Director Compensation in the Spotlight

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Individuals serving on company boards of directors should carefully examine director compensation programs and decisions involving their own compensation following an April 30, 2015, ruling by the Delaware Court of Chancery. In *Calma v. Templeton*, the Court of Chancery denied Citrix Systems Inc.'s motion to dismiss the plaintiff's breach of fiduciary duty claim, holding that the claim would move forward under the heightened "entire fairness" standard rather than the business judgment rule.

> The *Calma* court rejected Citrix's contention that prior approval by its shareholders of its equity plan was tantamount to ratification of the directors' equity grants made under that plan.

The plaintiff claimed that the directors of Citrix had breached their fiduciary duty in approving excessive compensation for themselves, which included both cash and equity. Although decisions made by boards of directors generally are afforded the protection of the business judgment rule, which requires a plaintiff to show that a decision had no rational business purpose, decisions involving self-interest are reviewed under the business judgment rule only if ratified by the company's shareholders. The *Calma* court rejected Citrix's contention that prior approval by its shareholders of its equity plan was tantamount to ratification of the directors' equity grants made under that plan. The court found that the "entire fairness" standard applied because the equity plan lacked "meaningful limits" on director awards — the plan did not have director-specific equity award limits, only a general per-person limit of 1 million shares in a year.

Companies and boards should consider taking one or more of the following steps to maintain the protection of the business judgment rule and reduce exposure to claims similar to those asserted in *Calma*:

- Carefully review existing director compensation arrangements.
- Add to the current equity plan a meaningful annual share limit or annual formula-based grant for director awards and seek shareholder approval of that limit or grant. Alternatively, companies may consider adopting, and seeking shareholder approval of, a stand-alone director compensation plan.
- If shareholder approval or ratification is not feasible, the board of directors should develop a factual record of its director compensation program, aimed at withstanding "entire fairness" scrutiny, including peer group analysis, possibly with assistance from a compensation consultant.
- In the company's annual proxy disclosure, consider expanding the description and rationale supporting the company's director compensation program beyond the minimum required under the applicable rules.

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