April 11, 2017

Delaware Court of Chancery Holds That Stockholder Vote on Equity Incentive Plan Ratifies Later Awards

In a recent decision in *In re Investor Bancorp, Inc. Stockholder Litigation*, the Delaware Court of Chancery held that a fully informed stockholder vote approving adoption of an equity incentive plan also ratified subsequent equity awards to individual directors under the plan. The court found that the plan included limits on grants to directors as a beneficiary group, as opposed to "generic" limits applicable to all plan beneficiaries. In dismissing the shareholder derivative suit, the court applied the business judgment standard of review to the directors' decision to make the awards to themselves.

Background

In 2015, the directors of Investors Bancorp, Inc. adopted an equity incentive plan applicable to the company's officers, employees, non-employee directors and service providers. The plan imposed numerous limitations, including, among others, limits on (i) the number of shares that may be issued or delivered to any one employee pursuant to the exercise of stock options, (ii) the number of shares that may be issued or delivered to any one employee pursuant to a restricted stock or restricted stock unit grant and (iii) the number of shares that may be issued or delivered to all non-employee directors pursuant to the exercise of stock options or grants of restricted stock or restricted stock units. The board sought and received stockholder approval of the plan at the company's annual meeting. Thereafter, all 12 directors awarded themselves substantial restricted stock and stock options under the plan (with a grant date value of $51.5 million in the aggregate). Following public announcements of these awards, the plaintiff stockholders brought a derivative action alleging that the compensation awards were excessive and unfair to the corporation.

Analysis

In granting the defendants' motion to dismiss, the Court of Chancery made the following key findings:

- *The stockholder vote approving adoption of the equity incentive plan served to ratify the specific equity awards to the directors under the plan because the plan contained "specific" limits*. Relying on precedent (specifically *In re 3COM Corp. Shareholders Litigation* and *Calma on Behalf of Citrix Systems, Inc.* v. *Templeton*), the court observed that entire fairness is the default standard of review for equity awards by directors to themselves under an incentive plan due to the conflicted nature of the action. However, a fully informed stockholder vote approving adoption of the incentive plan will serve to ratify future grants under the plan, so long as the plan sets "specific limits" for the class of beneficiaries in question and therefore approval represents a "meeting of the minds" between stockholders and the board on the grants. By contrast, stockholder approval of a plan will not extend to ratify future grants under the plan if it sets only "generic" limits applicable to all plan beneficiaries. Where a stockholder vote ratifies an equity grant by the board, the business judgment standard of review will apply to the board's action, and the grant would only be set aside if it constituted waste. Here, the court found that the company's equity incentive plan contained meaningful, specific limits on awards to all director beneficiaries, which were disclosed to and approved by stockholders, and the directors made the awards within these limits. Accordingly, the stockholder approval of the company's equity incentive plan served to ratify the director equity grants, and the decision would only be reviewed for waste, which the court found the plaintiffs failed to plead.

- *The stockholder vote approving the adoption of equity incentive plan was fully informed, and therefore disclosure concerns did not invalidate its ratifying effect.* The court found that plaintiffs either alleged omissions in the proxy that were not material as a matter of law or selectively referred to portions of the proxy without providing full context. Thus, plaintiffs failed to identify any bases upon which the court could reasonably infer that the stockholders' approval of the adoption of the equity incentive plan was uninformed.

Observations

The company's equity incentive plan's specific limit for non-employee directors applied to all non-employee directors as a group, as opposed to individual limits for each non-employee director. The limit for the non-employee directors was 30% of all options or restricted stock shares available for awards, all of which may be granted in a single year. Companies adopting specific limits in equity plans may consider whether to provide specific limits to non-employee directors as a group, rather than on an individual director basis.

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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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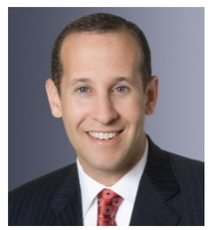

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