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Meridian Client Update

Two Lawsuits Brought Over Alleged Excessive Director Compensation

Two recent lawsuits represent an emerging trend of shareholder plaintiffs raising allegations that directors' pay is excessive and that the equity plan in which they participate does not set forth meaningful limits on their compensation.

In early June 2014, a derivative action was filed in Delaware Chancery Court against executive officers and directors of Facebook, including Mark Zuckerberg, alleging that the social media company's equity plan in which its employees, executives and directors participate, allows the directors unfettered discretion to set their own compensation and that the Board awards excessive compensation to directors. Under Facebook's 2012 Equity Incentive Plan, the company may grant no more than 2.5 million shares each year to any plan participant, including Facebook's non-employee directors. This limit means that the Board could annually award each director 2.5 million shares of Facebook stock, the value of which would vary based on share price (based on Facebook's August 7, 2014 closing share price of $73.17, such an award would have a value of $182,925,000). Although the Board has never awarded equity grants to non-employee directors of such magnitude, the complaint alleges that the average of $461,000 paid per non-employee director in 2014 was excessive relative to Facebook's peers noting that it was 43% (or $140,000) higher than the average director pay awarded by companies in Facebook's peer group. The lawsuit alleges breaches of fiduciary duty, waste of corporate assets and unjust enrichment.

In a similar case, C*ambridge Retirement System v. Slavko James Joseph Bosnjak, et al. and Unilife Corp.*, the plaintiff challenged two components of compensation awarded to Unilife Corp. non-employee directors: (1) equity awards the directors granted to themselves which were approved by shareholders, and (2) cash compensation the directors paid to themselves without obtaining shareholder approval. The plaintiff alleged that the amounts awarded to directors in cash and equity were excessive compared to Unilife's revenue and to similarly sized companies in its sector and, therefore, constituted corporate waste. Plaintiffs further alleged that the directors' approval of such compensation constituted a breach of their fiduciary duty to shareholders. The Court granted the defendants' motion to dismiss with respect to the breach of fiduciary duty claim on the equity component of compensation as such awards were approved by shareholders and therefore protected by the business judgment rule. The Court also dismissed the corporate waste claim on the basis that the complaint failed to sufficiently allege that the pay was so one-sided to be unfair. However, the Court did not dismiss the fiduciary duty claim related to the cash compensation, partially due to an ambiguity in Unilife's proxy disclosure on director pay.

Meridian Comment: As in *Seinfeld v. Slager* (discussed in Meridian's Client Update dated September 4, 2012), the *Facebook* and C*ambridge* cases have not been decided on their merits. As with executive compensation, we believe it is highly unlikely that a court would find compensation paid to a director excessive and therefore the decision to approve such compensation is not protected by the business judgment rule. However, companies amending an existing equity plan or adopting a new one in which directors are eligible participants should consider whether it would be prudent to set forth meaningful annual award limits on director compensation, separate from those that apply to executives.

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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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