The Consumer Finance Podcast: Equity Award Delegations for Publicly Traded Companies

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Date Aired: January 11, 2024

Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. And I'm glad you've joined us for our episode today where we're going to be talking about a really important issue for our public company clients, and that's equity award delegations. But before we jump into that, let me remind you to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And don't forget to check out our other podcasts. We have lots of them. We have the *FCRA Focus*, all about credit reporting, *The Crypto Exchange*, all about crypto. We have *Unauthorized Access*, which is our privacy and data security podcast, and our newest podcast, *Payments Pros*, all about the payments industry. All of those are available on all popular podcast platforms.

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Now, as I said, today we're going to be talking about a very timely topic for our public company clients. And you know if you're a regular listener to this podcast that I really enjoy showcasing the fact that our firm can be a one-stop shop to serve all of the legal needs of our financial services clients. And for those clients who are publicly traded companies and those particularly who are incorporated in Delaware, we've got a very important development because the Delaware legislature has been amending the rules relating to equity award delegations, that is the process by which you make equity awards to employees of a publicly traded company. And there's a lot of opportunity for our public company clients to take advantage of these new rules. So joining me to talk about that today is my partner, Sheri Adler. Sheri is a member of our Employee Benefits and Executive Compensation Group. Welcome to the podcast again, Sheri. Thanks for being here.

Sheri Adler:

Thanks so much for having me, Chris. I'm looking forward to our discussion today.

Chris Willis:

Yeah, I really feel so lucky to have the opportunity to have your expertise for our clients and for the listeners of our podcast, but let's start with the background of why we're talking about this today. Can you give me and the listeners a 30,000-foot view of what equity incentive plans typically look like at a public company, like a publicly traded bank or another publicly traded financial institution?

Sheri Adler:

A public company will typically maintain an omnibus equity incentive plan. That's an equity plan that provides for the grant of a multitude of different types of equity-based awards, most commonly stock options, stock appreciation rights, restricted stock and restricted stock units or RSUs. And under the New York Stock Exchange and Nasdaq rules, the equity plan needs to be approved by the company's shareholders.

Once it's approved, usually the equity plan is administered by the compensation committee of the company's board of directors. But many plans also allow for the comp committee to delegate certain authorities under the plan, such as the ability to award certain grants under the plan to other individuals.

Chris Willis:

So this delegation that you just spoke of sounds like a Ministerial detail, but it's really a lot more important than that, isn't it? And in your experience, do many compensation committees of publicly traded companies do such delegation by appointing an officer or other delegate to grant equity awards to employees?

Sheri Adler:

Yeah, Chris, it really is quite common in my experience because think about it. In the context of a big global public company, the comp committee really is primarily concerned with executive pay, executive level grants, really high level, but when it comes to equity grants to the next tiers of employees, so say Vice Presidents or lower, the comp committee isn't typically as concerned about these smaller grants and often it winds up deferring to management anyway as to what is appropriate for those individuals based on their performance, incentivizing them, rewarding them, retaining them, et cetera.

So what often you'll see is that at a high level, the committee will say, okay, let's take a certain percentage of the shares that we have available in the share pool. So if we have 2,000,000 shares left, let's take 500,000 of them and essentially give them to the CEO, allow the CEO to grant them to these tiers of employees that we don't necessarily get involved in their comp decisions typically.

Also, Chris, another practical reason for the delegation is the comp committee typically only meets a handful of times each year, but let's say that management is working on a fast-moving new hire, we're not talking about an executive officer. Let's say we're talking about a VP level individual. They're trying to hire this VP really quickly, or a VP level employee has given notice. They have a counter offer and management really wants to incentivize them to stay. So it can be really useful there to be able to grant equity to those individuals, and this enables management to get that authorized much faster and not have to wait until the next comp committee meeting to get that specific smaller grant approved.

Chris Willis:

So it sounds like we should understand this equity award delegation issue is number one, being part of taking care of the board and making sure that we don't burden the board with things that they don't normally want to be involved in, like lower-level employees compensation. And then also giving the flexibility to management to manage compensation of lower-level employees in a way that maximizes the business. Do I basically have that right?

Sheri Adler:

Yeah, definitely. And you'll see it in different ways. I have plenty of companies where when the comp committee, let's say is meeting anyway during the first quarter of the year, and that's when they're approving their annual grants for their executive officers, the appendix just includes the annual grants for everyone. At that point, okay, they know the aggregate number of shares that they're granting and management helps determine within the lower ranks who's getting what, and they'll just approve it and it doesn't feel administratively burdensome. Other companies will completely remove that piece of those employees from the comp committee's approvals. But I think a big part of when it can be very helpful, the delegation is for the rest of the year in-between meeting times or in this context of a new hire.

Chris Willis:

So let's say that we have a public company and they want to do a delegation like we're talking about to allow management or some other delegate to be able to make equity awards to other employees. Let's talk about the nuts and bolts of how a company would go about doing that. So first of all, do they have to have an equity plan that allows specifically for the delegation?

