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Say No More: The Latest Blow to Suits Challenging Proxy Disclosures About Say-On-Pay and Stock Incentive Plans

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Over the past eighteen months, public companies have drafted their annual proxy statements knowing that they could become the next target of a new wave of disclosure lawsuits. Those suits have challenged the adequacy of disclosures on executive compensation in connection with say-on-pay votes mandated by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), as well as votes on amendments to stock incentive plans.[1]

Public companies have been concerned that no matter the quality of disclosure, and regardless of a proxy statement's compliance with federal law and best practices, the proxy statement would be attacked for not saying enough. These claims have been modeled on disclosure claims pursued under state law routinely asserted in merger and acquisition litigation. As in the M&A context, plaintiffs would seek an injunction, here of the company's annual meeting.

Faced with the threat of an injunction, and the costs and disruption of expedited litigation, some companies agreed to make supplemental disclosures and pay six-figure settlements to plaintiffs' counsel. Other companies resisted. Those that did have now helped create a string of rulings that could put an end to the routine filing of these cases, the most recent of which was by a California judge in *Mancuso v. The Clorox Company* ("*Clorox*").[2]

MANCUSO V. THE CLOROX COMPANY: *AN OVERVIEW*

The *Clorox* case began as typical for this new type of disclosure suit. The plaintiff alleged that the proxy statement should have said more to enable shareholders to cast an informed vote on a non-binding say-on-pay proposal and a vote to increase the number of authorized shares for a stock incentive plan.

The plaintiff contended that the directors breached their fiduciary duties of care and loyalty under Delaware law by not disclosing a "fair summary" of information presented to the compensation committee by its independent compensation consultant, including comparative shareholder return data; analysis of peer compensation data; simulations of potential proxy recommendations by a proxy advisory firm; and reports on share usage, burn rate, and aggregate costs related to the company's stock incentive plan, particularly as compared to peers. The plaintiff claimed that shareholders would consider all this information material, a standard that requires showing that "there is a substantial likelihood that a reasonable stockholder would consider it important in deciding how to

[1] 15 U.S.C. § 78n-1(a)-(b).

[2] *Mancuso v. The Clorox Co.*, No. RG12-651653 (Cal. Super. Ct. Alameda Cnty.). The authors of this client alert are counsel for defendants in the *Clorox* action.

vote."[3]

The suit didn't seek damages. Instead, the plaintiff sought injunctive relief to block the shareholder vote on these proposals. The court initially rejected the claims when the plaintiff presented them on an expedited basis to obtain a preliminary injunction. On November 13, 2012, the court ruled that allowing a vote to go forward did not risk irreparable harm. The court also ruled that the plaintiff's evidentiary showing with respect to the merits of his disclosure claim were "meager, at best."[4]

The plaintiff then tried to pursue his claims after the shareholder vote overwhelmingly approved both challenged proposals. Following discovery, the court then rejected the claims on the merits after a bench trial based on a fully developed written record.

On September 23, the California court entered judgment in favor of defendants. The court held that there was no duty to say more in the proxy statement. After considering the evidentiary record, which included testimony from directors, a compensation consultant, and experts, the court concluded that plaintiff failed to meet his burden of showing the materiality of any undisclosed information presented to the compensation committee.[5] The *Clorox* court emphasized that the challenged proxy statement at issue included "a wealth of information on the two Proposals, the approach of the compensation committee, the reasons for its recommendations, and the impact these proposals may have." The court pointed out that additional information was "available in the Company's other SEC filings and those of its peers."[6] Under Delaware law, the court opined, "the duty to disclose 'is not a mandate for prolixity.'"[7] The court also underscored that "[n]ot all information considered by a board is material and subject to disclosure to shareholders."[8]

Noting the slippery slope of the plaintiff's disclosure claim, the court observed, "What Plaintiff has done is simply discovered what additional information was presented" to the compensation committee and then claimed that "such information would be 'helpful.' Were this court to find on this record that material information was withheld, it would be license to file suit where *anything* was withheld, for any information can always be labeled as potentially 'helpful.' Delaware law provides no such license." In so ruling, the court rejected the notion that any information made available to directors is necessarily material to shareholders. That ruling guts a core premise of this type of disclosure claim.

The *Clorox* court also rejected another core premise of this new wave of disclosure litigation—the idea that votes on compensation matters are as significant to shareholders as their votes on merger transactions, where courts have required companies to disclose a "fair summary" of analyses and fairness opinions prepared by investment advisors. In the context of mergers, some courts have required disclosure of fair summaries of certain types of

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3 *Loudon v. Archer-Daniels-Midland Co*., 700 A.2d 135, 143 (Del. 1997).

