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Plaintiffs' Firms Gaining Steam in New Wave of Say-On-Pay Shareholder Suits?

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Over two years ago, Congress enacted Section 951 of the Dodd-Frank Act, which requires public companies to conduct an advisory shareholder vote on the company's executive compensation plan – the so-called "say-on-pay vote." Immediately after its enactment, plaintiffs' firms began filing shareholder actions against directors, executive officers, and compensation consultants of companies that failed to obtain a majority shareholder vote in favor of their plans. With a growing number of courts dismissing such suits, plaintiffs' firms have orchestrated a new strategy to hold companies liable: suits to enjoin the shareholder vote because the proxy statement fails to provide adequate disclosure concerning executive compensation proposals. Such suits have met with some success – with two court orders enjoining shareholder meetings and five settlements prior to companies' annual meetings.

The Say-on-Pay Statute

Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act on July 21, 2010 ("Dodd-Frank Act"). Section 951 of the Dodd-Frank Act amends the Securities Exchange Act of 1934 ("Exchange Act") by adding Section 14A ("Say-on-Pay Statute"), which requires public companies: (1) to conduct a separate shareholder advisory vote to approve the compensation of executives, (2) to conduct a separate shareholder advisory vote to determine how often an issuer will conduct a shareholder advisory vote on executive compensation, and (3) when soliciting votes to approve merger or acquisition transactions, to provide disclosure of certain golden parachute compensation arrangements and, in certain circumstances, to conduct a separate shareholder advisory vote to approve those arrangements. On January 25, 2011, the Securities and Exchange Commission adopted rules implementing Section 951 of the Dodd-Frank Act, which became effective on April 4, 2011.

The Onslaught of Shareholder Derivative Actions Following the Dodd-Frank Act.

Immediately after passage of Section 951, plaintiffs' firms began filing shareholder actions against directors, executive officers, and compensation consultants of companies where a majority of the shareholders voted against approval of recommended executive compensation—so called, failed "say-on-pay votes." The suits included: (1) claims against directors and executive officers for breach of fiduciary duty and violation of Section 14(a) of the Exchange Act, (2) claims against compensation consultants for aiding and abetting breach of fiduciary duty and breach of contract for failure to render competent and sound advice regarding executive compensation, and (3) claims against executive officers for unjust enrichment. The allegations of misconduct in these suits were similar—the defendants recommended purportedly excessive executive compensation: (1) at a time when the company's financial performance was dismal, (2) that violated the company's pay-for-performance compensation policy, and (3) that was not in the best interests of shareholders, as evidenced by the failed say-on-pay advisory vote.

In 2010, shareholders filed suits against the directors and officers of two of the first companies with failed say-on-pay shareholder votes. Both of these cases subsequently settled with attorneys' fees awards ranging between $1.0-1.75 million.

Emboldened by the foregoing results, in 2011, plaintiffs' firms piled on. In 2011, the shareholders of 43 public companies voted against the approval of executive compensation proposals at annual shareholder meetings. Plaintiffs' firms sued directors, officers, and/or compensation consultants of at least 15 of those companies—comprising 35% of all companies with failed say-on-pay shareholder votes. 87% of those suits were filed prior to September 2011—the month in which the first court decision was issued granting defendants' motion to dismiss. *See Teamsters Local 237 Additional Security Benefit Fund v. McCarthy (Beazer Homes USA, Inc.),* Case No. 2011cv197841 (Ga. Sup. Ct. 2011).

To date, 10 of the 15 suits or 67% resulted in defendants' motions to dismiss being granted —two of which are currently on appeal and one of which is pending the filing of an amended complaint. Of the remaining 5 suits, only one court denied defendants' motion to dismiss—*NECA-IBEW Pension Fund v. Cox (Cincinnati Bell)*, Case No. 1:11-cv-00451 (S.D. Ohio 2011—and the parties subsequently settled. A second case—pending in the U.S. District Court in Delaware—settled prior to the court's decision on defendants' motion to dismiss and included payment of $1.1 million in attorneys' fees and expenses to plaintiffs' counsel. The remaining three cases have motions to dismiss pending.

With a growing trend of courts dismissing failed say-on-pay suits, in 2012, shareholders filed suits against directors and officers concerning say-on-pay votes at only five companies—four companies with failed say-on-pay votes and one company for allegedly providing false and misleading statements in a proxy statement that resulted in a favorable say-on-pay shareholder vote. In addition, the two plaintiffs' firms leading the charge in 2010 and 2011 ceased filing such suits. Presumably, those law firms decided to cut their losses when their strategy did not yield anticipated returns on their investment of resources. Four of these 2012 cases remain pending and one was dismissed by the court pursuant to a motion to dismiss.

