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Delaware Court Denies Attorneys' Fees for Alleged Dodd-Frank Disclosure Deficiencies

Posted by Yaron Nili, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Friday July 18, 2014

Editor's Note: The following post comes to us from Stewart D. Aaron, partner in the Securities Enforcement and Litigation practice at Arnold & Porter LLP, and is based on an Arnold & Porter publication by Mr. Aaron and Robert C. Azarow. This post is part of the Delaware law series, which is cosponsored by the Forum and Corporation Service Company; links to other posts in the series are available here.

Under Delaware's corporate benefit doctrine, a stockholder who presents a meritorious claim to a board of directors may be entitled to attorneys' fees if the stockholder's efforts result in the conferring of a corporate benefit.[1] On June 20, 2014, the Delaware Chancery Court considered in *Raul v. Astoria Financial Corporation*[2] whether attorneys' fees are warranted under this doctrine when a stockholder identifies potential deficiencies in executive compensation disclosures required by the SEC pursuant to the Dodd-Frank Act "say on pay" provisions.[3] The court held that the alleged omissions at issue failed to demonstrate any breach of the Board of Directors' fiduciary duties under Delaware law and accordingly the Plaintiff did not present a meritorious demand to the Board. This decision makes clear that the courts will not shift fees to a stockholder (and the stockholder's law firm) who "has simply done the company a good turn by bringing to the attention of the board an action that it ultimately decides to take."[4]

Background

The Dodd-Frank Act, enacted in 2010 following the financial crisis, imposed new corporate governance and disclosure requirements in the area of executive compensation. Publicly-traded companies must include a non-binding resolution in their annual proxy statements asking shareholders to approve, in a non-binding vote, the compensation of their executive officers.

[1] *See Tandycrafts, Inc. v. Initio Partners*, 562 A.2d 1162, 1164 (Del. 1989).
[2] Civil Action No. 9169–VCG, 2014 WL 2795312 (Del. Ch. June 20, 2014). Astoria was represented by Arnold & Porter LLP and Young Conaway Stargatt & Taylor, LLP.
[3] *See* Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[4] *Raul*, 2014 WL 2795312, at *1.

Companies must include a separate non-binding resolution every six years to determine whether the say-on-pay votes will occur every one, two, or three years. Finally, the Act requires corporations to disclose 1) how frequently future say-on-pay votes will be held, and 2) whether, and if so how, the Board of Directors considered the results of the say-on-pay votes in establishing executive compensation.[5]

Astoria held its first annual meeting following the enactment of Dodd-Frank on May 18, 2011. Astoria's Proxy Statement for the meeting disclosed the Board's recommendation that shareholders vote to hold annual say-on-pay votes and approve the executive compensation packages disclosed in the Proxy Statement. Although the Proxy Statement noted that the shareholder votes were advisory, it specified that the Board would take the outcome of the votes into account in considering future executive compensation arrangements. At the meeting, approximately 65% of the shareholders voted to approve the executive compensation packages recommended by the Board and approximately 75% of the shareholders voted to hold annual say-on-pay votes. Astoria filed a Form 8-K following the meeting, in which it disclosed that "the results of the future advisory shareholder votes to approve the compensation of the Company's named executives is every year."

Astoria issued its 2012 Proxy Statement on April 6, 2012. Like the 2011 Proxy Statement, the 2012 Proxy Statement announced an upcoming say-on-pay vote and recommended that the shareholders approve the 2012 executive compensation packages. The 2012 Proxy Statement also listed several factors that informed the Board's executive compensation determinations and again stated that the Board would take into account the results of the say-on-pay votes.

Procedural History

On April 16, 2012, attorneys for the Plaintiff sent a demand letter captioned "Shareholder Litigation Demand Pursuant to Delaware Law" accusing the Board of failing to disclose information required by Dodd-Frank. Plaintiff contended that the Board concealed material information and that the disclosures in the 2012 Proxy Statement were inadequate. Based on those purported deficiencies, Plaintiff claimed that the Board breached its fiduciary duties of loyalty, candor, and good faith. Shortly after Astoria received the April 16th letter, it issued a brief supplement to its proxy statement and filed a form 8-K/A, both of which in large part repeated the information previously disclosed. Approximately 18 months after Astoria issued the subsequent disclosures, Plaintiff sued Astoria under Delaware's corporate benefit doctrine, which allows fee

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[5] For more information on these rules, *see The Corporate Governance and Executive Compensation Provisions in the Dodd-Frank Act—What to do Now*, Arnold & Porter LLP Advisory (July 2010), *available here*.

shifting when a stockholder notifies a corporation of corporate wrongdoing and, in doing so, confers a benefit on the corporation. Astoria promptly moved to dismiss the case. Plaintiff opposed the motion, arguing that his demand presented a meritorious claim—i.e., a claim that could withstand a motion to dismiss—to the Board and that the Board's actions in issuing supplemental disclosures conferred a corporate benefit on Astoria.

The Court Denies Plaintiff Attorneys' Fees

Without determining whether Plaintiff's demand conferred a corporate benefit, the court rejected the argument that Plaintiff presented a meritorious claim to the Board. A meritorious claim, according to the court, exists only when the shareholder can point to some kind of "corporate wrongdoing." In other words, "[o]nly where the stockholder has acted on behalf of the corporation because those whose duty it is to act, the directors, have breached their fiduciary duties, will the stockholder be entitled to compel payment of fees and costs by the stockholders generally, via the equitable power of this Court." Despite the fact that Plaintiff failed "in briefing to articulate the basis of the underlying fiduciary duty claim asserted in his Demand, nor [did] his Complaint identify such a basis," the Chancery Court analyzed whether Plaintiff's allegations of deficient say-on-pay disclosures stated a claim for the breach of the duty of candor, loyalty, or care.

First, the court determined that the complaint failed to state a claim for breach of the duty of candor because the "actionable omissions" could not be considered material because the supplemental disclosures—which Plaintiff contended cured any alleged deficiencies in the original disclosures—essentially repeated information initially disclosed to shareholders. Second, the complaint did not state a claim under *In re Caremark Int'l Inc. v. Derivative Litigation* because, not only did Plaintiff's counsel disavow such a claim, but they also could not show that the Board "failed to institute procedures aimed at ensuring the Company satisfies applicable disclosure laws." Third, Plaintiff failed to present a meritorious claim based on the breach of the duty of good faith because neither the Demand nor the complaint suggested that the Board intentionally broke the law. Finally, Plaintiff failed to "state a meritorious claim for the breach of the duty of care" because "his Demand and Complaint contain no allegations indicating that the Astoria directors acted with gross negligence."

Significance

This decision holds significant ramifications for the standard of care to which corporate officers will be held under Delaware law. The Chancery Court roundly rejected the notion that fiduciary duties under Delaware law will be dictated by federal securities regulations. In other words, a meritorious demand must state some claim for breach of fiduciary duty under Delaware law;

pointing to a hypothetical deficient disclosure under federal law is insufficient. More importantly, though, the decision clearly declines to grant “license [to] each stockholder to decide how much oversight must be devoted to any given corporate activity, and when a benefit results, [to] shift the cost to the corporation.” Thus, unless the shareholder can point to a breach of a fiduciary duty, it cannot hold the corporation captive for attorneys’ fees by alerting the corporation to a potential “action that it ultimately decides to take.” The Delaware Chancery Court has therefore properly limited plaintiff’s firms abilities’ to extract attorneys’ fees from public companies under the guise of protecting stockholders.