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An Updated Framework for Delegating Equity Grant-Making Authority in a Delaware Public Company

WRITTEN BY

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Effective as of August 1, amendments to the Delaware General Corporation Law (DGCL) update the framework under which a company's board of directors may delegate its authority to grant equity incentive awards.

Overview

Equity incentive plans are typically administered by the compensation committee of a public company. As the plan administrator, the compensation committee is responsible for approving each grant made under the company's equity incentive plan. For administrative ease and efficiency, the compensation committee will often establish a share pool, out of which management may grant equity awards to employees below the officer level, without needing to obtain committee approval for each grant. This allows management to negotiate incentive compensation packages with prospective hires, reward internally promoted candidates, and grant retention awards, in each case on a timely basis. Any equity awards to directors or executive officers would continue to be authorized by the full board or applicable board committee, not by management.

Background

Delaware law allows a board to delegate its authority to grant equity awards so long as certain requirements are met. Section 152 of the DGCL historically governed the board's delegation of its authority to issue capital stock (which includes grants of restricted stock awards), and Section 157(c) governed options and rights (most commonly, time-vesting and performance vesting restricted stock units (RSUs)).

Prior to the amendments to the DGCL that went into effect on August 1, there was a misalignment between Section 152 and Section 157(c) of the DGCL. Section 152 allowed the board to delegate authority to any person to grant restricted stock awards, whereas Section 157(c) allowed the board to delegate authority only to an officer of the company to grant options or RSUs. In addition, Section 152 gave the delegate broader discretion than Section 157(c) to establish the terms and conditions of the grant. For example, the delegate could establish the vesting conditions for a restricted stock award, but not an option or RSU. The vesting conditions for options or RSUs granted by the delegate had to be fixed by the board. As a result, under the old regime, delegates had limited authority to structure the terms and conditions of option and RSU awards.

Amendments Effective August 1, 2022

Practitioner Observations

The amendments give companies greater flexibility in delegating equity grant-making authority. At the same time, there are ambiguities in the amended statute and interpretive questions that arise when applying it in practice. We have set forth below our current view as to how the amended statute may be applied in practice, which may evolve in the future in light of new legislative guidance and judicial interpretation.

Delegate Need Not Be an Officer

The amendments to the DGCL align Section 157(c) with the prior Section 152. Under the amended rules, the board may, by resolution, delegate to any person or body (not just an officer) the authority to grant restricted stock, options, or RSUs. The amendment gives companies greater flexibility in selecting a suitable delegate. While we anticipate that many boards will continue to delegate grant-making authority to a high-ranking officer, some companies may now find it less burdensome to delegate grant-making authority to a non-officer of the company, such as a human resources manager. In each case, the individual or group serving as the delegate may not make grants to themselves.

Scope of Delegation Is Broader

Under the amended DGCL rules, the delegate may fix the terms and conditions of a restricted stock, option, or RSU grant, such as the vesting conditions and consideration for the grant, subject to any parameters established in the authorizing resolutions and the applicable plan.

Authorizing Resolutions

The board resolution establishing a Section 157(c) delegation for grant of options or RSUs must meet the following requirements under the amended DGCL provisions:

1. Fixes (a) the maximum number of options or RSUs that may be granted by the delegate, and (b) the maximum number of shares issuable upon the exercise*[1] *of the awards granted by the delegate.

It is clear under clause (b) that the resolution must state an aggregate number of shares that may be issued pursuant to all awards granted by the delegate. In addition, at a minimum, under clause (a) the resolution must specify the extent to which this share pool may be utilized toward the grant of options, RSUs, or both. For example, the board may authorize a total share pool of 100,000, and state that up to 50,000 shares may be granted as RSUs and up to 50,000 as options. Alternatively, the board may authorize the same total share pool of 100,000, but provide that all 100,000 shares may be granted as options or RSUs. In this case, the delegate is free to choose how to allocate the share pool of 100,000 as between options and RSUs. The statute is not entirely clear, however, whether clause (a) might require an additional limit on the number of individual option or RSU awards that may be granted by the delegate (*e.g.,* “the delegate may grant up to 1,000 individual option or RSU awards, provided that the maximum number of shares issuable pursuant to all of the option and RSU awards is 100,000 shares.”)[2] We will continue to monitor how this portion of the amended statute is interpreted in practice.

