# "Say on Pay" Goes to Court

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By John Orr

Earlier this year the SEC adopted regulations implementing provisions of the Dodd-Frank Act relating to shareholder approval of executive compensation and disclosure. Commonly referred to as "Say on Pay" regulations, the rules, effective January 25, 2011, provide for shareholder advisory votes to approve executive compensation and the frequency of executive compensation votes, as well as to approve golden parachute compensation arrangements.

But what happens when shareholders say "no" on pay and the company approves the compensation anyway? In the case of Umpqua Holdings Corporation, shareholders filed suit, asserting claims for breach of the duty of loyalty against company directors, unjust enrichment claims against executive officers, and aiding and abetting claims against the company's executive compensation consultant. In the director claims, for example, plaintiffs alleged that the directors' decisions to increase executive pay, notwithstanding the company's "severely impaired financial results," were "disloyal, irrational and unreasonable, and not the product of a valid exercise of business judgment."

Similar cases have been filed by shareholders of Jacobs Engineering Group, KeyCorp and Beazer Homes USA.

Say on Pay regulations are applying pressure on companies to modify compensation practices in an effort to secure broader shareholder approval. However, it should be noted that the shareholder vote is merely advisory in nature. It remains to be seen, therefore, whether companies approving compensation despite shareholders' non-binding "no" votes can still give rise to liability for directors and officers (and their advisors). It also remains to be seen whether the suits themselves will result in settlements involving modified pay practices, without admissions or findings of liability, as an alternative to costly litigation.

In addressing these and other issues associated with Say on Pay, companies should review their Directors & Officers (D&O) liability policies in consultation with their insurance broker and counsel. Among the issues to consider is the extent to which the D&O insurers restrict coverage for claims of unjust enrichment or disgorgement. Attention also should be paid to limitations on the ability of insurers to trigger exclusions for money or other personal gain received by directors or officers to which they were not legally entitled.

Furthermore, depending on state law, companies may face restrictions on their ability to indemnify directors and officers for various costs and liabilities associated with claims that are derivative in nature, or claims alleging breach of the duty of loyalty. Companies should therefore consult counsel on this subject and consider the scope and sufficiency of ‘Side A’ coverage (coverage for non-indemnifiable losses) within their D&O program. Risk modeling that specifically addresses susceptibility to the ‘Side A’ exposure should also be used in evaluating these questions.

## For More Information

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