4 After the close of discovery, defendants moved for summary judgment. In response to the court's urging, the parties stipulated to a trial on the record presented in connection with the defendants' summary judgment motion. The court issued a tentative statement of decision on August 22, 2013, which became final effective September 23, 2013.

5 *Id.* at 11.

6 *Id.* at 17 (brackets omitted).

7 *Id.* at 10 (quoting *Ryan v. Lyondell Chem. Co.*, No. 3176-VCN, 2008 WL 2923427, at *19 (Del. Ch. July 28, 2005)*, rev'd on other grounds*, 970 A.2d 235 (Del. 2009)).

8 *Id.* at 6-7 (citing *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000)).

valuations and projections of future performance, finding them material to investors who are being asked to give up the possibility of future gains from the ongoing operation of the company in exchange for an immediate cash payment.[9]

Similar concerns, however, do not arise when companies seek shareholder approval of compensation decisions. Say-on-pay votes are nonbinding, and an authorization of additional shares for future issuance under a stock incentive plan is not itself dilutive; indeed, the future issuance of stock pursuant to a stock incentive plan may never be dilutive. The *Clorox* court noted the distinction, finding that the challenges to routine proxy statement disclosures arise "in very different circumstances" from those of a merger.[10] The court's recognition of that distinction should undermine efforts by plaintiffs' counsel to analogize these claims to merger cases.

Similar Cases and Mostly Similar Outcomes

The *Clorox* trial ruling follows other recent rulings rejecting nearly identical disclosure claims. In August, a California court dismissed claims against Symantec Corporation and its directors by a plaintiff who sought supplemental disclosure of a "fair summary" of various peer data and benchmarking analyses presented to the compensation committee.[11] In June, a New York state court rejected claims asserted against The Hain Celestial Group, Inc. and its directors. The plaintiff there sought a fair summary of the peer data and compensation analyses relating to a say-on-pay proposal, the criteria utilized in deciding to make additional shares available under a stock incentive plan (including the analyses developed by the company's compensation consultant), and the "dilutive" impact of the additional stock authorization.[12] In April, a federal district court in Illinois dismissed claims asserted against AAR Corporation by a plaintiff seeking disclosure of information about the compensation committee's independent consultant and its selection by the committee, analysis of peer compensation data, and information about how the committee made certain compensation decisions.[13]

In all three cases, plaintiffs unsuccessfully asserted pre-vote and post-vote challenges to proxy statement disclosures.[14] In denying preliminary injunctions and dismissing the claims, the courts recognized that the asserted claims were trying to impose new obligations. According to the *Symantec* court, "there is no controlling authority that requires disclosure of underlying benchmarking data in order that shareholders may independently determine the propriety of how executive compensation was determined."[15] The court added that such a duty of disclosure would not "be consistent with Delaware law on materiality" given that the proxy at issue "adequately disclosed what the pay targets were based on."[16]

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[9] *See, e.g.*, *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 209 (Del. Ch. 2007).

[10] *Mancuso v. The Clorox Co*., No. RG12-651653, slip op. at 4 (Cal. Super. Ct. Alameda Cnty. Nov. 13, 2012) (distinguishing *In re Netsmart Tech., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007); *In re Pure Res. Inc. S'holders Litig.*, 80 A.2d 421 (Del. Ch. 2002)); *see also Clorox*, Statement of Decision at 7.

[11] *See Gordon v. Symantec Corp.*, No. 1-12-CV-231541, slip op. at 5-6 (Cal. Super. Ct. Santa Clara Cnty. Aug. 2, 2013).

[12] *Morrison v. Hain Celestial Grp.*, 40 Misc. 3d 812, 814 (Sup. Ct. N.Y. Nassau Cnty. 2012).

[13] *See Noble v. AAR Corp.*, No. 12-C-7973, 2013 U.S. Dist. LEXIS 48075, at *6-9 (N.D. Ill. Apr. 3, 2013).

[14] *See id.*, at *2; *Gordon,* slip op. (Aug. 2, 2013).

[15] *Gordon*, slip op. at 8 (Aug. 2, 2013).

