

Federal Jurisdiction Over Say-On-Pay Lawsuits

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The Ninth Circuit recently issued an opinion in *Dennis v. Hart*, in which it held that the district court lacked subject matter jurisdiction over various say-on-pay lawsuits originally filed in state court and subsequently removed to federal court. In 2010, the board of directors of PICO Holdings, Inc. increased executive compensation notwithstanding that the company reported negative annual net income and free cash flow for the year. In a May 2011 advisory vote on executive compensation, 61% of PICO's shareholders voted against the 2010 compensation package. The PICO board, however, made no changes to compensation following the vote.

Shareholders subsequently filed lawsuits in California state court asserting various state common law claims, including breach of fiduciary duty. One of the shareholder plaintiffs also sought a declaration that the advisory vote rebutted the board's business judgment concerning 2010 executive compensation, and another claimed that the board breached its duty by failing to respond to the shareholder vote. The defendants removed the cases to federal district court and moved to dismiss the complaints; plaintiffs moved to remand the actions. The district court dismissed the declaratory judgment claim and the claim that the board breached its fiduciary duty by failing to respond to the say-on-pay vote. It then determined that there was no federal jurisdiction over the remaining claims because none of them raised a federal claim or issue, and therefore remanded the cases back to the state court.

On appeal, the plaintiffs argued that removal of their cases and dismissal of their claims was improper because the district court lacked subject matter jurisdiction over their state-law causes of action. The Ninth Circuit agreed, holding that the plaintiffs asserted only state law claims in their complaints, none of which conferred federal jurisdiction on the district court. Specifically, the court ruled that Section 27 of the Exchange Act does not confer federal jurisdiction over state law claims relating to say-on-pay votes, because the plaintiffs were not seeking to enforce any liability or duty created by the Exchange Act or its rules and regulations. Instead, the plaintiffs were seeking to enforce liabilities created solely by state law. The court also rejected the argument that say-on-pay lawsuits necessarily involve a significant federal issue. Responding to the defendants' argument that the plaintiffs were improperly seeking to impose liability relating to say-on-pay votes, which defendants contended Congress had prohibited, the court said that this is a federal defense that does not create federal jurisdiction under longstanding rules concerning well-pleaded complaints. And finally, the court held that the doctrine of complete preemption did not preclude the plaintiffs' state law claims, because Congress did not completely displace state law causes of action when it created the say-on-pay scheme. To the contrary, Congress expressly preserved existing state laws. The Ninth Circuit therefore vacated the dismissal of the plaintiffs' claims and ordered the district court to remand the cases to the state court where they were originally filed.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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