***2. Fixes the time period during which the options or RSUs may be granted*.**

The board must set a time period during which the delegate is authorized to make grants. The company must therefore be diligent about obtaining a new authorization from the board, if desired, once the original delegation has expired.

***3. Fixes the time period during which shares may be issued in respect of the exercise of awards granted by the delegate*.**

Many public company equity incentive plans specify a maximum term during which an option may be exercised (*i.e.,* 10 years), and shares must be delivered promptly following exercise. On the other hand, an equity incentive plan typically gives the plan administrator broad flexibility to establish the settlement timing for an RSU and does not specify an outer time limit by which shares must be delivered. Even after the plan administrator sets the settlement date for the shares underlying a particular RSU, a public company's deferred compensation program may allow a grantee to elect to further defer the settlement date of those shares. As a result, fixing in the authorizing resolution a specific time period during which shares underlying RSUs may be delivered may significantly limit the delegate's flexibility to grant RSU awards in accordance with the company's regular practices.

Practitioners may take different approaches to fulfilling this statutory requirement. Some may advise companies to set clear outer limits in the authorizing resolution for the permitted settlement timing of awards granted by the delegate, based upon the plain reading of the statute. Others might be of the view that where an equity incentive plan (and if applicable, deferred compensation program) gives a plan administrator broad flexibility to determine the settlement timing of a grant, it would be contrary to the intent of the amendments to limit the delegate's flexibility by requiring that a fixed time period for the delivery of shares be hardwired into the authorizing resolution. These practitioners may be comfortable with an authorizing resolution that states that the shares underlying any option or RSU granted by the delegate may be issued during any time period permitted under the applicable equity incentive plan or deferred compensation arrangement maintained by the company.

The interpretation of this portion of the statute is another area that will require continued monitoring.

***4. Fixes a minimum amount of consideration (if any) for which options or RSUs may be issued*.**

In practice, grantees do not typically pay consideration upon the grant of an option or RSU. The statute contemplates this by qualifying the requirement to state a minimum amount of consideration for the grant of an award with "if any." We would expect most authorizing resolutions to state that options or RSUs may be granted for no consideration.

***5. Fixes a minimum amount of consideration for the shares issuable upon exercise of awards granted by the delegate*.**

In contrast to #4 above, this portion of the statute is not qualified by "if any," indicating that some nonzero amount must be established as minimum consideration for shares issued in settlement of an award. Under Delaware law, this minimum amount must be at least equal to the par value of a share of the company's stock, which is oftentimes as minimal as fractions of a penny.

Many public company equity incentive plans mandate that the exercise price of an option be at least equal to the fair market value of a share of stock on the grant date[3], which we would expect in all cases to be greater than par value. Fair market value is typically defined based on objective criteria (*i.e.,* closing price or average of high and low stock prices on the date of grant). Accordingly, the authorizing resolution may state that the exercise price for an option granted by the delegate must be at least equal to the minimum exercise price specified by the applicable equity incentive plan.[4]

Unlike options, grantees do not typically pay any consideration for the issuance of shares underlying an RSU at the time of settlement. How can the authorizing resolution fulfill the requirement to set minimum consideration in this case? The resolution may provide that a grantee's past or future provision of services to the company may constitute minimum consideration for the issuance of shares. Under Delaware law, this is acceptable so long as the value of the services is at least equal to the par value of the company's stock, which requirement should easily be met by a grantee who has or will provide any bona fide services to the company.

Similar to Section 157(c), the amended 152(b) provides that a board resolution establishing the delegation of authority to grant shares of restricted stock must set a maximum number of shares that may be issued by the delegate, a time period during which the shares may be issued, and minimum consideration for which the shares may be issued. Here too, a grantee's past or future service would suffice as minimum consideration.

The delegation rules of Sections 152(b) and 157(c) do not apply to the delegation of grant-making authority by a company's board to a committee of the board. Therefore, if the compensation committee of the board has been duly authorized by the board to administer the company's equity plan and to exercise all of the powers and authority of the board in administering the plan, the compensation committee would not be constrained by the requirements that apply to delegates appointed under Section 152(b) or 157(c). Moreover, a duly authorized compensation committee could itself delegate grant-making authority under Sections 152(b) and 157(c) to another person or body in the manner described above; the delegation is not required to be approved by the full board.

