IPO and Public Company Readiness: Focus on Executive Compensation

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Presenters



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Outline

- Introduction
- Compensation and Benefits Issues to Consider in the IPO Context
 - Compensation Philosophy
 - Stock Incentive Plans
 - Severance and Employment Agreements
 - Non-Employee Director Compensation
 - Corporate Governance
 - Financial and Wealth Transfer Planning

Introduction

Introduction

- Why Focus On Executive Compensation?
 - Creation of a public market introduces a number of significant new legal and business factors that have a substantial impact on the appropriate design of a company's long-term compensation and benefits strategy Including:
 - Increased value and liquidity of equity-based awards
 - Public disclosure of financial results
 - Public disclosure of executive compensation for "named executive officers"
 - Increased scrutiny of management performance and compensation decisions, "say-on-pay"
 - Shorter-term focus by investors
- Investor Expectations Regarding Executive Compensation

Compensation Philosophy

Compensation Philosophy

- Establish a Post-IPO Compensation Philosophy That Accounts for these Material Changes
 - Objectives of the compensation program
 - Driving Performance
 - Retention/Attraction of Executive Officers and Other Employees
 - Reassess total pay mix
 - Cash vs. Equity-Based Compensation
 - Balance of Short-Term and Long-Term Incentives
 - Type of Equity Compensation Used
 - Limited Perquisites

Compensation Philosophy

- Establish appropriate peer group and desired competitive market position
 - Market capitalization peers/direct competitors
 - Similar organizational structure or business model
 - Where is talent lost or recruited from
- Keep in mind public disclosure requirements for "named executive officers"
 - Mandatory "say on pay" (except for EGCs)
 - Institutional investor preferences/"pay-for-performance"
- Reassess approach to benefits and perquisites in public company environment
- Consider engaging an outside compensation consultant to assist Board's compensation committee

- Adoption of New or Amended "Omnibus" Stock Incentive Plan
 - All pre-IPO companies should adopt a new or amended stock incentive plan
 - Include full menu of stock awards, such as options, stock purchases, restricted stock bonuses, and stock appreciation rights
 - Single, unified pool for equity-based awards
 - Strongly consider "evergreen" share reserve
 - Post-IPO stockholder approval required to increase share reserve
 - Section 162(m) transition period and related issues

- Adoption of Employee Stock Purchase Plan
 - Allows eligible employees to purchase the company's shares periodically throughout a year (offering periods can be as long as 27 months, although usually not longer than 6 months)
 - Shares are purchased with after-tax dollars withheld from payroll at the employees' election
 - Plans can offer a discount of up to 15% of the trading price either at the beginning or end of the purchase period
 - May be more efficient than stock option or RSU awards in the US (under Section 423 of the IRC there is no immediate taxation on purchase at a discount)
 - Can include an evergreen reserve

- Existing Employee Equity Awards
 - "Cheap stock" and Section 409A issues in lead up to IPO
 - Pre-IPO lack of liquidity
 - Increasing use of restricted stock units in lieu of stock options pre-IPO with service-based and liquidity restrictions ("Facebook" RSUs)
 - SEC registration (Form S-8)
 - Introduction of "Same-Day Sale" Program
 - Other post-IPO stock plan administration considerations (in-house vs. outsourcing)

Severance and Employment Agreements

Severance and Employment Agreements

- Consider severance pay/retention arrangements
 - Private companies may not have in place any severance or retention arrangements
 - Executives with substantial stock holdings may become more of a retention risk post-IPO
 - Public scrutiny of corporate financial performance and executive compensation may also increase need for retention incentives and executives' desire for severance protection
 - Severance/retention arrangements can be limited to senior management or broad-based
 - Plan/policy vs. individual agreements (trend in recent years has been to use plans/policies)

Severance and Employment Agreements

- Consider new or amended executive employment agreements
 - Consider whether existing employment agreements are appropriate in a public company context
 - SEC disclosure requirements for employment agreements with "named executive officers" and other "executive officers"
 - Consider eliminating employment agreements in favor of a severance plan or policy

Non-Employee Director Compensation and Corporate Governance

Non-Employee Director Compensation

- Non-Employee Director Compensation Considerations
 - Minimal cash compensation for directors pre-IPO
 - New/independent board members are added in connection with IPO
 - Compensation mix for non-employee directors post-IPO
 - Automatic annual equity grants in addition to cash compensation
 - Heightened scrutiny on compensation decisions regarding non-employee directors
 - Consider separate shareholder-approved director equity plan and/or lower limits on director awards as compared to employee awards to manage threat of lawsuits alleging directors of self-dealing when compensating themselves

Corporate Governance

- Formalized compensation process
 - Public companies are subject to more stringent corporate governance rules regarding executive officer compensation
 - Stock exchange listing requirements relating to compensation committee duties and independence
 - Stock exchange listing requirements relating to compensation committee authority to engage consultants and advisors and related independence requirements
 - Securities laws (Section 16) require compensation committee approval of executive officer equity awards and transactions in connection therewith (i.e. share withholding)
- Obtain adequate Directors and Officer's liability insurance

Financial and Wealth Transfer Planning

Financial and Wealth Transfer Planning

- Financial and Wealth Transfer Planning
 - Often overlooked by executives pre-IPO
 - Executives should consider the impact of an IPO on personal financial and estate planning
 - Tax-efficient approaches exist for achieving financial and estate planning objectives
 - Advance planning can prove very beneficial, especially from a tax perspective



Presenter Profiles

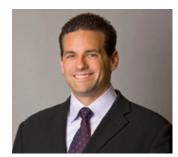
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Stephen W. Fackler is a partner in the Firm's Palo Alto and New York offices and Co-Chair of Gibson Dunn's Executive Compensation and Employee Benefits Practice Group. Over the years, Mr. Fackler has advised scores of companies planning to go public and assisted them with the implementation of the changes to their equity and cash compensation plans and programs in advance of their IPOs. Mr. Fackler has been selected by *Chambers and Partners* as a Leading Employee Benefits Lawyer each year since 2006 (the first year in which the category was included) in its publication and for the last few years has been ranked in the highest Tier 1 band. He has been named among the Top 20 Most Powerful Lawyers for Employee Benefits and ERISA in the *United States in Human Resource Executive* magazine and *Lawdragon* every year from 2012 through 2018. Just recently he was named 2019 "Lawyer of the Year" in the area of Employee Benefits in the Silicon Valley/San Jose region.



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Sean C. Feller is a partner in the Firm's Century City office and member of the Executive Compensation and Employee Benefits Practice Group. His practice focuses on all aspects executive compensation and employee benefits. His practice encompasses tax, ERISA, accounting, corporate, and securities law aspects of equity and other incentive compensation plans; qualified and nonqualified retirement and deferred compensation plans and executive employment and severance arrangements. Mr. Feller has been recognized by his peers as one of The Best Lawyers in America in the area of Employee Benefits (ERISA) Law. *BTI Consulting* named Mr. Feller as a 2018 BTI Client Service Super All-Star, one of six "standout attorneys who received recognition from multiple influential General Counsel and legal decision makers." In 2017, he was ranked by *Chambers USA* as a Leading Lawyer in California in the area of Employee Benefits and Executive Compensation.

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