Share Plans

How to Get Your Share Plan Approved

By Chris Havey and James Limmer

Approximately 25 percent of U.S. public companies will be asking shareholders to approve a new or amended share plan this proxy season. Since most companies do not revise share plans on an annual basis, boards may want a refresher on issues to consider when seeking shareholder approval.

When asking for approval of a share plan, it is important to review the plan's provisions, taking into account changing internal needs, evolving governance standards, and trends in market practices. Plan provisions that should be reviewed include:

- **Change-in-control vesting.** Historically, single-trigger vesting was the most common practice, but double-trigger vesting is rapidly growing in prevalence and is strongly favored by shareholder advisory groups such as Institutional Shareholder Services (ISS). The plan does not necessarily need to require either—it could allow the board to determine treatment in individual award agreements.
- **Tax withholding.** Recent accounting rule changes now allow companies to withhold at the maximum tax rates, but some companies may need to modify their share plan's language to allow this.
- **Treatment of dividends on unvested awards.** ISS prefers plans that prohibit the payment of dividends on all unvested awards. Companies would still be allowed to accrue dividends and pay them at vesting, which is the most common practice.
- **Individual share limits.** Companies typically have individual limits on share grant sizes for various types of awards to comply with Section 162(m) of the Internal Revenue Code. It is worth double-checking those numbers to make sure there is no risk of exceeding the limits.
- **Director award limit.** Including a separate limit on equity awards to individual non-employee directors may help protect against a shareholder lawsuit alleging self-dealing and excessive director pay. Typically, the director award limit is dollar-denominated and approximately three to four times that of an annual non-employee director's equity award.

A Key Provision

The most important plan provision is the number of shares requested. This number is the first one that shareholders review when evaluating the request, and it obviously impacts how often a company will need to seek shareholder approval for more shares.

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For a price, ISS's consulting arm will tell you exactly how many shares they'll allow under their policies. If you don't want to pay ISS's fee or if ISS's views are not important to your shareholders, there are other ways to determine a reasonable request:

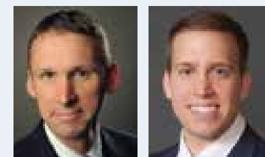
- **Bottom-up analysis.** Model the projected annual share usage over the next three to five years to determine what range of requests would be internally reasonable.
- **Top-down analysis.** Benchmark the potential dilution of recent share requests by companies that are similar with respect to industry and size to provide an external benchmark of reasonableness.

Hopefully, the results of these two analyses converge to allow a company to request three to five years' worth of shares while not exceeding competitive benchmarks for dilution levels.

Shareholder Approval Risks

There are substantial consequences if the binding shareholder vote fails: the company may have to call a special meeting later in the year to get approval or may not be able to grant equity awards. However, the likelihood that a proposal fails is very small, even if ISS recommends against the plan proposal. Last year, out of approximately 800 Russell 3000 companies that requested approval of their share plan, approximately 200 (roughly 25 percent) received an ISS "against" recommendation, but the proposal failed at only three of these companies. Typically, the biggest issue cited in a failing vote is the sheer size of the share request, so it is important to get that right.

For any company that does receive an ISS "against" recommendation, it will be important to engage with shareholders to explain the importance of the plan passing and the rationale for the size of the request. The shareholder engagement is more likely to be successful if there is solid analysis to support the company's request.



Chris Havey (left) is a partner and James Limmer (right) is a consultant at the executive compensation consulting firm Meridian Compensation Partners LLC, in The Woodlands, Texas.