

Delaware Court Emphasizes Importance of Corporate Formalities in Facebook Director Compensation Case

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The litigation against Facebook for their director compensation raised a question of first impression: whether a disinterested controlling stockholder can ratify a transaction approved by an interested board of directors by expressing assent informally, instead of using one of the prescribed methods under Delaware corporate law, and be able to shift the standard of review from entire fairness to the business judgment presumption.

The board's decision to approve the compensation of outside directors in 2013 was governed by the entire fairness review as a self-dealing transaction. After the filing of the lawsuit, which we previously discussed [here](#) and [here](#), Mark Zuckerberg, who controlled over 61% of the voting power, approved the compensation in a deposition and with an affidavit. The company argued that these actions were enough to ratify the compensation and thereby shift the standard of review to the business judgment presumption.

The Court of Chancery of the State of Delaware disagreed. Stockholder ratification of a self-dealing transaction must be accomplished formally by a vote at a stockholder meeting or by written consent. In denying the company's motion for summary judgment, the court concluded that even a single controlling shareholder cannot ratify an interested board's decision without adhering to the corporate formalities spelled out in Delaware corporate law.

A decision by interested directors about their own compensation will be reviewed as a self-dealing transaction under the entire fairness standard, but can gain the protection of the business judgment rule if a fully informed disinterested majority of stockholders ratifies the transaction. Under Section 228 of the DGCL, unless the charter otherwise restricts, any action that may be taken at any annual or special meeting of stockholders may be taken by majority stockholder consent without a meeting, notice or a vote. However, notice of the written consent (the taking of the action) must be provided to non-consenting stockholders to ensure some level of transparency.

Due to the potential for abuse, Delaware courts have traditionally adhered strictly to the technical requirements that signify stockholder approval. This court noted that if affidavits are considered sufficient as ratification, that could eventually lead to "Liking" a Facebook post of a proposed corporate action as being enough to express approval.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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