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Delaware Court of Chancery: Compensation Awards to Directors Not Ratified by Stockholder Approval and Subject to Entire Fairness

In *Calma* v. *Templeton*, the plaintiff alleged that a board of directors breached their fiduciary duties in awarding themselves restricted stock units (RSUs) pursuant to a stockholder-approved equity incentive compensation plan. The Court of Chancery held on a motion to dismiss that (i) the directors were interested in the award of the RSUs, and (ii) although the stockholders had approved the plan under which the RSUs were awarded, stockholder approval of the plan could not act as ratification because the plan did not include enough specificity as to the amount or form of compensation to be issued. The court, therefore, held that the awards were to be reviewed under the non-deferential entire fairness standard, rather than under the business judgment rule, and declined to dismiss the plaintiff's breach of fiduciary duty claim.

In 2005, a majority of the stockholders of Citrix Systems, Inc. approved an equity incentive compensation plan that, by 2014, encompassed 48.6 million total shares, of which 16 million could be awarded as RSUs. The only limit on the amount of compensation that could be issued to any eligible beneficiary, including the non-employee directors, under the plan was a cap of 1 million shares or equivalent RSUs per director per calendar year, which in 2014 amounted to $55 million in value. The awards being challenged generally ranged from approximately $253,000 to $339,000 per year per director and were made by the board's compensation committee, whose members were independent but were also recipients of the awards.

The plaintiff filed a derivative suit challenging the awards under theories of breach of fiduciary duty, waste of corporate assets and unjust enrichment. On a motion to dismiss, the Court of Chancery held:

- *The stockholder approval of the plan did not amount to ratification of the challenged awards because the stockholders had approved only the generic outlines of a compensation plan, and did not approve any action bearing "specifically on the magnitude of compensation to its non-employee directors"* – In so holding, the Court noted that Delaware does not embrace a "blank check" theory of stockholder ratification, whereby approval by stockholders of prospective director action within "broad parameters would insulate all future action by the directors within those parameters from attack." Rather, approval of more "specific" board decisions is required. The Court differentiated other cases where, for example, the stockholders had approved a compensation plan that was in effect self-executing by setting specific awards to be granted upon election to the board and annually (*Steiner* v. *Meyerson*), where the plan included ceilings on awards each year based on factors such as committee service or appointment as the lead director or board chair (*In re 3COM Corp.*) or otherwise included specific details as to the actual awards to be granted. Accordingly, the challenge to the awards in this case was subject to review under the entire fairness standard, rather than the deferential business judgment rule, and was found, on the facts alleged, to survive a motion to dismiss. Among the facts that contributed to the Court's decision were that the Citrix board, in setting director compensation, relied on a peer group (as identified by the company in its SEC filings) that the plaintiff argued should not have included companies with much higher market capitalizations, revenue and net income than Citrix.

- *The non-employee directors were interested in the RSU award, and therefore entire fairness review applied* - The Court of Chancery held as a threshold matter that demand was excused because "the law is skeptical that an individual can fairly and impartially consider whether to have the corporation initiate litigation challenging his or her own compensation." Further, the Court noted that "director self-compensation decisions are conflicted transactions" that require a showing of fairness to the corporation in the absence of a valid act of ratification.

We view this case as a helpful reminder that in order for ratification of self-interested compensation awards to be effective, companies cannot rely on stockholder approval of generic compensation plans but instead must provide stockholders with specific details of, or limits on, the compensation to be approved.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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