

# Attempt to Limit Directors' Liability for Setting Their Own Compensation is Rejected

## WRITTEN BY

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A recent Delaware Court of Chancery decision<sup>[1]</sup> on a challenge to Goldman Sachs directors' setting their own compensation is interesting because the court rejected the company's attempt to make an end run around current law. The stockholder-approved compensation plan included a novel provision limiting the directors' liability if they acted "in good faith." The Court found that, even if there could be a stockholder waiver of fiduciary duty (of which it was "dubious"), the stockholder approval in this case was not sufficiently specific to support a waiver. Accordingly, the entire fairness standard applied to reviewing the "directors' actions in awarding their own compensation."

The Chancery Court denied the defendant directors' motion to dismiss and allowed the lawsuit to proceed under the criteria articulated by the Delaware Supreme Court for reviewing breach of fiduciary claims based on directors' approval of their own compensation?:

- the award of compensation by directors to themselves is a self-interested transaction that is tested against the "entire fairness" standard; and
- the pleadings had established a sufficient inference that the directors breached their fiduciary duties in making unfair and excessive discretionary awards to themselves.<sup>[2]</sup>

As long as directors have discretion to set their own compensation, even within limits, the first criterion will apply, so the case cannot be dismissed under the "business judgment rule." <sup>[3]</sup> The directors argued, however, that the plaintiff's failure to allege bad faith justified dismissal of the action on the basis of the exculpatory provision. As noted above, the Court rejected this argument.

We have long understood that the fiduciary duties of directors of a Delaware corporation (as distinct from a limited liability company or partnership, which are governed by contract) cannot be modified by private ordering. The Chancery Court here supported that view, stating that "stockholder approval of the [exculpatory provision] does not set a standard for [reviewing] director self-dealing at anything less than the entire fairness standard?"

The bottom line for corporate boards setting their own compensation is that they must establish a thorough process and follow it conscientiously if they want to reduce the chance of successful stockholder suits. We [outlined](#) the recommended process at the time high profile litigation over director compensation came on the scene, and our views have not changed.

We continue to believe that courts are not eager to get into the business of evaluating director compensation and will set the bar high for stockholders challenging the fairness of director compensation in all but the most

egregious situations. We do not expect, however, that the Delaware courts will sanction limiting fiduciary duties through exculpation provisions. Rather, it is a corporation's job to ensure that its director compensation process and criteria are both procedurally and substantively reasonable and fair so that it can discourage and counter stockholder challenges.

[1] *Stein v. Blankfein*, C.A. No. 2017-0354-SG (Del. Ch. May 31, 2019)

[2] See *In re Investors Bancorp, Inc. Stockholder Litigation*, 177 A.3d 1208 (Del. 2017)

[3] Of course, stockholder approval of the compensatory awards themselves, or of a formula that set the amount of awards, *would* constitute ratification that would justify dismissing the complaint.

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