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Beyond Say on Pay: The Latest Round of Executive Compensation Litigation – And Some Considerations On Defending Against It

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Companies and directors have seen wave after wave of executive compensation litigation, from "say on pay" suits in the wake of Dodd-Frank, to threatened preliminary injunctions to enjoin shareholder votes. These cases initially gained some traction: After Knee v. Brocade—in which a plaintiff successfully enjoined a shareholder vote on the grounds that an allegedly misleading proxy statement would deprive shareholders of an informed vote—many companies settled suits demanding additional disclosures in advance of a shareholder meeting.

There are several steps companies and directors can take with an eye to defeating these claims all together. Some of these steps—such as moving to transfer venue, arguing that precedent precludes attorneys' fees, or asserting that a compensation plan issue is actually a derivative claim of waste—are helpful once litigation is under way. But there also is much that can be done before a complaint is filed. This article focuses on some of the steps that directors can consider taking before litigation—steps that should make that company and its directors a less attractive target and provide additional defenses to directors that are facing a shareholder lawsuit. They include:

• Including all information required by Regulation S-K. There is growing support, from recent decisions involving AAR Corporation and Apple, that only the information required by Regulation S-K—specifically Item 402—is necessary in advance of a shareholder vote. Directors should consider whether each of these requirements is satisfied in full, and whether the Compensation Committee's processes and considerations are reflected in board minutes.

• Reexamining language concerning Section 162(m) compliance. To avoid litigation for misleading statements about a compensation plan's adherence with Internal Revenue Code Section 162(m), it may be possible to limit liability by using more tentative language. For example, instead of stating that a compensation plan "will" satisfy Section 162(m), consideration could be given to the possibility of a proxy stating that the plan "may" or "might" satisfy that statute, provided that the proposed stockholder approval of the plan and performance incentives are in accordance with applicable interpretations of 162(m).

• Exculpatory Provisions. Liability may be cabined through reliance on exculpatory provisions, as allowed by 8 Del. C. 102(b)(7), in governing documents. Many companies already have an exculpatory provision in their charters. Although such measures will not excuse violations of the duty of loyalty, it can excuse breaches of the duty of care for directors, and in some jurisdictions, also for officers.

• Adding venue provisions in corporate documents. Delaware courts, generally available to corporations incorporated in Delaware, are uniquely well versed in cases involving corporate governance and may be more receptive to the arguments of corporate defendants. Although company defendants traditionally have had little control over where their shareholders sue them, it may be possible to add forum-selection provisions in governing documents designating exclusive forums for intra-corporate disputes. Although these provisions have not been consistently upheld, majority shareholder approval of a venue provision would increase its chances of binding plaintiff shareholders.

• Ascertain adherence to stock plans and best practices within industry. To avoid clear-cut violations of a compensation plan, companies should look to adherence with the plan before any compensation awards are made. The number of cases involving relatively straightforward violations of a compensation plan suggests that some compensation committees are not taking this step.

For additional security, examining prevailing industry compensation norms—and staying within their bounds—is well worth considering. This step is especially important given the ever-evolving tactics plaintiffs employ in executive-compensation suits, since adherence to generally accepted compensation metrics may defeat a novel theory of liability against which a company is otherwise unprepared to defend.

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