

E-ALERT | Securities

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SOMETHING TO WATCH THIS PROXY SEASON: NEXT GENERATION EXECUTIVE COMPENSATION LAWSUITS

Covington is closely following news about a number of executive compensation lawsuits that have arisen in the past year in relation to the annual meeting proxy statements.

As recently reported in a *Wall Street Journal* [article](#), plaintiffs' lawyers hatched a new generation of executive compensation lawsuits in 2012, which are expected to be rolled out again in 2013. While the likelihood of a company being hit by one of these lawsuits is low, companies, senior management, and boards can benefit from understanding this recent phenomenon and be prepared to act swiftly should such a lawsuit hit. Below is a sketch of what you need to know.

What are these lawsuits?

These lawsuits are distinct from the first generation of "say-on-pay" lawsuits in 2011, which generally were filed against companies following shareholder meetings based on failed shareholder votes on "say-on-pay" proposals. Instead, borrowing techniques developed in M&A litigation, the lawsuits are styled as class actions that seek to enjoin a company from holding its annual shareholders meeting on the basis that disclosures relating to executive compensation matters being submitted for shareholder approval are inadequate.

How many of these lawsuits have been brought and by whom?

Since January 2012, there have been at least 18 such cases. The cases have been filed mostly in California and New York state courts, all but one by the law firm Faruqi & Faruqi LLP.

How have these lawsuits been resolved?

None of these cases have actually gone to trial. Some companies have settled for meaningful amounts, while others, including Microsoft Corporation, have successfully defeated the suits.

What have the lawsuits targeted?

These lawsuits typically focus on the "say-on-pay" executive compensation vote that the Dodd-Frank Act now requires. Some cases have also targeted management proposals seeking shareholder approval of new or amended equity compensation plans.

Tips to prepare for possible lawsuits

- **Ensure that proxy disclosures are consistent with the decision-making that such disclosures are intended to describe.** For example, companies that describe their compensation structure as reflecting a "pay-for-performance" philosophy should make sure that the compensation, as

described, reflects such philosophy. To the extent that it does not, companies should consider explaining why the reported compensation is appropriate under the circumstances.

- **Have support for reliance on “peers” as a basis for executive compensation.** Companies that compare their compensation to peer companies should make sure they have actually evaluated the disclosures and the compensation practices of those companies.
- **Finalize corporate governance documents that memorialize executive compensation decision-making.** To prevent discovery of any meeting notes or drafts, the board of directors and compensation committee should compile and finalize any minutes or other board or committee materials from executive compensation meetings.
- **Have a constructive relationship with institutional investors that might vouch for the adequacy of your disclosure.** At least one company that successfully defended itself against an executive compensation lawsuit obtained a declaration from a large, well-known institutional investor indicating its views that the company’s disclosures were adequate.
- **Review governing instruments to evaluate viable options.** Consider the possibility of adjourning the vote or taking other steps to blunt the threat of enjoining a meeting. While a company will generally prefer to proceed on the announced annual meeting date, it is valuable to know ahead of time what you could do if litigation exigencies require postponement.
- **Identify a qualified expert.** In defending these cases, companies have successfully established the adequacy of their proxy statement disclosures through a qualified expert declaration. Having a qualified expert identified in advance can ensure swift action in an expedited preliminary injunction proceeding.

Since these cases are being filed in the jurisdiction in which a company has its principal place of business, and because they involve actions for injunctive relief, having qualified counsel in your state at the ready can help implement a quick response plan should a lawsuit be filed.

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