

Say-on-Pay Litigation Update

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Since our [last blog post](#) on say-on-pay litigation in January 2012, there have been several dismissals of say-on-pay lawsuits on procedural grounds – principally the failure of plaintiffs to satisfy the demand standard, which requires a plaintiff seeking to bring a derivative action to first make a demand on the corporation's board so that it can determine whether to pursue the action. Under Delaware law, failure to make a demand may be excused if the plaintiff can raise a reasonable doubt that (1) a majority of the board is disinterested or independent or (2) the challenged act was a product of the board's valid exercise of business judgment. In particular, a number of lawsuits were dismissed, because they could not satisfy the first prong and could not successfully establish that a failed say-on-pay vote rebuts the board's business judgment to satisfy the second prong.

For example, in January 2012, a plaintiff, without making a pre-suit demand, filed a lawsuit against [Navigant Consulting](#), which had increased executive compensation for 2010 despite negative shareholder return. Although the plaintiff alleged that a say-on-pay approval vote of 45% was enough to excuse the demand requirement, a federal district court in Illinois applied Delaware law and [ruled](#) that this alone was not enough to raise a reasonable doubt of the board's valid exercise of its business judgment. The court pointed out that the plain language of Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides that say-on-pay requirements do not (1) create or imply any change in the fiduciary duties or (2) create or imply any additional fiduciary duties of the company or its board.

Similarly, in March 2012, a California federal district court dismissed a lawsuit against [Intersil Corporation](#), where the compensation of the company's named executive officers for 2010 had increased by an average of 41.7% over the prior year. Intersil had received 44% approval for say-on-pay. The plaintiff did not make a pre-suit demand, and the court, applying Delaware law, held that additional facts must be pled to raise a reasonable doubt that the decision was not a valid exercise of the board's business judgment.

A few months later in June 2012, in [Monolithic Power Systems](#), the same California federal court, again applied Delaware law and held that a 36% say-on-pay vote did not raise a reasonable doubt of the board's valid exercise of its business judgment when it increased executive compensation.

These cases, decided by federal courts applying Delaware law, contribute to a line of cases holding that a failed shareholder say-on-pay vote alone does not rebut the business judgment rule presumption afforded to a board's decisions, including in the realm of executive compensation. In contrast, a prior federal case applying Ohio law, the [Cincinnati Bell](#) decision, excused pre-suit demand on the board on the basis that, under Ohio law, the business judgment rule is an affirmative defense and not an element of excusing demand. It should be noted that, shortly after the *Cincinnati Bell* case was decided, the case was settled and thus there will be no appeal.

Despite the Cincinnati Bell ruling, which at this point appears to be anomalous, the growing consensus appears to be that courts will continue to defer to a board's decisions regarding executive compensation, as long as such decisions are made in good faith and pursuant to the board's fiduciary duties. For example, in [Jacobs Engineering](#), the Superior Court of California, applying California corporate law, which the court stated is identical to Delaware corporate law, ruled that a say-on-pay approval vote of 45% in 2011 was not enough to rebut the board's business judgment. Similarly, in [BioMed Realty Trust](#), a Maryland federal district court, applying Maryland law, ruled that the mere involvement by directors in a challenged transaction as well as a say-on-pay approval of 46% was not enough to raise a reasonable doubt of the board's valid exercise of its business judgment.

Despite these recent dismissals, there are still three ongoing say-on-pay lawsuits pending – against Hercules Offshore, Dex One and Janus Capital Group – that were filed prior to the annual shareholder meetings held in 2012.

Plaintiffs appear to be undeterred and continue to file say-on-pay lawsuits, which typically allege low or negative approval for say-on-pay as evidence of inappropriate pay practices. For example, in July 2012, a lawsuit was filed against [First Merit Corp.](#), which received 46% approval for its 2012 executive compensation. Plaintiffs alleged that the board's decision to raise executive compensation was inappropriate, since the company's stock price had declined by approximately 25% during 2011 and its long-term shareholder return had been negative over the last 10-, 5-, 3- and 1-year periods. Similarly, plaintiffs filed suit against [Simon Property Group](#) earlier this month, which received a say-on-pay approval of 26%, alleging that its board improperly approved the CEO's compensation package, which had included a \$120 million retention award through 2019 that is tied to the CEO remaining employed by the company, rather than being tied to the company's performance. This lawsuit surprised many because Simon Property had experienced high performance (e.g., as disclosed in its 2011 proxy, the company stated it falls within the 94th percentile of all companies in the S&P 500 Index over the past 10 years). Additionally, plaintiffs have filed a lawsuit related to compensation disclosure, despite receiving positive approval on say-on-pay. For example, in July 2012, plaintiffs filed suit against Johnson & Johnson, alleging breach of fiduciary duties concerning the disclosures in the company's annual proxy statements filed from 2008 through 2012. [Johnson & Johnson](#) received a 55% say-on-pay approval in 2012. These cases are all currently pending.

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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