteed to be affirmative, although it's likely corporate governance observers will analyze the vote outcome with management-owned shares removed to measure the satisfaction of institutional investors.

Key Takeaways

Companies going back to shareholders for a new or amended share request or for 162(m) purposes should consider adding express non-employee director compensation limits to their equity plans in order to avoid lawsuits similar to what Facebook and others have dealt with recently. For companies not seeking immediate shareholder approval of an equity plan, we suggest approving non-employee director compensation policy documents (i.e., formalizing existing compensation-setting processes) and/or enhancing director compensation disclosure—particularly around benchmarking, as the reasonableness of peer groups has come up in related lawsuits.

Some commentators have recommended that companies possibly hold nonbinding director say-on-pay votes as a way to avoid such lawsuits. We would caution companies against this strategy since it could open the door for further shareholder and proxy advisory firm scrutiny regarding the "reasonableness" of director compensation. Institutional Shareholder Services (ISS) currently uses quantitative analyses to assess the reasonableness of director compensation under its QuickScore methodology (see board pillar Question #315). ISS will measure your company's prior year average outside director pay (based on total compensation reported for each director in the company's proxy statement) as a multiple of the median director pay of an ISS-determined comparator group for the same period.

For more information about our Governance Services Practice, please visit our website. To speak with a member of our compensation consulting group, please write to consulting@radford.com.

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