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SECTION 162(M) LITIGATION: WHAT WE KNOW SO FAR

In recent years, stockholders have brought actions against directors alleging that proxy statements soliciting shareholder approval of incentive compensation plans are false or misleading in stating that the plans, if approved, will result in favorable tax treatment under the Internal Revenue Code. The authors set forth the allegations typically found in such complaints, how the courts have resolved defendants' motions to dismiss, and the measures companies can take to make their plans more defensible in litigation

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Over the past few years, enterprising plaintiffs' lawyers have increasingly targeted companies and their directors in lawsuits alleging that they have materially misrepresented in proxy statements the deductibility of certain incentive compensation under Section 162(m) of the Internal Revenue Code. Remarkably, these cases are brought – purportedly on behalf of the company – before the Internal Revenue Service has questioned the company's compensation plan or the deductibility of any compensation awards. Equally troubling, lawsuits challenging seemingly compliant plans are costly to defend, and some have withstood motions to dismiss.

Company counsel, compensation experts, and corporate and securities lawyers are likely to encounter these issues soon, if they have not already. Attorneys seeking guidance, however, will consult treatises in vain; the theories alleged are many and novel, and scant authority from the IRS exists.

Although the law remains unsettled, there are sufficient judicial decisions (primarily from the District of Delaware) from which to find useful guidance. This article sets forth some typical allegations found in complaints challenging Section 162(m) plans, discusses the courts' treatment of various arguments that have been raised in motions to dismiss, describes what typical settlements look like, and provides practical advice to mitigate the risk of becoming the target of one of these lawsuits.

THE REQUIREMENTS OF SECTION 162(m)

Ordinarily, public companies cannot deduct, as an expense, compensation over $1 million. The Internal Revenue Code, however, allows the deduction of qualified, performance-based compensation in excess of $1 million paid to certain covered employees if (1) a compensation committee of the board of directors composed of two or more outside directors determines

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performance goals for the employee, (2) the shareholders approve by vote the material terms of the performance goals before compensation is paid, and (3) the compensation committee certifies before payment that the performance goals and any other terms were satisfied.[1]

Although these requirements appear straightforward, the technical details of the Treasury Regulations implementing them have proven to be a fruitful source for plaintiffs' counsel to develop new theories of liability. Two requirements in particular – the performance goal requirement and the shareholder approval requirement – lie at the center of the allegations in these lawsuits.

The Performance Goal Requirement: Companies may deduct compensation of a covered employee in excess of $1 million only if the covered employee has achieved a pre-established, objective performance goal. For a goal to be considered pre-established, the compensation committee must establish the goal in writing no later than 90 days after the start of the period of service pertaining to the performance goal, and in no event after 25 percent of the total performance period has elapsed.[2] These limits contribute to the further requirement that the goal be "substantially uncertain" when established.[3]

The Treasury Regulations provide that a performance goal is objective "if a third party having knowledge of the relevant facts could determine whether the goal is met."[4] (The mention of a third party notwithstanding, neither Section 162(m) nor the related Treasury Regulations describe this as a *disclosure* requirement – although some plaintiffs allege that the disclosures in the proxy are deficient on that basis.) Once the goal is established, the compensation committee must not be able to increase the amount of compensation payable upon attainment of the goal, although it may retain the discretion to reduce or eliminate the compensation.[5]

The Shareholder Approval Requirement: For performance-based compensation to be deductible, shareholders must approve the material terms of the performance goal before the payment of compensation.[6] Disclosing the titles or class of eligible employees suffices to satisfy the requirement that the employees eligible to receive compensation be disclosed.[7]

The company must disclose the business criteria on which the performance goals are based, but not the specific targets.[8] Companies must further disclose details sufficient to allow shareholders to determine the maximum amount of compensation payable to an employee during a specified period. If the terms of the performance goal do not include a maximum dollar amount, the formula for calculating the amount of compensation must be disclosed.[9]

THE TYPICAL SECTION 162(m) COMPLAINT

Although the precise allegations vary, complaints challenging Section 162(m) plans follow a predictable pattern. The typical complaint is predicated on the allegation that the company has failed to comply with the technical requirements of Section 162(m), such as the performance goal requirement, and the claim that the IRS will inevitably disallow a deduction for incentive compensation. Complaints often allege that the proxy statement does not contain all material terms of the compensation plan, rendering the shareholder approval

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[1] I.R.C. § 162(m)(4)(C). The phrase "covered employee" refers to the chief executive officer and the four highest-compensated employees exclusive of the CEO. *Id.* § 162(m)(3). The IRS interprets Section 162(m)(3) to exclude the chief financial officer from the definition of "covered employee." I.R.S. Notice 2007-49, 2007-1 C.B. 1429.

