

Compensation and Benefits Insights

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OUTSIDE DIRECTOR COMPENSATION LITIGATION – *IN RE INVESTORS BANCORP*

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At the end of 2017, the Delaware Supreme Court issued an opinion with significant implications for stockholder lawsuits that challenge the compensation of non-employee directors of public companies. In *In re Investors Bancorp, Inc. Stockholder Litigation*, the Court held that a commonly used affirmative defense to such lawsuits—stockholder ratification of the directors’ compensation plan—is unavailable where the plan allows directors discretion to set their own compensation awards. Under such circumstances, the defendant directors cannot rely on the business judgment rule, but rather must show that their compensation decisions are entirely fair to the company. This article provides a brief summary of *Investors Bancorp* and analyzes the important implications this decision has for company boards.

Background – Director Compensation Litigation and the Stockholder Ratification Defense

A stockholder may bring a derivative suit on behalf of a corporation when the stockholder believes the corporation has a valid legal claim—for example, against its board of directors—but has failed to take action. One such potential claim is that the corporation’s board of directors has granted themselves excessive compensation, thereby committing waste and breaching fiduciary duties owed to the company. The compensation most often at issue in these cases involves grants of equity compensation, such as stock options or restricted stock units. These grants are typically made pursuant to equity plans that are pre-approved by the company’s stockholders.

Our Practice

We advise public, private, taxable and tax-exempt clients on a wide variety of issues related to the design, preparation, communication, administration, operation, merger, split-up, amendment and termination of all forms of employee benefit plans and executive compensation programs and related funding vehicles. The firm has defended clients in significant high-profile ERISA litigation matters, including 401(k) plan “stock drop” cases and other breach-of-fiduciary-duty class actions.

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Prior to 2012, the Delaware Court of Chancery generally dismissed stockholder derivative lawsuits that challenged director compensation. The Court of Chancery held that when a majority of disinterested stockholders approved an equity compensation plan—that is, ratified the plan—decisions made by directors in accordance with the plan were subject to the deferential business judgment rule. That standard entitled directors to a presumption that they acted in good faith and in the best interest of the company, with the burden on the plaintiff to prove otherwise. Under the business judgment rule, a board’s grant of equity compensation to its members was not self-dealing as long as the grants were made consistent with the terms of a shareholder-approved equity compensation plan and did not constitute waste.

The use of stockholder ratification and the business judgment rule is uncontroversial where a compensation plan approves *specific* director equity awards, or a formula used to calculate such awards. However, in 2012, the Court of Chancery addressed compensation plans that gave directors *discretion* to set their own awards, often within a certain range. The Court of Chancery concluded that, so long as the compensation plan placed “meaningful limits” on the directors’ discretion, stockholder ratification and the business judgment rule still applied. But if the compensation plan lacked such limits, then the presumption that the directors acted in good faith and in the best interest of the company would not apply. The directors would thus be subject to an entire fairness standard, under which they have the burden of proving that the awarded compensation is inherently fair to stockholders.

***In re Investors Bancorp* – Delaware Supreme Court Holds Stockholder Ratification Does Not Apply When a Plan Gives Directors Discretion to Set Their Own Compensation**

The issue of whether the stockholder ratification defense applies to compensation plans that reserved discretion to directors reached the Delaware Supreme Court in *Investors Bancorp*. In contrast to the Court of Chancery, which had held the defense could still apply so long as a plan contained “meaningful limits” on directors’ discretion, the Supreme Court held that the ratification defense does *not* apply to claims that directors inequitably exercised the discretion afforded to them under an equity compensation plan.

Investors Bancorp was a stockholder derivative suit brought against the board of directors of Investors Bancorp, Inc., a holding company for Investors Bank, a New Jersey chartered savings bank. In 2014, Investors Bancorp became a publicly traded company through a mutual-to-stock conversion. In connection with that conversion, Investors Bancorp’s board adopted an equity incentive plan (“EIP”). The EIP reserved 30,881,296 common shares of Investors Bancorp stock for awards, including both options and full-value awards such as restricted stock. The Company’s 1,800 employees, officers, directors, and service providers were eligible to receive awards under the EIP. The number of shares that could be granted to non-employee directors was limited to thirty percent of the shares authorized under the EIP, but the precise amount of the awards remained subject to the discretion of the board’s compensation committee. The EIP was described in the company’s proxy statement, and was approved by over 96% of voting shares.

