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Meridian Client Update

Companies Should Consider Implementing Limits on Share Grants to Directors

Two Delaware court decisions are causing many companies to contemplate including in their equity plans annual share limits on grants (and possibly annual limits on cash awards) to non-employee directors.

In *Calma v. Templeton*, the Delaware Chancery Court refused to dismiss a shareholder lawsuit claiming that the Board of Directors of Citrix Systems, Inc. engaged in self-dealing by approving its own equity pay in accordance with Citrix's 2005 Equity Incentive Plan ("Plan"). The Court held that the operative standard of review for such self-dealing is "entire fairness" rather than the more deferential business judgment rule.

In the derivative action, the plaintiff challenges the appropriateness of restricted stock unit (RSU) awards granted to Citrix's non-employee directors under the Plan in 2011, 2012 and 2013. The Plan empowered the Board's Compensation Committee broad discretion to determine the amount and form of awards to be granted under the Plan. Additionally, the Plan provided that the maximum number of shares (e.g., RSUs) that may be granted to a plan participant was 1 million shares per year. This maximum limit applied to employees and directors. In 2011, 2012 and 2013, each Board member received RSU awards that were substantially under the annual limit.

The Court found that Citrix's shareholders did not ratify the director compensation in voting to approve the Plan by merely approving "generic limits" on compensation for all plan participants under the Plan. Analogous to a prior Delaware case, *Seinfeld v. Slager*, the Plan did not have meaningful limits on the amount of equity compensation that the Company's non-employee directors could receive (refer to Meridian's Client Update dated September 4, 2012 for a discussion of *Seinfeld v. Slager*).

Since Citrix's shareholders did not ratify the director pay, the Court held that the deferential judicial review standard of the business judgment rule does not apply to self-dealing transactions. Rather, the defendants have the burden to establish the "entire fairness" of the RSUs awards. Under the entire fairness standard, the directors must establish that the transaction was the product of both fair dealing and a fair price.

The Court's ruling was not a decision on the merits of the case. If the case should move to trial, then the defendants would need to show that amounts they awarded themselves under the Plan were "entirely fair" to avoid a finding that they breached their fiduciary duties and were unjustly enriched.

Meridian comment. The *Calma* and *Seinfeld* cases may usher in a new era of litigation on director pay. To avoid such potential litigation, companies should strongly consider the merits of subjecting equity awards to non-employee directors to an annual share limit and including dollar value limits on cash incentive awards to non-employee directors in their omnibus equity plans. While some companies preferred to wait until the next required shareholder approval of their omnibus equity plans to add limits on director equity grants and cash awards, many companies may now decide to amend their plans currently to minimize the litigation risk.

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The ***Client Update*** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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