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Victory for Board of Directors in Executive Pay Lawsuit

Plaintiffs' lawyers have recently attempted to convert a negative shareholder advisory "say on pay" vote under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) into a breach of fiduciary duty where the board of directors implements a compensation program and awards thereunder. A U.S. district court in Oregon has rejected such a claim on procedural grounds, applying Delaware corporate law in affirming the business judgment presumption for the directors' vote. Plumbers Local No. 137 Pension Fund v. Davis.

While the "say on pay" rules issued by the Securities and Exchange Commission are mandated by Dodd-Frank, it is those SEC rules that require companies to have such a vote. More importantly, the vote is on ALL executive compensation and its elements, not any specific aspect thereof.

The company in question, Umpqua Holdings Corp., indicated in its corporate proxy statement that its executives had met their independent and collective goals for 2010 and were rewarded with incentive pay. The board approved the compensation program and awards thereunder and then submitted the program and awards to shareholders for an advisory vote under Dodd-Frank. A majority of the shareholders rejected the entire package – not any specific aspect thereof.

Thereafter, the board notified shareholders that it would endeavor to more closely link executive pay to stock price and dividend performance, but maintained the incentive award.

A shareholder derivative suit followed. The defendants moved to dismiss on the grounds that no pre-lawsuit demand was made, as is normally required for derivative suits. The court granted defendants' motion because shareholders were unable to establish that the pre-lawsuit demand was futile, as plaintiffs failed to plead facts establishing that the directors were not independent or disinterested. The court also rejected the shareholder argument that the demand be excused because the board members faced a substantial likelihood of liability. In doing so, the court rejected the holding of a similar case brought under Ohio law against Cincinnati Bell, Inc. in NECA-IBEW Pension Fund v. Cox.

The court noted that futility can be shown where reasonable doubt is created that the challenged action was otherwise the valid exercise of business judgment and rejected the argument that reasonable doubt existed merely because of the company's poor financial performance and the shareholder's disapproval of the incentive pay package. In this case, the board's actions did not violate any corporate bylaws, shareholder agreement or legally mandated reporting or disclosure requirement. Accordingly, the attempted leveraging of the advisory "say on pay" vote by shareholders was unsuccessful.

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