[2] Treas. Reg. § 1.162-27(e)(2)(i).

[3] *Id.*

[4] *Id.* The formula or standard used to calculate the compensation to be paid upon achievement of the goal must also be objective, again as measured by whether a third party could calculate the amount to be paid. *See id.* § 1.162-27(e)(2)(ii).

[5] *See id.* § 1.162-27(e)(2)(iii).

[6] *Id.* § 1.162-27(e)(4)(i). The material terms include "the employees eligible to receive compensation; a description of the business criteria on which the performance goal is based; and either the maximum amount of compensation that could be paid to any employee or the formula used to calculate the amount of compensation to be paid to the employee if the performance goal is attained (except that, in the case of a formula based, in whole or in part, on a percentage of salary or base pay, the maximum dollar amount of compensation that could be paid to the employee must be disclosed)." *Id.*

[7] *Id.* § 1.162-27(e)(4)(ii).

[8] *Id.* § 1.162-27(e)(4)(iii)(A). If the compensation committee determines that the disclosure of a material term of a performance goal would reveal confidential commercial or business information that would have an adverse effect on the company, it may disclose this belief to shareholders in lieu of disclosing the term. *Id.* § 1.162-27(e)(4)(iii)(B).

[9] *Id.* § 1.162-27(e)(4)(iv).

requirement unsatisfied. Based on these allegations, plaintiffs argue that the proxy statement soliciting shareholder approval of the plan is false or misleading under Section 14(a) of the Exchange Act and SEC Rule 14a-9 insofar as it states that, if approved, the plan will result in favorable tax treatment pursuant to Section 162(m).

Plaintiffs also allege largely co-extensive state law fiduciary disclosure claims against the directors of the company. In fact, some plaintiffs forgo the Section 14(a) cause of action, relying solely on fiduciary duty and other state law claims. Finally, plaintiffs typically add claims for corporate waste (based on the alleged payment of non-deductible compensation) and unjust enrichment (based on the alleged receipt of compensation obtained through a false and misleading proxy statement).

MOVING TO DISMISS THE SECTION 162(m) COMPLAINT

The defendants' motion to dismiss is the crucial stage of these cases; none appears to have gone to trial, and most that withstand motions to dismiss ultimately settle. Unfortunately, a Section 162(m)-compliant plan does not guarantee that a motion to dismiss will succeed. Cases may survive motions to dismiss even when the plans appear to technically comply with the Internal Revenue Code and the Treasury Regulations. The reason seems to be that some judges may be more comfortable postponing the resolution of complex and unfamiliar areas of tax law until after merits discovery.[10]

Defendants typically move to dismiss on the following three grounds: (1) the case is not ripe because the IRS has not yet opined on the plan or any compensation awards, (2) the plaintiff has failed to plead particularized facts sufficient to excuse a pre-suit demand on the board under Rule 23.1, and (3) the complaint fails to state a claim on the merits, *i.e.*, the plan does in fact comply with Section 162(m).

Courts have thus far rejected ripeness arguments. Essentially, courts have not been willing to defer to the IRS to determine whether a given plan fails to comply with Section 162(m) because the cases allege disclosure violations. As explained in one decision, "if Section 14(a) and Rule 14a-9 were violated, they were violated by the making of the allegedly false and misleading statements in order to solicit shareholder approval."[11]

