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# Delaware Court Rejects Entire Fairness Standard in Cablevision Compensation Fight

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Vice Chancellor John W. Noble, of the Delaware Chancery Court, last month refused a shareholder's attempt to second guess Cablevision's independent compensation committee's decision to award the company's founder and executive chairman Charles Dolan and his son James Dolan, the company's CEO, over $40 million in compensation each between 2010 and 2012. In doing so, the court rejected the entire fairness standard as the default for executive compensation decisions for family controlled companies. Some background on Cablevision is required for context. The company was founded in 1973 and is the fifth largest cable television provider in the country. Among other things, through a subsidiary, Cablevision owned Madison Square Garden, the New York Knicks, and the New York Rangers, before the subsidiary was spun off into its own company, The Madison Square Garden Company. Charles Dolan has served as Cablevision's executive chairman since 1985, and James Dolan has been CEO since 1995. Between 2010 and 2012, Cablevision's compensation committee consisted of three directors. The first, a director as of 1996 and a compensation committee member as of 2004, simultaneously served as a director for Madison Square Garden, where the director's brother also worked, but was otherwise retired. The second, on the board since 2002 and the compensation committee since 2007, was also retired. The third was also a director as of 2002 and on the

compensation committee as of 2009. The opinion reported that "[a] majority of Class A votes cast in [Cablevision's] 2010 and 2012 elections withheld support for the Compensation Committee" directors. Notwithstanding, because the Dolan family held a majority of Cablevision's voting power through its Class B shares, the compensation committee directors continued to serve on the board and on the committee. In setting compensation for 2010 through 2012, James "assist[ed] the Compensation Committee and its compensation consultant in determining the Company's core peer group and the peer group comparisons." More than half of the peer group companies had market capitalizations of more than double Cablevision's market cap. And Charles's compensation was guided by the compensation committee's conclusion "that as a result of Charles's important role," he should earn just less than his son, the company's CEO. Based on the resulting compensation – $41.18 million for James and $40.27 for Charles – and a one-sided severance provision in favor of James included in an amended employment agreement in early 2013, a shareholder initiated a derivative action, asserting breach of fiduciary duty and waste claims against Charles and James Dolan and the compensation committee. (Although not addressed in this article, the complaint also included a claim for breach of fiduciary duty against Charles's three daughters, all non-employee directors, for causing the company to award and accepting hundreds of thousands of dollars in director compensation while allegedly being unqualified to serve on the board and failing to adequately perform as board members.) The executives moved to dismiss the complaint pursuant to Rule 12(b)(6), arguing, among other things, that the business judgment rule applied and that the complaint failed to allege either a lack of independence or bad faith necessary to overcome that presumption. The shareholder argued that the entire fairness standard should apply to the compensation decisions "because a controller (namely the Dolan family) was on both sides of the transactions." Under the entire fairness standard, the burden shifts to the director or officer to show that, for a given transaction, both the price and the process to produce that price were fair – an exacting standard when contrasted with the more lenient business judgment rule. The court rejected the shareholder's view. In turn, the court emphasized "the significance of an independent committee" under Delaware law, reasoning that the rationales typically supporting a court defaulting to an entire fairness review – informational advantage and coercion – were not alleged to be present. Accordingly, the court defaulted to the business judgment rule, refusing to conclude that "every controlled company, regardless of use of an independent committee, must demonstrate the entire fairness of its executive compensation in court whenever questioned by a shareholder." The shareholder further challenged the compensation committee members' independence based on their "long term board service, service at other Dolan controlled entities, age, retirement status, a sibling's employment, continued self-nomination with board approval, and the fact of the challenged awards." The court found that, in and of themselves, none of the challenges established a lack of independence, and that the shareholder failed to "provide a basis to find that these alleged conflicts are material such that they would prevail over the directors' business judgment." Specifically, Cablevision shareholders were on notice of the procedure for electing directors, and the complaint did not allege that the compensation committee members "had infirmities or were dependent on their compensation." The court also questioned why a director's sibling's employment at Madison

Square Garden would undercut that director's independence. It concluded that the shareholder ultimately did not "make a reasonably conceivable case that the directors wanted to remain on the board so much that they sacrificed their professional integrity." The court also found that the shareholder's allegations similarly could not support a finding of bad faith. The court recognized that the committee had retained a compensation consultant and evaluated peer company executives' compensation. The court discounted that some of the peer companies used were less similar to Cablevision than were others, ruling that the compensation committee did not demonstrate an "utter failure to fulfill responsibilities" needed to establish bad faith in the absence of a violation of the law. The court concluded that it was "poorly equipped to determine how much the services of an executive are worth," and in light of the shareholder's failure to rebut the business judgment rule, the court did not have to make such a determination. And the court reached this holding despite finding it "hard to look at the facts of this case without going away troubled." This case highlights the importance for public companies – particularly those that are family controlled – to maintain an independent compensation committee that takes reasonable steps to determine executive compensation. It is also another reminder that a company's process that determines executive compensation is often more important than its ultimate amount. *Friedman v. Dolan*, No. 9425-VCN (Del. Ch. June 30, 2015)

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