Three days after stockholders approved the EIP, the board began a series of meetings to approve awards of restricted stock and stock options. The board met with both outside legal counsel and a compensation consultant, who presented data on director compensation for other companies that had completed mutual-to-stock conversions. Following four meetings, the board awarded each non-employee director stock options valued at \$780,000 and restricted shares valued at \$1,254,000. The non-employee directors’ equity awards for 2015 averaged \$2,159,400—over twelve times the peer company average of \$175,817.

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Following disclosure of the awards, stockholders filed three separate complaints in the Court of Chancery alleging breaches of fiduciary duty, which were consolidated into a single action. The defendant directors moved to dismiss for failure to state a claim, and the Court of Chancery granted the directors' motion. The Court of Chancery found that the plan contained meaningful, specific limits on director awards, thus subjecting the board's compensation decisions to the business judgment rule.

The Delaware Supreme Court reversed and remanded. After reviewing previous decisions on the stockholder ratification defense, the Court concluded that the defense "cannot be used to foreclose the Court of Chancery from reviewing" discretionary director actions taken pursuant to a compensation plan. The Court explained that while a discretionary plan may *legally* authorize directors to determine the level of equity awards, those determinations are still subject to principles of equity. Since the directors' compensation decisions were inherently conflicted, the entire fairness standard applied, and the directors had to demonstrate that their self-interested actions were entirely fair to the company.

The Court found that the plaintiffs had alleged facts supporting a reasonable inference that the directors breached their fiduciary duties in making unfair and excessive discretionary awards to themselves after stockholder approval of the EIP. Among other things, plaintiffs alleged that the board used the EIP to reward past efforts for the mutual-to-stock conversion, despite telling shareholders the EIP would reward future performance. Moreover, plaintiffs alleged that the awards to the non-employee directors were multitudes higher than director pay at similarly sized and even larger companies, including at every Wall Street firm. Because the stockholders did not ratify the specific awards under the EIP, the Court held that the affirmative defense of ratification did not apply and refused to dismiss the complaint.

Investor Bancorp's Implications for Director Compensation Plans

Investors Bancorp represents a significant restriction of the stockholder ratification defense in director compensation litigation. Companies can no longer assume that a director compensation case will be dismissed just because the awards were made pursuant to a shareholder-approved plan that included "meaningful" director award limits. The Delaware Supreme Court has made clear that such decisions are subject to an entire fairness standard, regardless of any "meaningful" director award limits contained in the plan. This is a much more difficult standard to meet, and increases the likelihood that a stockholder derivative complaint challenging director compensation will survive a motion to dismiss.

In the wake of *Investors Bancorp*, boards can do a few things to help minimize litigation exposure:

- Use peer-company comparisons to help benchmark the appropriate level of director compensation, and engage independent compensation consultants to advise on market levels and best practices.
- Document and disclose the process for setting director compensation, along with the rationale regarding the award levels.
- Consider whether to change the equity plan to provide either a specific award level or a predetermined formula for determining awards. As part of this process, companies will need to balance the risk of litigation against the loss of flexibility to adjust awards levels to reflect changes in the market, as well as consider the timing of such change (i.e., seek stockholder approval now, or wait until the plan needs new shares).

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King & Spalding LLP would be delighted to assist you with any questions that may arise in connection with director compensation.

February and March 2018 Filing and Notice Deadlines for Qualified Retirement and Health and Welfare Plans

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Employers and plan sponsors must comply with numerous filing and notice deadlines for their retirement and health and welfare plans. Failure to comply with these deadlines can result in costly penalties. To avoid such penalties, employers should remain informed with respect to the filing and notice deadlines associated with their plans.

The filing and notice deadline table below provides key filing and notice deadlines common to calendar year plans for the next two months. If the due date falls on a Saturday, Sunday, or legal holiday, the due date is generally delayed until the next business day. Please note that the deadlines will generally be different if your plan year is not the calendar year. Please also note that the table is not a complete list of all applicable filing and notice deadlines (including any available exceptions and/or extensions), just the most common ones. King & Spalding is happy to assist you with any questions you may have regarding compliance with the filing and notice requirements for your employee benefit plans.

Deadline	Item	Action	Affected Plans
February 14 (within 45 days after the close of the fourth quarter of previous plan year)	Quarterly Fee Disclosure	Deadline for plan administrator to disclose fees and administrative expenses deducted from participant accounts during the fourth quarter of the previous plan year. Note that the quarterly fee disclosure may be included in the quarterly benefit statement or as a stand-alone document.	Defined Contribution Plans that allow participants to direct investments
	Benefit Statements for Participant- Directed Plans	Deadline for plan administrator to send fourth quarter benefit statement for previous plan year to participants in participant-directed defined contribution plans.	

