



Executive Compensation and Benefits Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Marc S. Gerber

Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Neil M. Leff

New York
212.735.3269
neil.leff@skadden.com

Regina Olshan

New York
212.735.2644
regina.olshan@skadden.com

Erica Schohn

New York
212.735.2823
erica.schohn@skadden.com

Joseph M. Yaffe

Palo Alto
650.470.4650
joseph.yaffe@skadden.com

Alessandra K. Murata

Palo Alto
650.470.3194
alessandra.murata@skadden.com

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Four Times Square
New York, NY 10036
212.735.3000

Fairness of Director Awards Granted Under Market-Standard Equity Plans Comes Under Increased Scrutiny

A Delaware court opinion issued late last week may subject equity grants to directors to increased judicial scrutiny (*Calma v. Templeton*, No. 9579-CB (Del. Ch. Apr. 30, 2015)). In *Calma*, the Chancery Court denied the defendant's motion to dismiss a claim that Citrix directors breached their fiduciary duties and were unjustly enriched when awarding themselves equity where a shareholder-approved omnibus equity plan lacked "meaningful" director-specific limits on grants. Although it is too early to tell if this decision, which was procedural in nature and did not reach the merits, will encourage a new round of lawsuits challenging public company compensation practices, the decision is a reminder of the attention required for decisions regarding director compensation. Companies may want to review their equity plans and consider whether to include, and seek stockholder approval of, separate limits on the amount of equity awards that may be granted to non-employee directors.

Background

The derivative stockholder action challenges awards of restricted stock units (RSUs) granted to eight non-employee directors of Citrix in 2011, 2012 and 2013. The majority of the directors' compensation consisted of these RSU awards, which the board's compensation committee granted under the company's stockholder-approved 2005 equity incentive plan (the Plan). Citrix's directors, officers, employees, consultants and advisors were beneficiaries under the Plan. The only limit on compensation imposed by the Plan was that no participant could receive an award covering more than 1 million shares per calendar year. There were no sublimits based on the award recipient's position at Citrix (e.g., employee, director or consultant). Based on Citrix's stock price when the action was filed, 1 million RSUs were worth over \$55 million.

The plaintiff alleged that the RSU awards received by non-employee directors were, when combined with cash payments they received for their services, "excessive" in comparison with the compensation received by directors at certain of Citrix's "peers." The plaintiff sought to hold the members of Citrix's board liable, under three theories: breach of fiduciary duty, waste of corporate assets and unjust enrichment.

The plaintiff did not contend that Citrix stockholders failed to approve the Plan; that Citrix stockholders were not fully informed when they approved the Plan; or that the RSU awards violated the Plan. Instead, the plaintiff asserted that the burden was on the defendants to establish the entire fairness of the RSU awards, as the directors were conflicted when making these compensation decisions and because the Plan did not have any "meaningful limits" on the annual stock-based compensation that Citrix directors could receive from the company.

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The defendants moved to dismiss the complaint in its entirety under Chancery Rule 12(b)(6) for failure to state a claim upon which relief may be granted, and under Chancery Rule 23.1 for failure to make a pre-suit demand or to plead facts excusing such a demand.

The defendants' primary argument was that Citrix stockholders had ratified the awards by approving the Plan. The defendants conceded that Citrix stockholders were not asked to ratify the specific RSU awards granted to directors. Nonetheless, defendants contended that Citrix stockholders ratified the Plan, so that any award of RSUs to the directors under the generic 1 million RSU limit in the Plan must be reviewed under a waste standard and that it is not reasonably conceivable that the RSU awards constituted waste.

Decision

Generally, stockholder ratification will subject decisions relating to director compensation to a waste standard of review if stockholders are fully informed and approve a specific level of, or limit on, compensation. Stockholder approval of a compensation plan that does not specify the actual compensation or set meaningful limits on the amount to be received by directors is insufficient to invoke a waste standard of review, and compensation decisions under such a plan are, therefore, subject to the entire fairness standard of review.

The opinion concluded that the defendants did not establish that Citrix stockholders ratified the RSU awards because, in obtaining stockholder approval of a plan covering multiple and varied classes of beneficiaries, Citrix did not seek or obtain stockholder approval of any action bearing specifically on the magnitude of compensation to be paid to its non-employee directors. Accordingly, because the RSU grants made to directors were inherently self-dealing decisions, the operative standard of review is entire fairness, which normally precludes granting of a motion to dismiss for failure to state a claim. Nevertheless, a plaintiff still must allege some fact to support the view that the grants were not fair, which plaintiffs were able to do by questioning the appropriateness of the peer companies used in the compensation decision-making process. As a result of these meaningful questions around the peer group, the court concluded that it is reasonably conceivable that the total compensation received by the non-employee directors was not entirely fair to the company and that it is reasonably conceivable that the defendants were unjustly enriched by the RSU awards, but not that the RSU awards constituted waste. Therefore, while the defendants' Rule 12(b)(6) motion was granted as to the corporate waste claim, the motion to dismiss was denied as to the claims for breach of fiduciary duty and unjust enrichment.