DELAWARE BUSINESS COURT INSIDER

May 20, 2015 An ALM Website

Stockholder Ratification of Compensation for Non-employee Directors

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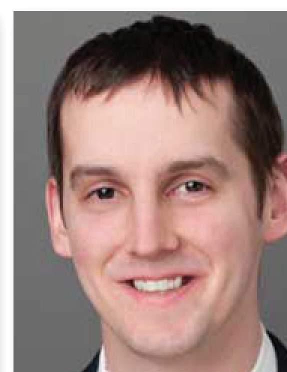

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In Calma v. Templeton (Del. Ch. Apr. 30, 2015), the Delaware Court of Chancery analyzed whether stockholder approval of a general "compensation plan subjects the self-interested payment of compensation to non-employee directors under such a plan to judicial review under a waste standard instead of an entire fairness standard." In adjudicating the defendants' motion to dismiss, Chancellor Andre G. Bouchard concluded that "advance stockholder approval of a compensation plan with multiple classes of beneficiaries and a single generic limit on the amount of compensation that may be awarded in a given year" does not necessarily establish a ratification defense to challenges to compensation paid pursuant to the plan. Accordingly, claims relating to such payments would be subject to review under the entire fairness standard applicable to conflicted transactions, rather than the more forgiving waste standard.

Plaintiff John Calma, an individual stockholder of Citrix Systems Inc., derivatively challenged the grants of restricted stock options and cash payments to eight non-employee directors of Citrix in 2011, 2012 and 2013 under theories of breach of fiduciary duty, waste of corporate assets, and unjust enrichment. The directors received their stock grants under Citrix's equity incentive plan, which was approved by a majority of Citrix's disinterested stockholders in 2005. The plan did not, however, "specify the compensation that the company's non-employee directors w[ould] receive annually," the court said. Instead, the "only limit on annual compensation under the plan [wa]s the generic 1 million share limit ... applicable to all beneficiaries," with "no sub-limits varied by position within the company." At the time of the suit, 1 million shares of stock were valued over $55 million. Pursuant to the plan, in 2011, 2012 and 2013, Citrix's compensation committee, composed of three non-employee directors, granted each member of the board, including themselves, at least $250,000 in stock grants and options, as well as additional cash payments.

The court concluded that the plaintiff had stated a claim for breach of fiduciary duty relating to the board's award and receipt of the stock grants. As an initial matter, the court held that the business judgment rule did not apply because "at least half of the directors who approved [the grants] [we]re not independent or disinterested." Accordingly, the decision to award the grants was subject to review under the entire fairness standard, which

would require the directors to "establish … 'that the transaction was the product of both fair dealing and fair price'" unless the transaction was ratified by a majority of the company's disinterested stockholders.

Bouchard disagreed that stockholder approval of the 2005 plan amounted to a ratification of the stock awards. In so doing, Bouchard surveyed 60 years of Delaware law on stockholder ratification concerning director compensation, which originated in Kerbs v. California Eastern Airways, 90 A.2d 652 (Del. 1952). In Kerbs, the Delaware Supreme Court "concluded that, because the plan set forth the specific options to be awarded, stockholder approval of the earlier-in-time decision of the board to adopt the plan was a ratification of the consideration and 'effective for all purposes unless the action of the directors constituted a gift of corporate assets to themselves or was ultra vires, illegal, or fraudulent.'" Bouchard also discussed then-Vice Chancellor Leo E. Strine Jr.'s decision in Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007), which rejected a ratification defense and stated that "the mere approval by stockholders of a request by directors for the authority to take action within broad parameters does not insulate all future action by the directors within those parameters from attack." Similarly, in Seinfeld v. Slager (Del. Ch. June 29, 2012), the compensation plan for non-employee directors merely included a "generic limit" of $21.7 million in director compensation annually. The court in Slager concluded that, although stockholders had voted for the generic compensation plan, they had not voted for the specific grants at issue nor to impose "effective limits on the total amount of pay." As a result, the court rejected defendants' ratification defense. Ultimately, according to Bouchard, the analysis of whether stockholders have ratified a compensation plan turns on whether the stockholder-approved plan "set[s] forth any specific amounts (or director-specific ceilings) of compensation," as opposed to "generic limit[s] on the compensation that any one beneficiary could receive per fiscal year."

The court determined that stockholders' approval of Citrix's plan in 2005, which allowed every "eligible recipient under the plan [to] receive up to 1 million shares (or equivalent RSU awards) per calendar year," did not "establish a ratification defense" of the payments made to directors in 2011–13. Bouchard emphasized that this limit—the only relevant limit in the plan—could lead to grants valued at more than $55 million per director, and held that "Citrix stockholders were never asked to approve—and thus did not approve—any action bearing specifically on the magnitude of compensation for the company's non-employee directors." In so doing, Bouchard articulated two principles of common law relevant to stockholder ratification of director compensation. First, "the affirmative defense of ratification is available only where a majority of informed, uncoerced, and disinterested stockholders vote in favor of a specific decision of the board of directors." In other words, approval of a generic compensation plan will not necessarily insulate later awards that are not specifically set out in that plan. Second, "valid stockholder ratification leads to waste being the doctrinal standard of review for a breach of fiduciary duty claim."

In the wake of Calma, Delaware courts may increase scrutiny of non-employee director compensation awarded pursuant to stock award plans that do not contain meaningful limits, regardless of whether those plans have been approved by disinterested stockholders. Accordingly, companies may wish to review their compensation plans to determine the extent to which they set forth "any specific limits on the compensation of the particular class[es] of beneficiaries." Companies may also want to consider the extent to which adding more specific limits and obtaining additional stockholder approval of their plans is advisable.

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