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Deadline	Item	Action	Affected Plans
February 28 (if filing paper forms)	IRS Form 1099-R	Deadline for employer to file IRS Form 1099-R. If the form is filed electronically, the deadline can be extended until March 31.	Qualified Retirement Plans*
	IRS Form 1094-B Transmittal Forms	Deadline for providers of minimum essential coverage to transmit forms to IRS reporting the months during the year that individuals enrolled in the group health plan satisfied the individual mandate by enrolling in minimum essential coverage. If the form is filed electronically, the deadline can be extended until March 31.	Self-Insured Group Health Plans and Group Health Plan Insurers
	IRS Form 1094-C Transmittal Forms	Deadline for plan sponsors that employed an average of at least 50 full-time employees in 2017 (also known as “Applicable Large Employers” or “ALEs”) to transmit forms to IRS reporting whether the ALEs offered an opportunity to enroll in (and whether employees did enroll in) minimum essential coverage under the ALE’s sponsored plan. If the form is filed electronically, the deadline can be extended until March 31.	Applicable Large Employers

* Qualified Retirement Plans include all defined benefit and defined contribution plans that are intended to satisfy Internal Revenue Code §401(a).

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Deadline	Item	Action	Affected Plans
March 1 (60 days after the beginning of the plan year)	Medicare Part D Creditable Coverage Disclosure	Deadline for employers that provide prescription drug coverage to Medicare Part D eligible individuals to disclose to the Centers for Medicaid and Medicare Services (CMS) whether the coverage is “creditable prescription drug coverage” by completing the Online Disclosure to CMS Form at https://www.cms.gov/Medicare/Prescription-Drug-Coverage/CreditableCoverage/CCDisclosureForm.html	Health and Welfare Plans that provide prescription drug coverage to Medicare Part D eligible individuals
March 2	IRS Form 1095-B Individual Statements	Deadline for providers of minimum essential coverage to distribute forms used to report to responsible individuals the months during the year that the individuals satisfied the individual mandate by enrolling in minimum essential coverage. This deadline was extended from its original deadline of January 31. Note that self-insured ALEs can report this information on Form 1095-C. Fully insured plan sponsors that are not ALEs are not required to distribute Form 1095-B, which are distributed by the group health plan insurers.	Self-Insured Group Health Plans and Group Health Plan Insurers
	IRS Form 1095-C Individual Statements	Deadline for ALEs to report to provide a written statement to employees indicating whether the ALEs offered an opportunity to enroll in (and whether the employee did enroll in) minimum essential coverage under the ALE’s sponsored plan. This deadline was extended from its original deadline of January 31.	Applicable Large Employers

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Deadline	Item	Action	Affected Plans
March 15	Plan Contribution Deadline	Deadline for corporate employer contributions to be made to plan trusts in order for such amounts to be deductible on corporate tax returns (assuming the employer is operating on a calendar-year fiscal year). Note that this deadline may be extended if an extension is obtained for the corporate tax return.	Qualified Retirement Plans
March 15 (2 ½ months after the plan year)	Excess Contributions	Deadline for plan administrator to distribute any excess contributions and earnings from the prior year to avoid 10% excise tax on employer (other than eligible automatic contribution arrangements (EACAs)).	401(k) Plans Other Than EACAs
March 31 (last day of 3rd month following the end of the prior plan year)	Certification of Adjusted Funding Target Attainment Percentage (AFTAP)	Deadline for actuary to certify AFTAP to avoid presumption that AFTAP is 10 points less than prior year AFTAP.	Defined Benefit Plans
March 31 (if filing electronically)	IRS Form 1094-B Transmittal Forms	Deadline for providers of minimum essential coverage to transmit forms to IRS reporting the months during the year that individuals enrolled in the group health plan satisfied the individual mandate by enrolling in minimum essential coverage.	Self-Insured Group Health Plans and Group Health Plan Insurers
	IRS Form 1094-C Transmittal Forms	Deadline for ALEs to transmit forms to IRS reporting whether the ALEs offered an opportunity to enroll in (and whether employees did enroll in) minimum essential coverage under the ALE's sponsored plan.	Applicable Large Employers