Sheri Adler:

You want to make sure that the equity plan does allow so. If the equity plan just simply says, the comp committee will administer the plan and make all the grants thereunder, that's really not allowing for a delegation. You might be able to amend the plan perhaps even without shareholder approval. It might be something that the board can amend or the comp committee can amend depending on how the plan is drafted, but the plan should allow for the delegation as a very basic first step.

Chris Willis:

Okay. I mentioned in the lead-in to the episode that we've had some recent changes in Delaware law, Delaware of course, is a popular state to incorporate all kinds of companies including publicly traded ones. But can you talk to the audience about what laws govern the ability to delegate equity awards?

Sheri Adler:

Sure. This is a state corporate law matter, and as you mentioned, the reason why I've been talking about this to a lot of clients lately is because the Delaware legislature made changes to these rules in the summer of 2022 and 2023, which were generally welcomed by practitioners and companies alike because the goal was to give more flexibility to companies in setting up these delegations. There are those still some big questions and ambiguities that exist under the updated rules.

Chris Willis:

Well, let's jump into the requirements under the newly amended Delaware laws. What are those under the current regime after the amendments for setting up equity delegation in a Delaware company?

Sheri Adler:

First of all, the delegate can be anyone. Most commonly, it's a member of the c-suite like the CEO, but it doesn't have to be an executive officer. For example, a big public company might find it easier and more efficient to delegate authority to a human resources manager or a total rewards professional who's not necessarily an officer but is best equipped to manage these types of grants. And prior to the round of amendments to the DGCL made in 2022, only an officer could serve as the delegate to grant certain types of equity awards. So, this was really a welcome change.

The delegate is permitted to set all the terms and conditions of the awards, including vesting terms, as long as the delegate is sticking to the parameters set out for the delegation by the board, which we'll get to shortly. And again, this was another welcome change because prior to all these rounds of amendments, there were very specific limits on what terms and conditions could be set at least to certain type of equity awards by the delegate.

I will say from a practical perspective, we most commonly see the delegations contemplate time-based awards. Those are awards that vest over a period of time based on the employee's continued service. We don't as commonly see delegations used for performance-based awards like a PRSU, or a performance-based restricted stock unit. And that's really because more typically, PRSUs are granted once a year with a three-year performance period and very specific performance conditions to a smaller group of top individuals. And these are approved most frequently directly by the comp committee at its Q1 comp committee meeting.

Chris Willis:

Okay, got it. So there's more flexibility now in terms of who the delegate can be and what the delegate can do in terms of putting conditions on, but you mentioned that it had to be consistent with the delegation by the board. So when the board or the comp committee is setting up a delegation, what parameters do they need to build into those authorizing resolutions to make sure the delegation is actually compliant with the Delaware law as it's been amended?

Sheri Adler:

Well, Chris, the first one is really simple. The board needs to fix the number of shares subject to awards granted by the delegate. So basically, the board needs to establish a mini share pool. If there are 2,000,000 shares left in the equity plan share pool, maybe the board will provide that the delegate can grant up to 500,000 of those shares.

Chris Willis:

Okay. So the board has to decide how many shares, that makes sense, or the comp committee does. And then it seems like also, the board of the comp committee would have to put some sort of time restriction on it too, or else they might sit out there forever. Is that right?

Sheri Adler:

Exactly. And here it's a little more complicated. There’re two time periods here. One is simple, it's just the time period in which the delegate can make grants. So the delegate is authorized to make grants until the end of 2025. Clear, right? In 2026, can no longer make grants. The second part of the rule is that the board needs to fix a time period during which the shares may be issuable pursuant to options or rights granted by the delegate.

So what does this piece mean? This piece is not when the grants can be made. This is when the shares underlying the grants need to be issued by. And that can actually get a little bit more complicated, especially when you get into RSUs because you might have, for example, an RSU deferral plan in place at the company, and it's not necessarily clear offhand how many years later the RSUs are going to be issued. Perhaps somebody will defer the issuance of the shares under the RSUs all the way up until their retirement. So we get into a lot of discussions with clients when we're getting into the nitty-gritty of how to draft the resolutions authorizing the delegation, and just how to tie all those specific rules.

Chris Willis:

Got it. That sounds complicated, but obviously necessary for a delegation. And I know there's a third requirement that has to do with establishing minimum consideration for the grants. What's that all about?

Sheri Adler:

Right, Chris. The authorizing resolution has to state the minimum consideration, if any, for which options and rights may be issued. And the minimum consideration for the shares issuable pursuant to those awards. Two parts. The first part is pretty easy to take care of in the authorizing resolution. Usually we'll just state that the grants can be made for no consideration and the statute allows for that. It qualifies the minimum consideration requirement, if any.

But now what about the second part? The second part doesn't have an if-any qualifier, and in fact, Delaware law does require some minimum consideration to be paid when shares are issued. Again though, this is pretty easily handled in the resolutions because Delaware law does allow for the provision of bonafide services to constitute minimum consideration. And so generally speaking, we can say in the authorizing resolution that past or future services to the company constitute minimum consideration. The requirement I think sounds more complicated than it is, but it's fairly easy to dispose of in the authorizing resolutions.

Chris Willis:

Okay, got it. Well, now that we know the basic parameters for setting up one of these delegations under the Delaware corporate law, do you have any other tips or dos and don'ts for companies that are looking to set these up?

