Securities Litigation Alert:
'Tis the Season: Proxy Statements and Litigation Challenges to Compensation Disclosures

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BY KEVIN P. MUCK, DEAN KRISTY AND MARIE BAFUS

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Over the past several months, plaintiffs' lawyers have stepped up attacks on executive compensation disclosures in proxy statements. Although to date most of these attacks have been unsuccessful, the number of case filings is expected to increase in the weeks ahead as more companies head into this proxy season. Understanding the relevant litigation background and the claims typically made in these suits can help companies minimize their litigation risks.

Background

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") became effective. The statute requires public companies to conduct non-binding shareholder votes on executive compensation ("say-on-pay" votes) at least once every three years. In 2011 (the first year the requirement was in effect), say-on-pay proposals received a good deal of attention from proxy advisory services, activist shareholders and others – including the plaintiffs' bar. A number of derivative suits were filed in various courts around the country, based principally on the theory that a negative vote supported a finding that directors had breached their fiduciary duties with regard to executive compensation. Those cases have met with a notable lack of success, in large part because Dodd-Frank expressly provides that the say-on-pay requirement does not alter the fiduciary duties of directors or impose additional fiduciary duties upon them.

Undaunted, plaintiffs' lawyers have adopted a new tactic: filing class action suits (most often in state courts) challenging the sufficiency of disclosures relating to say-on-pay votes and other compensation-related proposals. More than a dozen companies have been hit with these suits in recent months, with actions filed in California, Illinois, Missouri, New York and Washington. The typical case is commenced shortly after the company files its proxy with the SEC, and seeks to enjoin the upcoming shareholder meeting.

Types of Claims Being Asserted

Thus far, these class actions have typically not alleged that the challenged proxy statements are false or inaccurate, or that they fail to comply with applicable SEC requirements. Instead, claims are premised on the theory that the directors breached their fiduciary duties by failing to furnish additional information necessary for shareholders to vote on the say-on-pay or other compensation-related proposals. In reality, though, the purported "omissions" tend to be immaterial detail consistent with what is already in the proxy or publicly available data. Examples include:

- Additional details regarding the process by which peer companies are selected;
- Financial data (*e.g.*, revenues, earnings, shareholder return) for peer companies;
- Further unspecified details regarding compensation risk assessments;
- To the extent that outside compensation consultants provide other services for the company, more detail regarding that work;
- Projections regarding dilution and burn rate (especially when seeking approval to increase shares available under equity compensation plans).

Early Results Have Not Been Favorable For Plaintiffs

A number of companies have elected to settle these cases to avoid the burdens and risks of litigation. However, in those instances where companies have chosen to fight, courts have been appropriately skeptical of plaintiffs' claims. In *Gordon v. Symantec Corp.*, the California Superior Court, Santa Clara County, denied a motion to enjoin a say-on-pay vote where the company was able to demonstrate that the additional disclosures sought were: (i) not material; (ii) consistent with what was already discussed in detail in the proxy; and (iii) publicly available information concerning other companies. Bolstering those arguments was the declaration of a corporate governance expert establishing that the challenged proxy satisfied all relevant SEC requirements, met the goals of Dodd-Frank, and was consistent with the disclosures provided by other comparable companies (both identified peers and a group consisting of the largest companies in Silicon Valley). Likewise, in *Noble v. AAR Corp*., a federal court in Illinois denied a motion for a temporary restraining order on the grounds that plaintiff could not establish that the additional disclosures sought were required by applicable law. A New York state court judge reached a similar result in *Wenz v. Globecomm Sys., Inc*. In *Mancuso v. Clorox Co.*, the California Superior Court, Alameda County, denied a preliminary injunction motion on the grounds that plaintiff failed to establish either a likelihood of success or irreparable harm, although it did order the parties to prepare for an expedited trial on the merits of plaintiff's claims (where the issue will apparently be whether plaintiff can demonstrate the propriety of requiring supplemental votes on a say-on-pay proposal and share increase). And in at least two other cases (involving Cisco Systems, Inc. and Microsoft Corp.), plaintiffs filed suit but then withdrew their requests to enjoin the shareholder meetings.[1]

In fact, there are apparently only a few instances in which plaintiffs have had even limited success. In *Knee v. Brocade Communications Sys., Inc.*, the California Superior Court, Santa Clara County, enjoined a shareholder vote on proposed increases to an equity incentive plan pending further disclosures regarding projected dilution. Notably, though, no additional disclosures were required with respect to Brocade's say-on-pay vote or any other proposal. In *St. Louis Police Ret. Sys. v. Severson*, a federal judge in the Northern District of California enjoined a vote on a proposal by Abaxis, Inc. to increase the number of shares available under an equity incentive plan, on the grounds that the proxy did not adequately disclose the reasons for that proposal (even though the information was apparently contained in other SEC filings).

1 Fenwick & West LLP represents Symantec Corp. and Cisco Systems, Inc. in these actions.

Summary

As the proxy season begins in earnest and additional cases are anticipated, more companies will need to assess whether to settle quickly or litigate. In making that assessment, it is important to recognize that those companies that have elected to fight have had considerable success in court, especially in cases challenging the sufficiency of disclosures provided in connection with say-on-pay votes. Cases involving amendments to equity incentive plans may, in some circumstances, present slightly different issues; however, by spending a bit more time focusing on those issues before the proxy is finalized, and ensuring that discussions of the reasons and impact of any proposed amendments are robust and comprehensive, companies can minimize the risks of adverse litigation results.

For further information, please contact:

Kevin P. Muck, Chair,
Securities Litigation Group
kmuck@fenwick.com, 415.875.2384

Dean Kristy, Partner,
Securities Litigation Group
dkristy@fenwick.com, 415.875.2387

Marie C. Bafus, Associate,
Securities Litigation Group
mbafus@fenwick.com, 415.875.2371

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