Arguments that plaintiffs have failed to allege demand futility have fared better, although results are mixed. As a threshold matter, some plaintiffs have argued that pre-suit demand is not required when challenging an omission in a proxy statement, because disclosure supposedly is not a matter of business judgment. The strength of this argument rests primarily on a single case, *Vides v. Amelio*,[12] in which the U.S. District Court for the Southern District of New York claimed that under Delaware law demand was not required for such causes of action. Numerous courts, however, have rejected *Vides* both by name and in principle.[13] Of courts adjudicating Section 162(m) cases, at least four, including the District of Delaware in its most recent Section 162(m) decision, have refused to credit it.[14]

Plaintiffs have had more success excusing demand by challenging director disinterestedness. For example, in *Resnik v. Woertz* and *Hoch v. Alexander*, both from the District of Delaware, the court determined that where a majority of directors are entitled to receive awards under

[10] For example, the court in *Hoch v. Alexander* called it a "close question as to whether [the plaintiff had] properly interpreted the proxy statement," yet found that, at the pleading stage, the plaintiff had met his minimal burden to state a claim. 2011 WL 2633722, at *6 (D. Del. July 1, 2011).

[11] *Seinfeld v. Barrett*, 2006 WL 890909, at *3 (D. Del. Mar. 31, 2006); *see also Resnik v. Woertz*, 774 F. Supp. 2d 614, 628-29 (D. Del. 2011) (refusing to dismiss breach of fiduciary duty, waste, and unjust enrichment claims for lack of standing on grounds of ripeness).

[12] 265 F. Supp. 2d 273, 275-76 (S.D.N.Y. 2003).

[13] *See, e.g.*, *Bader v. Blankfein*, 356 F. App'x 471, 473 (2d Cir. 2009); *Bader v. Blankfein*, 2008 WL 5274442, at *5 (E.D.N.Y. Dec. 19, 2008); *Risberg v. McArdle*, 529 F. Supp. 2d 213, 225-26 (D. Mass. 2008); *Scimeca v. Kim*, 2007 WL 7087065, at *11 (D. Ariz. Aug. 29, 2007); *In re F5 Networks, Inc. Deriv. Litig.*, 2007 WL 2476278, at *14 (W.D. Wash. Aug. 6, 2007); *In re CNET Networks, Inc. S'holder Deriv. Litig.*, 483 F. Supp. 2d 947, 966 (N.D. Cal. 2007); *In re Computer Scis. Corp. Deriv. Litig.*, 2007 WL 1321715, at *4 n.4 (C.D. Cal. Mar. 26, 2007); *St. Clair Shores Gen. Emps. Ret. Sys. v. Eibeler*, 2006 WL 2849783, at *4-6 (S.D.N.Y. Oct. 4, 2006).

[14] *Abrams v. Wainscott*, 2012 WL 3614638, at *3 (D. Del. Aug. 21, 2012); *Black v. Cincinnati Fin. Corp.*, 2011 WL 1640962, at *2-3 (S.D. Ohio May 2, 2011); *Resnik v. Boskin*, 2011 WL 689617, at *6-9 (D.N.J. Feb. 17, 2011); *Bader v. Anderson*, 101 Cal. Rptr. 3d 821, 836-38 (Cal. Ct. App. 2009); *see also Freedman v. Adams*, 2012 WL 1099893, at *16 n.155 (Del. Ch. Mar. 30, 2012) (expressing skepticism that the business judgment rule does not apply as a matter of law to a disclosure claim).

the plan, demand is excused.[15] A more recent decision from the District of Delaware, however, devotes much greater scrutiny to such allegations. Applying Delaware law that demand futility must be analyzed transaction by transaction, the court in *Abrams v. Wainscott* separately reviewed each proposal within the challenged incentive plan to determine whether the directors were interested so as to excuse demand.[16] In that case, the court found that although the outside directors may have been interested in a proposal regarding restricted stock rights, they had no discernible interest in the two proposals concerning the challenged performance goals.[17] The plaintiff thus failed to plead demand futility on this ground (as on others).

ADVICE FOR PLANS AND PROXIES

In seeking dismissal on the theory that the company's plan *does* comply with the requirements of Section 162(m) and the Treasury Regulations, defendants have confronted novel theories of liability alleged by plaintiffs. Although still developing, case law suggests several measures that are permissible or that companies can take to make their plans and proxy statements more defensible in litigation.

