JONES DAY

SEPTEMBER 2013

GOVERNANCE PERSPECTIVES

CLOROX PREVAILS IN KEY SAY-ON-PAY LITIGATION

- Ruling suggests that so-called "second generation" say-on-pay lawsuits may wane in much the same way as the "first generation" say-on-pay lawsuits.
- Settlement of these cases encourages additional litigation and may raise board–management relations issues; companies faced with these lawsuits should consider defending them, recognizing of course that the defense of these cases involves time and expense, as well as some risk.
- The court's parsing of Clorox's proxy statement disclosure was realistic and grounded in the notion that not all information that is purportedly "helpful" to investors will be material to investors, and that "the duty to disclose is not a mandate for prolixity."

This week, The Clorox Company won a critical victory in a say-on-pay class action lawsuit that was filed in a California state court about a month before Clorox's 2012 annual meeting. The lawsuit sought to enjoin shareholder votes on certain compensation-related proposals at the meeting, alleging that Clorox's proxy statement omitted material compensation-related information relating to its advisory say-on-pay proposal, as well as its proposal to amend its equity plan. The information that the plaintiffs alleged should have been disclosed included, among other things, the results of several analyses performed by the independent compensation consultant to Clorox's compensation committee. The court denied the preliminary injunction motion after concluding that allowing the meeting to proceed would not pose any irreparable harm, because if the plaintiffs ultimately prevailed, the court could void the shareholder action taken at the meeting. Thereafter, Clorox could resolicit proxies with supplemental disclosures and conduct a new vote.

In its statement of decision, the court concluded that Clorox's proxy statement contained "a wealth of information" on the two proposals, the compensation committee's approach and recommendations, and the impact that the proposals could have on Clorox and its shareholders. The court also noted that the additional information the plaintiffs argued should have been included was not required to be included in the proxy statement, and that much of the information was available to shareholders in Clorox's SEC filings. While the plaintiffs claimed that including additional information in Clorox's proxy statement would have been "helpful," the court determined that a finding that material information was withheld from shareholders on that basis "would be a license to file suit where *anything* was withheld, for any information can

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always be labeled as potentially 'helpful,'" adding, "Delaware law provides no such license."

The *Clorox* decision is a favorable development for U.S. public companies. Other companies have succeeded in securing dismissals of these types of lawsuits, but the Clorox litigation is significant because it proceeded well beyond the initial pleading stage. We are hopeful that Clorox's victory may signal that these "second-generation" say-on-pay lawsuits—like the "first generation" lawsuits that alleged fiduciary duty breaches against directors of companies with failed say-on-pay votes—may soon be largely eradicated.

In addition, although every situation is unique, we commend companies like Clorox that have resisted the inclination to settle these lawsuits quickly. These claims by their nature often arise only weeks before the annual meeting, which is an already demanding and hectic time for corporate managers. It is understandably distracting for management to prepare for the annual meeting with the threat of an injunction looming, and it is not unusual for injunctions to be denied on the very eve of the meeting, as was the case for Clorox. Moreover, victory in these cases is not assured—some courts have in fact enjoined shareholder votes and required additional disclosures. (Notably, although most of the companies targeted by these lawsuits are Delaware corporations, these lawsuits are routinely filed in other states.) Even when companies are victorious, defense costs must be incurred and time must be spent; Clorox's ultimate victory came this week when the court entered its judgment, more than 11 months after the suit was filed.

Settling these claims, however, encourages additional lawsuits and, in many cases, rewards the filing of frivolous claims. The plaintiffs' lawyers have the capacity and resources to sue scores of public companies simultaneously, and they will continue to do so if they are rewarded financially for their efforts. Although defending against these claims requires a commitment of corporate resources, we believe that as courts become more familiar with these types of cases, they will often reach the right conclusions, as we believe the court did in *Clorox*. Finally, given the extensive involvement of directors in compensation matters, including disclosure, these cases inevitably involve dynamics affecting the relationship between senior management and the board of directors. Although a "third generation" of say-on-pay claims may be unavoidable, we believe that plaintiffs' lawyers may move on to other issues if companies continue to defeat these types of claims.

FURTHER INFORMATION

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

GOVERNANCE TEAM LEADERS

Lizanne Thomas
Atlanta
+1.404.581.8411
lthomas@jonesday.com

Lyle G. Ganske
Cleveland
+1.216.586.7264
lganske@jonesday.com

Robert A. Profusek
New York
+1.212.326.3800
raprofusek@jonesday.com

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