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A New Wave of Say-on-Pay and Executive Compensation Proxy Litigation

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Nobody can accuse the plaintiffs' shareholder bar of suffering from a lack of creativity or being easily dissuaded from purporting to represent shareholders. Congress enacted the **Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")** in July 2010. Section 951 of Dodd-Frank requires a shareholder advisory vote on executive compensation (a "say-on-pay" vote). The Dodd-Frank Act, however, "specifically provides" that the **say-on-pay vote** (1) "shall not be binding on the issuer or the board of directors," and (2) does not "create or imply any change to the fiduciary duties of the board members." 15 U.S.C. § 78n-1(c)). Nonetheless, the plaintiffs' bar began filing shareholder derivative lawsuits alleging breach of fiduciary duty following an issuer's failed say-on-pay vote. The vast majority of these cases have been dismissed because the plaintiff failed to make demand on the company's board of directors before bringing suit. See ***Gordon v. Goodyear***, 2012 WL 2885695, *10 (N.D. Ill. July 13, 2012) (collecting cases); see also ***Swanson v. Weil*,** 2012 WL 4442795 (D. Colo. Sept. 26, 2012); ***Haberland v. Bulkeley*,** No. 5:11-CV-463-D (E.D.N.C. Sept. 26, 2012).

As a result, the plaintiffs' bar has resorted to a new attack: filing class action lawsuits against companies before the shareholder meeting to enjoin the say-on-pay vote based on alleged incomplete and misleading proxy disclosures. They also challenge disclosures in connection with any required vote in amending executive equity compensation plans, such as increasing the number of shares available for issuance.

Plaintiffs' Modus Operandi

These lawsuits have some common characteristics. Plaintiffs are bringing them as class actions, not stockholder derivative cases. Instead of attacking the merits of the proposed action, they are challenging the adequacy of the disclosures, claiming that the shareholders need more information in order to cast an informed vote. Plaintiffs are bringing these cases in the state courts in which the company's principal place of business is located, not in Delaware. The lawsuits seek to enjoin the upcoming vote, thereby pressuring the company to capitulate, provide additional disclosures and justify a fee award to plaintiffs' counsel. Finally, the "fight" does not begin with the initiation of a lawsuit. Rather, plaintiffs' lawyers are issuing notices of investigation as soon as the company has filed a proxy scheduling a shareholder vote, including more than 40 notices in the last month alone. These notices of investigation are designed to find a shareholder willing to serve as a plaintiff, and plaintiffs' lawyers have been quite successful in finding such a plaintiff: They have filed 20 lawsuits of which we are aware as of October 26, 2012.

The Allegations

In connection with the say-on-pay vote, the complaints generally allege that the following additional information should have been disclosed:

- The reasons that the company selected and/or changed its compensation consultant.
- A "fair summary" of the compensation consultant's analysis provided to the company's board of directors.
- The reasons that the company selected the particular mix of salary, cash incentive compensation and equity incentive compensation.
- The reasons that the company selected particular companies as peers for purposes of benchmarking compensation.
- Details concerning financial and/or compensation metrics concerning the peer companies.

In connection with votes to increase the number of shares available for issuance under equity incentive plans, the complaints generally allege that the following additional information should have been disclosed:

- Any projections considered by the company's board of directors concerning shares to be granted under equity incentive plans in the future.
- The reasons that the company determined the number of additional shares requested to be approved for issuance.
- The potential equity value and/or cost of the issuance of the additional shares.
- The potential dilutive impact of the issuance of the additional shares.
- A "fair summary" of any compensation consultant analysis provided to the company's board of directors.

Companies should review their proxy disclosures for compliance with the requirements of Items 402 and 407 of Regulation S-K and Item 10 of Schedule 14A and consider enhanced disclosure in certain circumstances to avoid being sued.

The Results

Plaintiffs have had mixed results in these cases, but they have been successful enough that this trend will continue and likely accelerate as companies with calendar year-ends enter the 2013 proxy season. Specifically, a plaintiff obtained an injunction stopping a shareholder vote by Brocade Communications Systems, Inc. on increasing the number of shares available under an equity incentive plan and was awarded attorneys' fees of $625,000. Plaintiffs have obtained settlements in cases involving H&R Block, Martha Stewart Living Omnimedia, Inc., NeoStem, Inc. and WebMD, LLC for amounts between $125,000 and $450,000.

In contrast, plaintiffs voluntarily dismissed a case against Amdocs after defendants opposed plaintiffs’ motion for a preliminary injunction and filed a motion to dismiss and plaintiffs failed to enjoin shareholder meetings of Ultratech, Inc. and AAR.

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