Other Considerations

Prior to authorizing any delegation under Section 152(b) or 157(c), a company should confirm that its compensation committee charter, equity incentive plan document, and other governing documents allow for the delegation. The company should also check whether, under its by-laws, the contemplated delegate will be automatically indemnified for any actions taken with the scope of the delegation. If not, it would be advisable for the board to approve this indemnification.

The authorizing Section 152(b) or 157(c) resolution should make it clear that the delegate may not grant awards to executive officers of the company for two reasons. First, most public company compensation committee charters mandate that the company's compensation committee approve equity incentive awards to executive officers. Second, an equity incentive award to an executive officer that is approved by the delegate (rather than the full board or independent directors of the board) will not be automatically exempt from the short-swing profit rules of Section 16 of the Securities Exchange Act of 1934, therefore making that award susceptible to disgorgement.

Contemporaneous written records should be maintained documenting the delegate's approval of each grant, such as by written consents or officer certificates. There should also be a governance procedure in place to ensure that awards granted by the delegate meet all requirements of the applicable equity incentive plan, such as individual award limits or minimum vesting requirements. That process might include requiring the delegate to have award approvals reviewed by the internal legal team. As a matter of good corporate governance, the delegate should make regular reports to the board or compensation committee on the delegate's grant-making activity.

The delegation should also document the extent to which the delegate has the power to amend award terms for awards granted by the delegate, such as the authority to accelerate vesting in connection with termination of employment. While the authority of the delegate to amend an award that the delegate previously granted is not specifically contemplated by the amended statute, we believe that it should be permissible given the flexibility afforded the delegate to fix award terms within the parameters set by the authorizing resolution. This too will require continued monitoring as practice develops under the amended statute.

Alternative Method of Delegation in Delaware

As noted above, if the board delegates its authority to make grants under the equity incentive plan to a board committee without qualification, the committee will have all of the powers of the board and will not be constrained by the rules of Section 152(b) or 157(c). Typically, the board of a public company will appoint the compensation committee to administer the company's equity incentive plan. Assuming that it is permissible under a company's governing documents and equity incentive plan document (and consistent with prior public disclosures), the board may concurrently establish a "committee of one director" to effectuate grants to non-officers under the equity plan. If the CEO, for example, serves on the board, she may constitute this "committee of one." The committee of one will not replace the compensation committee as the equity plan administrator, but rather the committee of one will exist as a concurrent committee with its own limited authority. The full board (not a board committee) should formally establish any committee of one and set clear parameters for the duties, responsibilities, and authorities of the committee. The committee of one should maintain good written records of the grants it approves, and regularly report on its grant-making activity to the board.

Where a company intends to designate its CEO as its delegate to grant equity awards, and the CEO serves on the company's board, there is an advantage to structuring the delegation as a committee of one. The company would be able to bypass Sections 152(b) and 157(c) and the interpretative uncertainty raised by the recent amendments.

To discuss equity delegation matters at your company, please reach out to any of the authors listed above or your regular Troutman Pepper contacts.

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[1] We note that Section 157(c), as amended, refers to the "exercise" of awards. Rights, such as RSUs, do not have an exercise feature. Rather, shares are issued in respect of vested RSUs in accordance with the settlement timing set forth in the applicable documents. Nonetheless, based on our reading of the amendments (and the legislature's synopsis of the amendments), our understanding is that the provisions of the statute referencing exercise are intended to apply broadly to both options and RSUs.

[2] Contrast this to Section 152(b), which requires the authorizing resolution to state only one limit — a cap on the

maximum number of shares that may be issued pursuant to the delegation.

[3] In order for an option to qualify as an incentive stock option or an exempt option under Section 409A of the Internal Revenue Code, the exercise price must be at least equal to the fair market value of a share on the date of grant.

[4] In this case, the minimum exercise price will fluctuate in the future based upon the fair market value of a share of stock at the time of an option grant. This is acceptable under the amended rules. “Facts ascertainable” outside of the resolution, such as the fair market value of a share of stock (and correspondingly the minimum exercise price of an option), may be referenced in the resolution so long as the facts are not ultimately determined in the discretion of the delegate. Because the fair market value of a share at the time of grant will not be determined by the delegate, but rather will be based on publicly available objective criteria, this should be permitted under the amended rules.

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