"Menu Plans" Are Permissible

Plaintiffs have attacked disclosure of the business criteria primarily on two grounds: that the proxy discloses the business criteria on which performance goals are based with insufficient detail, and that the number of potential criteria is too great.

Two courts that have examined this issue have ruled that the disclosure of a number of general business criteria from which the compensation committee may select performance goals – a "menu plan" of performance measures, as it is called – complies with the Treasury Regulations. In *Seinfeld v. O'Connor*, the court wrote that "[t]he regulation contemplates the kind of 'menu-plan' of possible performance measures and goals," which provides "earnings per share, " "reduction[s] in costs," and "increases in . . . sales by specified divisions" as examples of sufficiently detailed business criteria.[18] In *Black v. Cincinnati Financial Corp.*, when evaluating the likelihood of success on a motion for a temporary restraining order to prevent a shareholder proxy vote, the U.S. District Court for the Southern District of Ohio held likewise.[19]

What remains unclear is whether the criteria disclosed may be so numerous as to defeat the purpose of disclosure. The regulations themselves provide no ceiling, and some companies establish in excess of 100 business criteria. The proxy statement at issue in *O'Connor* disclosed 3 business criteria; in *Black*, the court concluded that a menu plan of 11 criteria did not run afoul of the rules. Plaintiffs argued that even these numbers defeated the purpose of Section 162(m), *i.e.*, to make awards transparent and objective. As discussed below, reducing the number of criteria tends to be a component of settlements in these actions.

In the Event of Retirement, Pro Rata *Awards May Be Made*

If an employee participating in an incentive program retires before the end of the performance period, the District of Delaware has held that paying a *pro rata* portion of the performance award does not violate the Treasury Regulations, provided that the payment is not made until the conclusion of the performance period and the compensation committee first certifies that the performance goals were achieved.[20] To avoid any

[15] *Woertz*, 774 F. Supp. 2d at 634-35; *Hoch*, 2011 WL 2633722, at *5. Under Delaware law, demand is excused only if "under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

[16] *Abrams*, 2012 WL 3614638, at *2. Although the *Abrams* court stated that the results of its proxy analysis distinguished its conclusion on demand from those in *Woertz* and *Hoch*, had the proxies in those cases received similar scrutiny, their conclusion regarding demand may well have been different.

[17] In one early Section 162(m) case, *Seinfeld v. Barrett*, 2006 WL 890909, at *3 (D. Del. Mar. 31, 2006), the court found that even where a majority of the board was disinterested and independent, demand was nevertheless excused because the plaintiff had pled facts sufficient to raise doubt that the action was taken honestly and in good faith. The court reasoned that the plaintiff had alleged that the defendants made false and misleading statements and omitted material terms in a proxy statement, and such allegations could raise issues of honesty and good faith. This reasoning is dubious under Delaware demand futility law and does not appear to have been widely adopted.

[18] 774 F. Supp. 2d 660, 670-71 (D. Del. 2011) (citing Treas. Reg. § 1.162-27(e)(4)(ix), Example 3).

[19] 2011 WL 1640962, at *6.

[20] *O'Connor*, 774 F. Supp. 2d at 669-70.

ambiguity, the terms of companies' plans should make clear that any such award will *not* be paid on account of retirement, but rather "solely on account of the attainment of one or more preestablished, objective performance goals," as required by the regulations.[21]

If the dates of a covered employee's employment contract and the relevant performance periods fell before certain dates in 2008 and 2009, companies may be able to pay the full, non-*pro rata* amount of a performance award to a retiring employee, regardless of whether he achieved the performance goal, without exposing themselves to liability. In *Seinfeld v. Slager*, the Delaware Court of Chancery concluded that paying a retiring covered employee such an award was not waste where the employment contract and the challenged performance periods fell before the dates when the IRS stated that it would begin to forbid the deductibility of such payments.[22]

In *Slager*, the employee's contract, effective February 21, 2007, provided for him to receive upon retirement the full amount of any performance award, regardless of whether he met the performance goal. His subsequent employment agreements limited such compensation to any performance period that began on or before January 1, 2009. IRS Revenue Ruling 2008-13 provides that such awards, because they are not based on the attainment of performance goals, do not qualify as performance-based compensation for purposes of Section 162(m). However, the IRS stated that it would not disallow deductions for performance periods that began on or before January 1, 2009, or under the terms of an employment contract in effect on February 21, 2008.[23]