Sheri Adler:

Absolutely. As to the don'ts, the statute makes it clear that delegates can't grant awards to themselves, which is intuitive and makes sense. We typically would broaden that and restrict grants to their family members too. Also, just given compensation committee charter requirements and the importance of having Section 16 executive officer grants approved by a board or an independent committee of the board to qualify for exemptions from the short swing profit rules, the delegate shouldn't make grants to executive officers. And again, we'd advise extending that to include their family members as well.

As to the dues, a lot of these really have to do with just having a very good process in place. You want to make sure the company's governing documents, their compensation committee charter, equity incentive plan, all of it allows for a delegation. Also, think about would the delegate be indemnified for the actions taken within the scope of the delegation? Perhaps if it's a non-officer, you might need additional approvals to make sure that there's an indemnity there.

I mentioned process earlier, and I think that is really the key part to all this. You're not going to have a comp committee meeting with someone taking minutes and getting those approved. Right? And so you really want to make sure there's a good process in place, and there's written records for documenting the grants. You want to make sure there's contemporaneous documentation. The last thing a public company wants is a claim that options are being backdated or granted in the money because there was no written approval at the time of the grant. You want to make sure that you've got legal involved, you've got stock administration involved. Right? Who's making sure that the grants actually comply with the plan? Let's say the plan has a minimum vesting provision. Who's tracking that? Who's making sure that the stock usage is being tracked?

You want to think about the timing of the grant. If the company has an equity award policy or other guidelines, what does it say about when grants may be made, and are you making sure that the delegate is sticking to those timing requirements? You also want to make sure there's a process in place for reporting out. The delegate should be reporting out on its grant activity to the board or the comp committee so that the shares that are being utilized can be tracked. And we want to also make sure no grants are being made after the delegation expires, basically that the delegate is sticking within the parameters that the board or the comp committee set out for them at the beginning.

Chris Willis:

Okay, got it. Well, I feel like we have a very good idea of how to set up one of these delegations now, but if we didn't want to have to comply with all of those requirements that we've talked about, is there any alternative method for setting up a delegation in a Delaware company that doesn't require compliance with all these things?

Sheri Adler:

There is Chris, and I'm glad you asked about that because we actually use it quite frequently. Let's just say you have a CEO and the CEO is also a director on your board. In that case, if you want the CEO to be the delegate, in any case, your board can create a committee of the board. So let's call it the equity award committee, which would consist of the CEO director. It's another way to get to the same place. The CEO is the delegate with the authority to grant awards to non-executive officers. And the benefit of this route is that all those DGCL rules I described earlier don't apply because if the board is simply delegating its authority to a committee of the board, it's not constrained by those rules.

It would have many similar features of a DGCL delegation, like the board would establish a budget for the equity award committee such as a mini share pool. But you wouldn't need to worry about some of the idiosyncrasies and nuances we talked about earlier. For example, you don't need an expiration date for the delegation. You don't need to set minimum consideration and some of those other specific requirements.

Another plus, and one of the other reasons I think we see companies using this is the board can allow the equity award committee the ability to accelerate vesting or otherwise amend grants to non-officers. And it's not totally clear if we can do this under a DGCL delegation. So while we think that under DGCL delegation, the delegate should be able to modify the terms of awards it previously granted, if the delegate could set up all the terms in the first place, why can't the delegate change them? There's no clear guidance on this.

And from an administrative perspective, this is really helpful because let's say a non-executive officer is leaving the company and the company is negotiating a separation deal with them. And as part of that, they want to accelerate the vesting of certain equity grants. Now, if you don't have a delegation in place that allows for this, you're going to have to go to the comp committee to accelerate that. Here, we can have the CEO as the equity award committee effectuate it themselves.

You want to make sure that you're checking the bylaws to see if a committee of one is allowed. For example, you might need to have two directors on the committee under the bylaws. And I'll also note that while a DGCL delegation can be set up by either the board or the comp committee, this committee, this equity award committee has to be established by the full board. And that's because the comp committee can only establish a subcommittee comprised of one or more of its members. For independence reasons, you're not going to have the CEO of a public company sitting on the comp committee. And so essentially, you have the board setting up this committee.

Sometimes that comes up as a question - We don't want to go to the full board. We'd rather have the comp committee do it - There are ways that we often help with where the board sets up the committee in the first place, but then the comp committee is responsible for some of the ongoing responsibility, is like reloading the share pool in this equity award committee, receiving the reports. So there are different ways to do this so that it's administratively practicable for companies.

Chris Willis:

Thanks, Sheri. That sounds like a really important route that some of our clients could consider. And I really appreciate you being on the podcast today and sharing your knowledge and expertise about this very important matter for our public company clients with the audience. And of course, thanks to our audience for tuning into today's episode. Don't forget to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And while you're at it, why don't you head on over to troutman.com and add yourself to our Consumer Financial Services email list. That way, you'll get copies of the alerts that we send out and invitations to our industry only webinars. And as I said before, don't forget to check out our handy mobile app for great access to all of our written and voice thought leadership content. And of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.