The courts that granted defendants' motions to dismiss in failed say-on-pay vote cases provided one or more of the following bases for their decisions:

- *Failure of Demand Futility.* The courts held that plaintiffs were not excused from making a litigation demand on the board of directors. Plaintiffs failed to adequately allege demand futility because the court found that a majority of the directors were disinterested and independent, and the complaint failed to allege any particularized facts suggesting that the decision was not made on an informed basis or providing any doubt that the decision was made in good faith and in the directors' honest belief that it was in the company's best interest.

- *The Say-on-Pay Statute.* The Say-on-Pay Statute specifically states that the shareholder vote is merely advisory and non-binding. It also states that shareholder votes do not "create or imply any change to the fiduciary duties of such issuer or board of directors" nor do they "create or imply any additional fiduciary duties for such issuer or board of directors."

- *Timing of Shareholder Vote.* The shareholder vote does not rebut the business judgment rule of the directors' decision regarding executive compensation because the shareholder vote occurred after the directors already made their decision. The directors did not have the result of the shareholder vote at the time they made their decision concerning executive compensation.

- *Evidentiary Weight of Shareholder Vote.* One court, however, noted that "a shareholder vote on executive compensation has substantial evidentiary weight and may be used as evidence by a court in determining whether" the presumption of the business judgment rule is rebutted; however, the "shareholder vote alone is not enough to rebut the presumption of the business judgment rule." *Laborer's Local v. Intersil*, Case No. 11-cv-04093 (N.D. Cal. 2011) (granting motion to dismiss).

The Recent Trend: Putative Class Actions Seeking Injunctive Relief

Undeterred by the growing list of adverse court decisions, certain members of the plaintiff securities bar have now taken a new approach to attack executive compensation plans. In advance of a company's annual shareholder meeting, these law firms file shareholder actions seeking to enjoin a shareholder vote for the approval of the executive compensation plan. These suits have been brought as putative class actions instead of derivative shareholder suits—presumably to avoid the barrier of pleading demand futility, which was a basis for dismissal of many of the earlier suits. These class actions typically allege claims against directors for breach of fiduciary duty and against the company for aiding and abetting breach of fiduciary duty claims, and some suits assert a claim for violation of Section 14 of the Exchange Act. Plaintiffs typically assert that the proxy statements fail to provide adequate disclosure regarding the proposed executive compensation plan, including, (1) the information that the Board of Directors considered in making the recommendation to the shareholders to approve the executive compensation plan, (2) the reasons for the proposal, (3) the effects of the proposal, (4) why such proposal is in the best interests of the shareholders, and (5) why a compensation consultant was not engaged to analyze the proposed executive compensation.

Plaintiffs' firms have filed at least 18 of these types of suits in recent months, including 9 in the last month alone. These suits have met with some success:

- In two of the cases, the courts granted the plaintiffs' motion for a preliminary injunction. One of these cases subsequently settled, which allowed the shareholder vote to go forward. The settlement resulted in an award of $625,000 of attorneys' fees to the plaintiffs' firm and the company's agreement to provide supplemental proxy disclosures. The company in the other suit filed supplemental disclosures and postponed its shareholder meeting.

- The companies in five of the cases settled prior to a ruling on plaintiffs' motion for preliminary injunction. The settlements include supplemental disclosures and/or undertakings with respect to the company's corporate governance practices, and a payment of attorneys' fees and costs to plaintiffs' counsel for up to several hundred thousand dollars.

- In two of the cases, the plaintiffs voluntarily dismissed the action without settlement.
- In four of the cases, the court has not yet ruled on a motion for preliminary injunction and the cases remain pending. The shareholder meetings are scheduled to occur later in November.

The same plaintiffs' firm filed 17 of the foregoing 18 suits. Indeed, this plaintiffs' firm has issued about two dozen press releases over the last two months announcing "investigations" of companies for potential breaches of fiduciary duty against directors for seeking shareholders' approval of the compensation of executive officers. This plaintiffs' firm may continue to file additional suits in the coming weeks because the annual shareholder meetings of several of the targeted companies have yet to occur. For a complete list of the current status and the jurisdictions in which cases have been filed, please see the attached charts.

