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Chancery Reaffirms Entire Fairness Standard to Directors Awarding Compensation

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In *Stein v. Blankfein*, No. 0354, 2017 (Del. Ch. May 31, 2019), the Delaware Court of Chancery reaffirmed that directors' self-interested decisions regarding their own compensation are subject to review under the entire fairness standard. The entire fairness standard requires directors to demonstrate that both the amount of compensation and the process by which the compensation is determined is "entirely fair" to the company.

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The complaint in *Stein* focuses on director compensation at Goldman Sachs via stock incentive plans, or SIPs. SIPs must be approved by a company's stockholders under the rules of the New York Stock Exchange. The vast majority of compensation received by Goldman's directors is paid pursuant to the company's SIPs, at the board's discretion.

The plaintiff, a Goldman Sachs common stockholder, alleges, among other things, that members of Goldman's board breached their fiduciary duty of loyalty by awarding themselves excessive compensation. Specifically, it is alleged that Goldman's board members set their compensation at almost double that of the company's peers, resulting in Goldman's nonemployee directors averaging about $605,000 in annual compensation between 2014 and 2016. By contrast, nonemployee directors at four U.S. peer companies identified by Goldman in its annual meeting proxy statements received an average of approximately $352,000. This was despite the fact that nonemployee Goldman directors attended fewer board and committee meetings than its peers in both 2015 and 2016 and despite the facts that Goldman's revenues, earnings, and assets were no greater than these four peers.

The defendants—Goldman Sachs and its directors—moved to dismiss Stein's complaint for failure to state a claim under Court of Chancery Rule 12(b)(6), arguing that the deferential business judgment rule should apply because the terms of the SIPs required the court to use a different standard than "entire fairness" to judge the board's self-interested compensation decisions, and the SIPs were approved by the company's stockholders who were adequately informed when they approved the SIPs and the standard stated in the SIPs.

The Goldman SIPs at issue provided that "no member of the board … shall have any liability to any person … for any action taken or omitted to be taken or any determination made in good faith with respect to the [SIPs] or any award." The defendants argued that, because of this language, any action taken by the Goldman board under the SIPs was reviewable only under a good-faith standard, saddling the plaintiff with the burden of demonstrating that the director compensation decisions were made in bad faith. The defendants also argued that they exercised good-faith judgment in setting their own compensation and that, even though the compensation was higher than that of their peer companies, it was warranted because they are directors of Goldman Sachs—a well-regarded investment bank. The Chancery Court rejected these arguments.

The court began its analysis of the Goldman SIPs with Section 141(h) of the Delaware General Corporation Law, which gives a corporation's board the power to set director compensation. The court noted that existing Delaware jurisprudence states that directors' self-interested decisions on their own compensation are inherently likely to be based on conflicted motives and therefore disloyal. Thus, such decisions are typically subject to review under the "entire fairness" standard, and directors have the burden to show both fair price and fair process.

In this case, the court found that the entire fairness standard applied to the facts of this case despite the language in the SIPs because the compensation decisions at issue were self-interested and therefore conflicted. The court emphasized that fiduciary limits on director behavior are a bedrock of Delaware corporate law, allowing stockholders of corporations to invest in companies secure in the knowledge that corporate decision makers are bound by fiduciary duties and not just limited by bad faith. As such, the court refused to allow stockholders to sign away or limit such fiduciary duties by approving language in the SIPs that theoretically would have imported lesser standards for directors than those imposed by settled Delaware law.

The court relied on a December 2017 opinion by the Delaware Supreme Court—*In re Investors Bancorp Stockholder Litigation*. In Investors Bancorp, the Supreme Court found that even though the stockholders had approved the equity incentive plan, entire fairness was the applicable standard of review because the directors were later able to determine their own compensation under the plan. Because Goldman's SIPs did not set a limit on nonemployee director compensation and gave directors the discretion to set that compensation, stockholders could not be considered to have approved the specifics of the compensation that the directors thereafter awarded themselves under the plans. Thus, in Goldman Sachs, as in the Investors Bancorp case, the stockholders did not "know precisely what they [were] approving." Moving forward, under the entire fairness standard of review, the burden now shifts to defendants to rebut the plaintiff's allegations. In other words, defendants must prove the fairness of the stock-compensation awards and the fairness of the process by which they were granted.

This decision is a helpful reminder that, in Delaware, investors have the right to "know precisely" what compensation they are approving for directors of public companies and that Delaware courts remain vigilant when considering claims that a company's directors have made self-interested decisions on director compensation.