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Investors Bancorp's Impact on Long-Term Incentive Plans

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Editor's note: Matthew B. Grunert and Scott C. Sanders are partners and Jackie Z. Coleman is an associate at Bracewell LLP. This post is based on their Bracewell memorandum, and is part of the Delaware law series; links to other posts in the series are available here. Related research from the Program on Corporate Governance includes Paying for Long-Term Performance by Lucian Bebchuk and Jesse Fried (discussed on the Forum here).

The trend of including director-specific limits on the size of annual equity awards to non-employee directors under long-term incentive plans ("LTIPs") continues to pick up steam, as evidenced by our survey of LTIPs filed this proxy season for shareholder approval. Nearly 75% of LTIPs reviewed now include a director-specific limit on the size of annual non-employee director grants, with a majority of those LTIPs restricting not only the size of annual equity awards, but also capping total annual compensation to non-employee directors.

This trend's beginnings arose from the 2017 Delaware Supreme Court decision in In re Investors Bancorp, Inc. Stockholders Litigation ("*Bancorp*"). In *Bancorp*, the court held that a shareholder-approved cap on the aggregate number of shares that could be granted to non-employee directors under the company's LTIP did not constitute shareholder ratification of the subsequent individual awards granted to non-employee directors of Investors Bancorp. As a result, the court held that the "entire fairness standard" should apply to any review of the size of non-employee director awards, requiring the board to demonstrate that the awards were fair to the company, as opposed to permitting application of the more company-friendly "business judgment rule," requiring a showing by the plaintiff of corporate waste.

The court stated that shareholder ratification "present[s] no real problems" in two cases, (i) shareholder approval of a "self-executing plan" (i.e., an LTIP that provides for automatic grants to non-employee directors based on fixed criteria with specific amounts and other terms approved in advance by shareholders), and (ii) shareholder approval of each individual grant to each non-employee director. The second option is impractical for obvious reasons, but this has not, at least yet, caused companies to flock to the "self-executing plan" option either.

After reviewing 100 randomly selected LTIPs from this proxy season, we discovered the following with respect to director awards, which almost certainly reflects the impact of *Bancorp*:

- Seventy-two of the LTIPs included explicit language limiting the size of annual non-employee director awards. The vast majority of these LTIPs expressed the limit in terms of dollars, meaning that the number of shares covered by the awards could vary from year-to-year, but the grant date fair market value would never be above a certain level. A small minority of these LTIPs limited the size of the award to specified numbers of shares.

- One unexpected finding was that the majority of these LTIPs set a limit on all director compensation, not just LTIP compensation. Forty-one of these 72 LTIPs capped director compensation from all sources, with the language in the LTIP in effect stating the annual LTIP award could be no more than a certain dollar amount minus all other compensation paid to such director for services that year. The remaining 31 LTIPs placed the limit solely on the LTIP compensation.
- Several of these LTIPs included language permitting the board to exceed the limit in "exceptional circumstances," which concept did not appear to be defined in any of the applicable LTIPs.
- Twelve of the LTIPs included a general participant limit on the size of annual awards. These LTIPs did not take any special measures to single out the size of non-employee director awards. Such general limits may be a holdover from the old Section 162(m) days or perhaps have been included as a sign of good governance.
- One LTIP limited all non-employee director awards over the life of the plan to 20% of the total share reserve.
- Three of the LTIPs included "self-executing plan" provisions calling for automatic grants. Two of these LTIPs provided for annual grants of specific types of awards to be made at preset dollar values. One of these LTIPs also included a statement that no other equity awards would be made under the plan except for the automatic grants. These provisions would appear to be within the parameters set forth in *Bancorp* regarding "self-executing" awards. The third of these LTIPs provided for annual grants of specific types of awards to be made with respect to a preset number of shares for each grant, but gave the board the authority to increase or decrease the number of shares to be subject to the automatic grant, raising the question as to whether such a feature is truly within the spirit of *Bancorp*.
- Twelve of the LTIPs included no limit on the size of annual awards. In effect, the only limit under these LTIPs is the overall share reserve. The lack of any specific limitations is likely a result of no longer needing to include annual grant limitations for certain participants for purposes of securing the now-repealed Section 162(m) deduction for performance-based compensation.
- As one would expect, none of the LTIPs called for shareholder approval of each individual non-employee director award.