Conclusion

Plaintiffs' firms have succeeded in extracting payment of legal fees in the settlement of five of the recently filed putative class action suits seeking injunctive relief. It is tempting for companies to settle such suits in order to avoid the expense of litigation and any disruption of the scheduled shareholder meeting. However, settling with plaintiffs' firms will only incentivize them to continue filing such suits and extracting a toll on all public companies as a cost of doing business.

Companies can demonstrate that this latest ploy will not generate positive returns for the securities plaintiff bar only by fighting back and prevailing. Thus, companies should consider taking a principled stand and opposing motions for preliminary injunction. It is important to note that substantive changes in companies' proxy statement disclosures are unlikely to deter plaintiffs' firms from instituting these new putative class action suits seeking injunctive relief. Nonetheless, adequate disclosures will strengthen the ability of companies to succeed in opposing motions for preliminary injunction. Companies should remain diligent in ensuring that there are adequate disclosures in their proxy statements concerning executive compensation proposals.

If you have any questions about the content of this alert, please contact the Pillsbury Executive Compensation and Benefits attorney with whom you regularly work, or the authors below.

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<u>Say-on-Pay Derivative Shareholder Suits Against 22 Companies: 2010-2012</u>

Disposition of Cases	No. of Cases	Percentage
Settled after Motion to Dismiss Denied	1	5%
Settled with No Ruling on Motion to Dismiss	3	13.5%
Motion to Dismiss Granted and Final	8	36%
Motion to Dismiss Granted But Not Final Disposition	3	13.5%
Pending	7	32%
Total	22	100%

Courts Granting Motions to Dismiss
U.S. District Court – N.D. California – 2 cases
U.S. District Court – S.D. California
U.S. District Court – Colorado
U.S. District Court – N.D. Illinois
U.S. District Court – Maryland
U.S. District Court – E.D. North Carolina
U.S. District Court – Oregon
U.S. District Court – S.D. Texas
Georgia Superior Court
California Superior Court – Los Angeles County
Courts Denying Motion to Dismiss
U.S. District Court – S.D. Ohio

Jurisdiction[1]	No. of Cases
U.S. District Court – N.D. California	2
U.S. District Court – S.D. California (two state court cases removed and consolidated, then remanded to California Superior Court – San Diego County)	1
U.S. District Court – Colorado (2 cases consolidated)	1
U.S. District Court – Delaware	3
U.S. District Court – N.D. Illinois	1
U.S. District Court – Maryland	1
U.S. District Court – New Jersey	1
U.S. District Court – S.D. New York (3 cases consolidated)	1
U.S. District Court – E.D. North Carolina	1
U.S. District Court – N.D. Ohio (4 cases – 3 of which were consolidated)	2
U.S. District Court – S.D. Ohio	1
U.S. District Court – Oregon	1
U.S. District Court – S.D. Texas	3
California Superior Court – Los Angeles County	2
Delaware Court of Chancery	2
Georgia Superior Court – Fulton County	1
Texas State Court – Harris County	2

[1] In numerous circumstances, plaintiffs filed suits in multiple courts. Consolidated cases are listed as a single case. Cases not subsequently consolidated are counted separately.

Recent Putative Class Actions Seeking Injunctive Relief
Against 18 Companies : 2012

Disposition	No. of Cases	Percentage
Plaintiffs' motion for preliminary injunction granted	2	11%
Plaintiffs' motion for preliminary injunction denied	5	28%
No ruling on pending motion for preliminary injunction or plaintiff has not filed a motion for preliminary injunction yet	4	22%
Settled prior to ruling on plaintiffs' motion for preliminary injunction.	5	28%
Plaintiff voluntarily dismissed case without settlement.	2	11%
Total	18	100%

Courts Granting Motions for Preliminary Injunction
California Superior Court – Santa Clara County
U.S. District Court – N.D. California

Courts Denying Motions for Preliminary Injunction
California Superior Court – Santa Clara County – 2 cases
California Superior Court – Alameda County
New York Supreme Court – Suffolk County
U.S. District Court – N.D. Illinois

Jurisdiction	No. of Cases
California Superior Court – Alameda County	1
California Superior Court – Santa Clara County	4
Circuit Court of Missouri – Jackson County	1
Supreme Court of New York – County of New York	4
Supreme Court of New York – County of Suffolk	1
Supreme Court of New York – County of Albany	1
Supreme Court of New York – County of Nassau	1
Washington Superior Court – King County	1
U.S. District Court – N.D. California (including one case removed from Santa Clara Superior Court)	2
U.S. District Court – N.D. Illinois (after removal from Illinois state court)	1
U.S. District Court – S.D. New York	1
Total	18