[16] *Id.*

The *Hain Celestial* decision emphasized that the plaintiff had "not established that the defendants failed to comply with compensation disclosure requirements imposed by the Dodd-Frank Act and has not cited persuasive statutory or case law authority which necessarily requires corporations to disclose more than what is mandated under Federal law."[17] The court added that there also was no "duty to disclose a dilution analysis in connection with the proposed stock issuance plan."[18] The *AAR* court concluded that the plaintiff failed to provide a basis to impose additional disclosure obligations beyond those already imposed by the Dodd-Frank Act, "especially in light of the business judgment deference accorded directors when setting executive compensation."[19] All three decisions further held that the plaintiffs failed to meet their burden of showing that the allegedly omitted information would significantly alter the total mix of information available to shareholders.[20]

The courts also agreed that, after a vote occurs, shareholders have no cognizable injury, do not face any threat of irreparable harm, and lack standing to assert individual claims that can be redressed by injunctive relief.[21] To the extent any claims arise, they belong to and can be pursued only by a corporation itself or by shareholders who sue derivatively—on behalf of the company—after satisfying the stringent pleading standards and standing requirements applicable to derivative lawsuits.[22] Given the significant hurdles faced by shareholders trying to bring derivative suits, it should not be a surprise that derivative lawsuits relating to say-on-pay votes and incentive plans have largely been unsuccessful.[23]

Just last week, a California Court of Appeal published its decision in *Charter Township of Clinton Police & Fire Ret. Sys. v. Martin*, which affirmed dismissal of a post-vote shareholder derivative suit against the directors of Jacobs Engineering Group, Inc.[24] The plaintiffs purported to assert post-vote claims that accused the directors of breaching their fiduciary duties by making misleading statements about compensation in a proxy statement, and by approving executive compensation, notwithstanding the fact that a majority of Jacobs' shareholders voted against the proposed compensation when they cast their non-binding say-on-pay vote. The court held that the plaintiffs failed to plead particularized facts demonstrating the futility of making a pre-suit demand on the board of directors of Jacobs Engineering, a threshold prerequisite before a court will permit a shareholder to bring a derivative suit. The plaintiffs also failed to allege facts creating a reasonable doubt that a majority of Jacobs's directors were "interested" in the litigation, finding that plaintiffs had not pleaded that the directors faced a substantial likelihood of personal liability for making allegedly false statements.[25] The plaintiffs were unable to overcome the presumption that the board adopted the executive plan on an informed basis and in good faith:

[17] *Id.* at 818.

[18] *Id.* at 818.

[19] *Noble*, 2013 U.S. Dist. LEXIS 48075, at *14.

[20] *Id.* at *14; *Morrison*, 40 Misc. 3d at 819; *Gordon*, slip op. at 7.

[21] *See id.*, at *14-18; *Gordon*, slip op. at 8 (Aug. 2, 2013); *Morrison*, 40 Misc. 3d at 816-817.

[22] *Id.*, at *17-18; *Gordon*, slip op. at 8 (Aug. 2, 2013); *but see Clorox*, Statement of Decision at 5 (observing that "a claim for injunctive relief regarding disclosures relevant to a say-on-pay vote may not be" derivative).

[23] *See id.*; *see also Iron Workers Local No. 25 Pension Fund ex rel. Monolithic Power Sys. v. Bogart*, No. 11-4604 PSG, 2012 WL 2160436 (N.D. Cal. June 13, 2012); *Gordon v. Goodyear*, No. 12 C 369, 2012 WL 2885695 (N.D. Ill. July 13, 2012); *Laborers' Local v. Intersil*, 868 F. Supp. 2d 838 (N.D. Cal. 2012).

[24] *See Charter Twp. of Clinton Police & Fire Ret. Sys. v. Martin*, No. B241087, 2013 Cal. App. LEXIS 737 (Ct. App. Sept. 17, 2013) (following *Raul v. Rynd*, No. 11-560-LPS, 2013 U.S. Dist. LEXIS 35256, at *28-32 (D. Del. Mar. 14, 2013)).

[25] *Id.*, at *19-30.

"Allegations the Board improperly supported the plan during the shareholder vote, and stuck with it after the negative vote, do not begin to approach the level of pleading necessary to overcome the presumption of the business judgment rule."[26]

Current State of Play

The recent victories for defendants in say-on-pay litigation should deter plaintiffs' counsel from bringing similar disclosure claims against public companies. As it stands, plaintiffs' counsel have announced about 100 investigations of public companies and filed approximately 30 cases. But they have prevailed on just two pre-vote disclosure challenges, while losing the rest, and have not prevailed on any post-vote disclosure claims.[27] Plaintiffs' most significant victory came early on against Brocade Communications Systems in April 2012. In *Brocade*, the plaintiff successfully obtained a preliminary injunction that blocked a shareholder vote on proposed increases to an equity incentive plan pending further disclosures regarding projected dilution.[28]

At this point, *Brocade* is an outlier decision. The case was decided as a matter of first impression on an expedited basis without the benefit of rulings from other courts. In *Brocade,* the company sought to add a relatively high percentage of shares to its stock incentive plan and created (but did not disclose) projections regarding future grants.[29]

