

Meridian Client Update

Two Federal Courts Dismiss Claims Arising From Failed Say on Pay Votes

Earlier this month, two federal courts dismissed lawsuits arising out of two separate 2011 negative say on pay votes. These decisions reaffirm a board's authority to determine executive compensation. Equally important, the decisions reject the claim that a negative say on pay vote undermines the protection afforded board decisions under the business judgment rule. In so holding, these courts declined to follow a prior federal court decision which denied a motion to dismiss a "say on pay" lawsuit against Cincinnati Bell and its directors.

The two cases were brought by shareholders against PICO Holdings, Inc., Umpqua Holding Corporation and their respective directors. The failure of these companies to receive a majority vote for their 2011 say on pay proposals served as a catalyst for the lawsuits. In both cases, shareholders alleged that despite negative financial results, the boards of both companies increased compensation for their respective executive officers. The decision to increase compensation was an unreasonable exercise of these boards' business judgment according to the plaintiff shareholders. Further, the plaintiff shareholders' allege that the negative say on pay vote is sufficient evidence that the boards' actions were not in the shareholders' best interest.

In the PICO Holdings case, the court dismissed plaintiff's case for the failure to state a claim. The court based its decision on the say on pay provisions of The Dodd-Frank Wall Street Reform Act ("Dodd-Frank Act") which expressly state that the provisions "may *not* be construed... to *create or imply* any change to fiduciary duties" nor does it "*create or imply* any additional fiduciary duties" (emphasis in the court's opinion). The court noted that the Dodd-Frank Act did not change state law regarding fiduciary duty or business judgment presumption.

In the Umpqua Holding case, the court ruled that the plaintiffs failed to raise a reasonable doubt that the challenged compensation was an unreasonable exercise of the board's business judgment. The court ruled that plaintiffs' "essential position... that if a simple comparison reveals that a level of compensation was inconsistent with general corporate performance, the business judgment presumption is necessarily overcome, [is] a position that is unsupported by the applicable [state law] standards." Akin to the court ruling in the PICO case, the federal district court in this case also held that the Dodd-Frank Act did not alter directors' fiduciary duties and that a negative "say on pay" vote alone is not sufficient to rebut the business judgment protection for directors' decisions on compensation matters.

Meridian Comment. *These two recent decisions further demonstrate that federal courts generally will provide corporate boards and Compensation Committees wide latitude in making pay decisions under the business judgment rule. The cases also provide precedence that the Dodd-Frank Act's advisory vote on executive compensation does not expand the scope of directors' fiduciary obligations to shareholders.*

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The **Client Update** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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