Rejecting the plaintiff's contention that the IRS lacked the authority to apply this ruling prospectively, the court found that "the decision of an independent board to rely, in setting compensation, on a revenue ruling of the IRS, is within the business judgment of the board" – a holding that may be of greater importance to companies than the question that led to it.[24]

Do Not Make Promises about Deductibility

One of plaintiffs' main lines of attack is that shareholders were informed, in absolute terms, that the payments would be tax deductible, yet the plan does not comply with Section 162(m), rendering this statement false and misleading. To circumvent this attack, proxy statements should avoid stating affirmatively that performance awards "will" be tax deductible and should instead use language of intention and possibility. In *O'Connor*, the court twice emphasized that, contrary to plaintiff's allegations, the proxy stated only that its incentive plan was *intended* to comply with Section 162(m).[25] This simple change to the proxy statement should place companies on the right side of the current case law.

Clarify the Basis on Which Non-Section 162(m) Bonuses May Be Awarded

The Treasury Regulations state that the shareholder approval requirement is not satisfied if "the compensation would be paid regardless of whether the material terms are approved by shareholders."[26] Nevertheless, companies routinely reserve the right to make incentive awards that do not comply with the requirements of Section 162(m) and disclose this reservation in their proxy statements. In *Shaev v. Saper*, the Third Circuit characterized one such statement as a "threat" that "undermine[d] the deductibility of the bonus even if the shareholders approved it."[27] Plaintiffs have seized on this language to argue that similar "coercive" statements in defendants' proxies prevent the company from deducting incentive payments under Section 162(m).

In *O'Connor*, the court pointed out that a post-*Shaev* private letter ruling from the IRS allows companies to pay discretionary bonuses provided that they are *outside* the bonus plan. In other words, companies cannot award a covered employee the bonus for a particular performance goal if the goal is not achieved, simply by relabeling it a discretionary bonus. But other bonus compensation may be granted so long as it is not within the terms of the plan. If a company reserves the right to pay certain bonus compensation even if shareholders do not approve the plan, the proxy should make clear that

[21] Treas. Reg. § 1.162-27(e)(2)(i).

[22] 2012 WL 2501105, at *7-10 (Del. Ch. June 29, 2012).

[23] *Id.* at *8.

[24] *Id.* at *9.

[25] *O'Connor*, 774 F. Supp. 2d at 667 ("Thus, it is plain that the proxy statement does not say what Seinfeld alleges. It does not assert that the [incentive plan] *will* be tax deductible, only that it is *intended* to be deductible under IRC § 162(m)."); *id.* at 669 ("An immediate problem with this theory is, again, that the proxy statement does not state that the [incentive plan] *will be* deductible.").

[26] Treas. Reg. § 1.162-27(e)(4)(i).

[27] *Shaev v. Saper*, 320 F.3d 373, 381 (3d Cir. 2003).

such compensation falls outside the bonus plan for which the company seeks shareholder approval.[28]

The Terms of the Plan Need Not Restrict Performance Periods

As mentioned above, the performance goal must be pre-established, which means in part that its achievement must be substantially uncertain when the compensation committee establishes it. In *Shaev* the Third Circuit held that a performance period of nine months was too short to be considered substantially uncertain. The court further wrote, "In the absence of special circumstances, such as when a new company is formed or when an established company changes its fiscal year in good faith, a performance period shorter than one year makes it much less likely that the [incentive plan] will meet this requirement."[29]

Regardless of whether the Third Circuit intended to make one year a formal requirement, on the basis of this authority, some plaintiffs assert one year as the minimum length of a performance period necessary to comply with the regulations. In *O'Connor*, the plaintiff went one step further, arguing that the incentive plan violated the rules because the proxy statement did not affirmatively state that all performance periods would be at least a year.