Takeaways

Although the recent wins by defendants in these say-on-pay suits should help limit proxy litigation relating to compensation-related disclosures, it is possible that plaintiffs persist in making these claims or come up with new variants of them. To minimize litigation risk related to disclosure claims, corporate counsel should consider the following:

- **Disclosures**. The game plan for plaintiffs is to compare the proxy disclosures to the Board materials. To the extent they differ, and they always will, plaintiffs may claim that any undisclosed information presented to the board was material and, therefore, should be disclosed. Minimize any appeal of this argument by reviewing the materials sent or presented to directors and draft proxy disclosures to ensure accuracy, consistency, and appropriate depth of treatment of subjects that were considered by the directors.

- **Deliverables**. Pay special attention to the materials delivered to the board. In planning for a board meeting, consider well in advance whether each prepared report or presentation should be delivered to directors if an

[26] *Id.*, at *33.

[27] *Greenlight Capital L.P. v. Apple, Inc.,* No. 13 Civ. 900*,* 2013 U.S. Dist. LEXIS 24716 (S.D.N.Y. Feb. 22, 2013); *Wenz v. Globecomm Sys., Inc.,* 969 N.Y.S.2d 63 (Sup. Ct. N.Y. Suffolk Cnty. 2012); *Morrison v. Hain Celestial Grp.*, 40 Misc. 3d 812, 814 (Sup. Ct. N.Y. Nassau Cnty. 2012); *Mancuso v. The Clorox Co.*, No. RG12-651653 (Cal. Super. Ct. Alameda Cnty. Nov. 12, 2013); *Gordon v. Symantec Corp.*, No. 1-12-cv-231541 (Cal. Super. Ct. Santa Clara Cnty. Oct. 17, 2012); *Rice v. Ultratech, Inc.*, No. 1-12-cv-226520 (Cal. Super. Ct. Santa Clara Cnty. July 16, 2012); *Haberland v. Bulkeley*, No. 5:11-cv-463-D, 2012 U.S. Dist. LEXIS 61408 (E.D.N.C. May 2, 2012). Morrison & Foerster LLP also represented defendants in the *Ultratech* case.

[28] *Knee v. Brocade Commc'ns Sys.*, No. 1-12-CV-220249, slip op. (Cal. Super. Ct. Santa Clara Cnty. Apr. 10, 2012).

[29] In another case, plaintiffs won a preliminary injunction where a proxy statement did not disclose that the reason why shareholders were being asked to increase the number of shares that could be issued under an equity plan was that the company had already issued shares in excess of the number authorized. *St. Louis Police Ret. Sys. v. Severson*, No. 12-cv-5086 YGR, 2012 U.S. Dist. LEXIS 152392, at *16 (N.D. Cal. Oct. 23, 2012).

executive summary (written or oral) might suffice. Consider sending directors only the information they actually use to make informed decisions.

- **Content**. Review materials prepared for Board review, the way an adversary would. Look for word choice, exaggerations, and inaccurate inflammatory words or images. Qualify information presented to the board, where appropriate, particularly when information is forward looking or when information presented is just one approach to analyzing a matter, or just a portion of the information that may factor into a board's decision. Be sure that transmittal documents and enclosed documents themselves do not imply that they are more important to directors than they actually are.
- **Drafts**. Control the process by which draft reports, analyses, and disclosures are prepared and sent to directors. Minimize the number of separate draft documents that are created. Corporate and litigation counsel should be involved to the extent appropriate to provide advice on draft materials.
- **Minutes**. Minutes should accurately reflect discussions and deliberations during meetings and provide summaries of agenda items that demonstrate a board's good faith and informed decision making.
- **Litigation Plan**. Be prepared for litigation. Well before the risk of litigation arises, review insurance coverage and indemnification obligations. For Delaware corporations, consider adding forum-selection provisions in articles of incorporation or bylaws. (Delaware Court of Chancery Holds Forum Selection Bylaw Provisions Are Enforceable)

CONCLUSION

Executive compensation remains a hot topic for shareholders, proxy advisory firms, and the SEC, as illustrated by approval last week of proposed rules for public comment that would implement Section 953(b) of the Dodd-Frank, by requiring companies to make pay ratio disclosures. (SEC Proposes Pay Ratio Disclosure Rules) As a result, companies can expect continued scrutiny of their executive compensation decisions and disclosures. Although the latest wave of suits relating to say-on-pay disclosures may abate in light of recent rulings, it is reasonable to expect that plaintiffs' counsel will continue to look for and find ways to target companies and their directors in this type of litigation.

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