



## ***Espinoza v. Zuckerberg* – Ratification of Compensation Decision By Controlling Stockholder**

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On November 30, 2015, the Delaware Supreme Court accepted interlocutory appeal of *Espinoza v. Zuckerberg*, C.A. No. 9745-CB, 2015 Del. Ch. LEXIS 273 (Del. Ch. Oct. 28, 2015), in which the Delaware Court of Chancery resolved an issue of first impression, holding that a controlling stockholder's informal expression of assent was insufficient to ratify a board action so as to shift the standard of review from entire fairness to the business judgment rule.

*Espinoza v. Zuckerberg* involved derivative claims challenging the Facebook board's 2013 approval of compensation to its outside directors. Given that a majority of the board were outside directors and were therefore conflicted regarding the compensation decision, the parties agreed that the entire-fairness standard would apply to the decision unless the defendants could successfully demonstrate that stockholder ratification entitled to the board to the presumption of the business judgment rule. The defendants, including Facebook's controlling stockholder and board chairman, Mark Zuckerberg, argued such ratification had occurred because Zuckerberg (in his capacity as Facebook's controlling stockholder) expressed his approval of the decision through his deposition and in an affidavit. The plaintiff countered that Zuckerberg's informal expressions of assent were insufficient to constitute stockholder ratification under Delaware law, and that to have a standard-shifting impact, ratification must be accomplished pursuant to Section 228 of the Delaware General Corporation Law (the "DGCL") by a stockholder vote at a meeting or by written stockholder consent.

On the defendants' motion for summary judgment, the court ruled in favor of the plaintiff, concluding that a controlling stockholder may effect standard-shifting

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Attorneys within our Corporate Counseling and Litigation practice group have extensive experience in guiding our clients through takeover battles and dissident stockholder situations. Our attorneys also have extensive experience in the prosecution and defense of litigation involving contests for corporate control, going private transactions, valuation disputes, director and officer indemnification and advancement, alternative entity (i.e., partnerships, limited partnerships, and limited liability companies) issues, and every other manner of corporate and alternative entity dispute in the Delaware courts. Some of the higher profile matters in which our attorneys have played an active role include those that produced the landmark *Burton*

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Young Conaway Stargatt & Taylor, LLP, one of Delaware's largest law firms, counsels and represents national, international and local clients, handling sophisticated advisory and litigation matters involving bankruptcy, corporate law and intellectual property. Nearing its sixth decade, Young Conaway also guides regional businesses and individuals through a myriad of employment, real estate, tax, estate planning, environmental, and banking issues from the firm's offices in downtown Wilmington, DE.

ratification only through formal stockholder action at a meeting or by written consent, and thus that the entire-fairness standard would be applied to the 2013 compensation decision. Among other grounds for its ruling, the court cited policy goals that would be advanced by a rule requiring ratification to comply with the “formal mechanisms” set forth in the DGCL. Specifically, the court noted that requiring adherence to corporate formalities would promote transparency, enable minority stockholders to stay abreast of decision making, and limit the potential for ambiguity and misinterpretation of an act by which ratification is later claimed to have been accomplished.

The court also observed that the presence of a single controlling stockholder in Facebook's case did not change the analysis. Even though Zuckerberg “can outvote all other stockholders and thus has the power to effect any stockholder action he chooses,” the court explained, “he still must adhere to corporate formalities (and his fiduciary obligations) when doing so, because his rights as a stockholder are no greater than the rights of any other stockholder—he simply holds more voting power.”

*Espinoza v. Zuckerberg* is the second 2015 decision addressing whether particular stockholder conduct accomplishes ratification so as to shift the standard of review applicable to director-compensation decisions. In *Calma v. Templeton*, 114 A.3d 563 (Del. Ch. 2015), the director defendants argued that stockholder approval of the compensation plan pursuant to which the challenged decisions were made constituted ratification sufficient to shift the standard of review. The court disagreed, concluding that “in obtaining omnibus approval of a Plan covering multiple and varied classes of beneficiaries, the Company did not seek or obtain stockholder approval of any action *bearing specifically on the magnitude of compensation to be paid to its non-employee directors.*” 114 A.3d at 569 (emphasis original). In reaching this conclusion, the court contrasted the plan at issue in *Calma* with plans that placed meaningful limits on director compensation, and emphasized that a stockholder vote must approve the “specific decision of the board of directors” under scrutiny to have a standard-shifting effect. *Id.* at 586.

*Espinoza* and *Calma* thus serve as a reminder that, although controlling stockholders have the ability to exercise their control and unilaterally ratify certain board actions, courts will hold them to the formalities of Delaware law in doing so—including the requirements that the stockholder approval be specific to the act taken and be done by way of a formal stockholder vote at a meeting or a written stockholder consent—if the controllers' ratifying actions are to shift the applicable standard of review.

A copy of the full decisions in *Espinoza* and *Calma* are available [here](#). The plaintiffs in both cases were represented by Young Conaway. The views expressed in this article do not reflect the views of the firm or its clients.