Although the court in *O'Connor* acknowledged the Third Circuit's dicta in *Shaev*, it nevertheless saw no need to determine the minimum permissible performance period, since the plaintiff had not alleged that the company had, in fact, established a performance period of one year or less. "There is no need," wrote the court, "to address the permissibility of an unalleged hypothetical situation."[30]

When establishing the length of performance periods, compensation committees should bear in mind the Third Circuit's dicta. If courts follow *O'Connor*, however, companies will be answerable only for the actual length of their performance periods, not for whatever may be conceivable under the terms of their incentive plans.

Companies Have No Duty to Adopt Section 162(m) Plans

The Section 162(m) cases took an ironic twist in *Freedman v. Adams*, where the plaintiff alleged that the defendants breached state law fiduciary duties and engaged in waste by *not* adopting a Section 162(m) plan. The Delaware Court of Chancery rejected this theory, holding that companies have no duty to adopt a Section 162(m) plan as part of some purported general duty to minimize taxes. Under Delaware law, there is no "general fiduciary duty to minimize taxes."[31] *Seinfeld v. Slager* held likewise.[32]

PLAINTIFFS MAY ATTEMPT TO ENJOIN SHAREHOLDER MEETINGS

Some plaintiffs have sought to enjoin shareholder meetings to approve Section 162(m) plans on the grounds that the company's proxy statement is materially misleading. This approach, which more closely mirrors a typical M&A strike suit, has met with some success.[33] For example, in *St. Louis Police Retirement System v. Severson*, the U.S. District Court for the Northern District of California enjoined a forthcoming vote on a proposal to amend the company's 162(m) plan until the company issued a supplement explaining that it had earlier issued common stock in

[28] I.R.S. Priv. Ltr. Rul. 200617018 (Apr. 28, 2006) ("Based on the forgoing [*sic*], we rule that Taxpayer's reservation of the right to pay discretionary bonuses outside of the Bonus Plan will not prevent the bonus plan from qualifying as a qualified performance-based compensation plan under section 162(m)(4)(C) of the Code and section 1.162-27(e) of the Income Tax Regulations.").

[29] 320 F.3d at 380.

[30] *O'Connor*, 774 F. Supp. 2d at 671-72.

[31] 2012 WL 1099893, at *12. The court also found that under the allegations of the complaint, not adopting a 162(m) plan did not constitute a claim of waste sufficient to excuse demand, although it left open the possibility that a properly supported waste claim could survive. *Id.* at *15 ("On the other hand, if a § 162(m) plan could have been implemented at little cost and without constraining the Board, and the Board knew this or came to the contrary conclusion in bad faith, then the forgone deductions may have constituted waste.").

[32] 2012 WL 2501105, at *3 ("[A] decision to pursue or forgo tax savings is generally a business decision for the board of directors. Accordingly, despite the plaintiff's contentions, Delaware law is clear that there is no separate duty to minimize taxes, and a failure to do so is not automatically a waste of corporate assets."). The plaintiff in *Resnik v. Boskin* also failed to persuade the U.S. District Court for the District of New Jersey of the existence under New Jersey law of a general duty obliging corporate directors to achieve maximum tax benefits for the corporation. 2011 WL 689617, at *6.

[33] As in a proceeding to preliminarily enjoin a merger, defendants in this setting must determine whether to make additional disclosures (or tweaks to the plan) prior to the injunction hearing as part of a settlement with the plaintiff or to fight the motion on the merits with the risk that the meeting is enjoined temporarily.

excess of the amount permitted under previously approved versions of the company's incentive plan, which placed it out of compliance with NASDAQ listing requirements.[34] Votes on other proposals at the shareholder meeting, however, could go forward.[35]

Because the standard for a preliminary injunction generally includes a showing of a likelihood of success on the merits, the defenses discussed above are equally applicable to motions for injunctive relief.[36] In addition, at least one court facing these issues at a preliminary injunction stage determined that the plaintiff had failed to show an imminent threat of irreparable harm because a "'long series of hypothetical events would have to occur before the IRS would ever address the tax deductibility of an award'" under the plan.[37] But that determination was made after the court had found that the plaintiff had failed to show a likelihood of success on the merits. Moreover, the court's rationale may conflict with case law (primarily in the M&A context) holding that the threat of an uninformed shareholder vote constitutes irreparable harm.[38]

