Chancery Dismisses Stockholder Suit Over Expedia CEO Award

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In *Friedman v. Khosrowshahi*, C.A. No. 9161-CB (Del. Ch. July 16, 2014), the Court of Chancery dismissed the plaintiff's claims challenging the decision by the compensation committee of Expedia Inc. to accelerate the vesting of a restricted stock unit award. Following the well-trodden path in this "seemingly increasing area of litigation," the plaintiff claimed that, under *Sanders v. Wang*, C.A. No. 16640-VCS (Del. Ch. Nov. 10, 1999), and its progeny, the compensation committee violated the unambiguous terms of the corporation's stock plan such that demand was excused under the second prong of *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). In dismissing the claim, the court essentially limited the application of *Sanders* to situations where plaintiffs have alleged with particularity "a clear or intentional violation of a compensation plan." Nevertheless, the opinion serves as a reminder that stockholders are increasingly scrutinizing actions taken under equity award plans, and that boards of directors and board committees should review the terms of the plans before making awards or adjusting the terms of existing awards.

In *Friedman*, the compensation committee, pursuant to a stockholder-approved compensation plan, granted the corporation's chief executive officer a restricted stock unit award satisfying the requirements of Section 162(m) of the Internal Revenue Code of 1986 (the RSU award). In addition to requiring that the committee, as plan administrator, impose specified conditions on certain types of awards, including the RSU award, the plan also granted the committee the authority to (1) impose additional conditions on awards as it deemed appropriate, and (2) unilaterally amend the terms of an award (provided that, prior to the plan's amendment in 2013, the committee did not have the authority to amend an award in a manner that would cause it to cease to qualify for the exemption from the limitation of deductibility imposed by Section 162(m)).

As granted, the RSU award satisfied the requirements of Section 162(m) by providing that the RSUs would vest upon the achievement of one or more performance goals identified in the RSU award. The committee also conditioned the vesting of the RSU award on the achievement of the "OIBA target," which was separately defined in the RSU award. The description of the conditions for the vesting of the RSUs set forth in the corporation's public filings distinguished between the performance goal and OIBA target conditions.

Years later, the committee, at management's recommendation, approved the acceleration and vesting of the RSU award even though the OIBA target had not been met. In a subsequent public filing, the corporation characterized the RSU award as having been subject to the achievement of a "business goal" that had not been achieved (i.e., the OIBA target), and "separately subject to the satisfaction of" the performance goals that had been achieved and were designed to satisfy the requirements of Section 162(m).

The plaintiff, Julie Friedman, commenced a derivative action claiming that, among other things, the director-defendants breached their fiduciary duty of loyalty by accelerating the vesting of the RSU award in violation of the plan because the OIBA target had not been met. Friedman further asserted that under *Sanders* and its progeny, the acceleration of the vesting of the RSU award was a clear violation of the terms of the plan that could not have been a valid exercise of business judgment such that demand was excused under the second prong of *Aronson*.

In concluding that demand was not excused, the court first considered the parties' competing interpretations of the RSU award. The critical question, according to the court, was whether the committee, when it granted the RSU award, intended to use the OIBA target as a condition to satisfy the requirements of Section 162(m) or whether the OIBA target was merely an additional condition that the committee was authorized to impose (and subsequently waive) under the plan. Noting that the achievement of either one of the performance goals would have been sufficient to satisfy the requirements of Section 162(m), the court highlighted the fact that the performance goals and OIBA target were separately defined terms in the RSU award and that the corporation's public disclosures in respect of the RSU awards had similarly distinguished between the two vesting conditions. Accordingly, the court found that, at best, the terms of the RSU award were merely ambiguous and that, in any event, the committee's decision to accelerate the vesting of the RSU award was not a "knowing" violation of the plan. Moreover, under the provisions of the plan giving the committee interpretive authority over the plan and the awards granted thereunder, the court noted that the committee had the authority to conclude that the OIBA target was not a condition imposed to satisfy the requirements of Section 162(m) and, as such, could be waived. Additionally, although not critical to its holding, the court questioned what damages, if any, the corporation had sustained. Despite allegations in the complaint that the corporation "has been and will be damaged," the court pointed out that the complaint failed to allege that the corporation had "ever lost the ability to take a tax deduction concerning the RSU award."

The court's decision in *Friedman* provides additional guidance on the types of plan-violation claims that are unlikely to give rise to demand excusal. Nevertheless, boards of directors and board committees should be mindful of the terms of applicable equity award plans when making or amending awards.

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