SETTLEMENTS ARE AKIN TO DISCLOSURE-ONLY SETTLEMENTS

Should a company find itself in Section 162(m) litigation, it may consider at the outset positioning the case for a potential settlement. Several Section 162(m) cases have resulted in court-approved, non-monetary settlements similar to disclosure-only settlements in merger strike suits. These settlements have largely centered around requiring the company's compensation committee to adopt a formal resolution that, in granting awards intended to comply with Section 162(m), the company will not rely on certain performance criteria stated in the company's compensation plan.[39] From a plaintiff's perspective, the rationale is that by reducing the number of performance criteria on which the compensation committee may base awards, the compensation structure becomes more transparent and objective, making compensation awards more likely to receive favorable tax treatment. In addition, these settlements have included that, for some period of time (usually three years), the company will make certain disclosures, such as which of the plan's performance criteria the compensation committee used in granting awards intended to comply with Section 162(m). In return, the lawsuit is dismissed and, without admitting any wrongdoing, defendants are granted full releases from liability.

Attorneys' fees for such settlements – which under Delaware law cannot be negotiated until the substantive terms of the settlement are final – have been negotiated and approved at approximately $400,000 to $600,000 per case, before a ruling on a motion to dismiss.[40] The attorneys' fees awarded in *Seinfeld v. Barrett*, which survived a motion to dismiss, were $862,500.[41] To support the settlement and fee award, plaintiffs argue that the settlement compensation includes a hypothetical monetary benefit to the company in the form of potential tax savings.

CONCLUSION

For now, Section 162(m) cases have been paying off for the attorneys who bring them. The complaints are relatively easy to draft, and, depending on the judge, even challenges to plans that appear to comply with Section 162(m) may withstand motions to dismiss. That means that these cases have settlement value.

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[34] 2012 WL 5270125 (N.D. Cal. Oct. 23, 2012).

[35] *See id.* at *7.

[36] *See Black*, 2011 WL 1640962, at *2–9 (denying motion for temporary restraining order and preliminary injunction to enjoin shareholder vote because plaintiff failed to show a likelihood of success on the merits because the plan did comply with Section 162(m)).

[37] *Id.* at *6 (quoting defendants' briefing).

[38] *See, e.g.*, *ODS Techs., L.P. v. Marshall*, 832 A.2d 1254, 1262 (Del. Ch. 2003) ("The threat of an uninformed stockholder vote constitutes irreparable harm."). The *Black* court's reasoning on irreparable harm, however, highlights some of the ripeness concerns raised in 162(m) cases as well as the irony that the plaintiffs purport to represent the interests of the company and its shareholders while at the same time inviting additional tax liability.

[39] *See, e.g.*, *Insulators & Asbestos Workers Local No. 14 Pension Fund v. Buckley*, Case No. 1:07-cv-00416-GMS (D. Del. June 5, 2009); *Pfeiffer v. Alpert*, Case No. 1:10-cv-01063-PD (D. Del. Aug. 3, 2011); *Lorber v. Barton*, Case No. 1:10-cv-01101-MPT (D. Del. Aug. 27, 2012).

[40] *See, e.g.*, *Insulators & Asbestos Workers Local No. 14 Pension Fund v. Buckley*, Case No. 1:07-cv-00416-GMS (D. Del. June 5, 2009) (order approving final settlement with attorneys' fees of $600,000); *Pfeiffer v. Alpert*, Case No. 1:10-cv-01063-PD (D. Del. Aug. 3, 2011) (order approving final settlement with attorneys' fees of $400,000); *Lorber v. Barton*, Case No. 1:10-cv-01101-MPT (D. Del. Aug. 27, 2012) (order approving final settlement with attorneys' fees of $400,000 and plaintiff's award of $2,000).

[41] Case No. 1:05-cv-00298-JJF (D. Del. May 23, 2007) (final judgment and order of dismissal).

Because so many companies are incorporated in Delaware, and given the case law from the Third Circuit and District of Delaware, Delaware courts are likely to remain attractive forums for plaintiffs. When adopting (or amending) a plan intended to comply with Section 162(m), having experienced counsel review the draft proxy statement may save a company from becoming a target of costly litigation. ■