UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF OHIO

NECA-IBEW PENSION FUND (THE DECATUR PLAN), Derivatively on Behalf of CINCINNATI BELL INC., Plaintiff, vs. PHILLIP R. COX, et al., Defendants, – and – CINCINNATI BELL INC., an Ohio corporation, Nominal Party.	)	No. 1:11-cv-00451-MRB-JGW

MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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SECONDARY AUTHORITIES

Plaintiff NECA-IBEW Pension Fund (The Decatur Plan) ("plaintiff") submits this Memorandum of Law in Opposition to the Motion to Dismiss of Defendants Cox, Byrnes, Haussler, Maier, Shumate, Wentworth, Zrno, Cassidy, Wojtaszek, and Wilson and the accompanying Memorandum of Law in support thereof ("Motion" or "Defs.' Mot.") (Dkt. No. 3).

I. INTRODUCTION AND SUMMARY

This is a shareholder's derivative action arising from defendants' failure to act in the best interests of Cincinnati Bell's shareholder owners. On May 3, 2011, pursuant to the say-on-pay vote authorized by the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), over 66% of Cincinnati Bell's voting shareholders (many of whom are sophisticated institutional investors holding tens of millions of shares of Cincinnati Bell stock) voted against the 2010 executive compensation packages approved by the Cincinnati Bell Board of Directors (the "Cincinnati Bell Board" or the "Board").[1] This resounding "no" reflects the conclusion by a majority of Cincinnati Bell's voting shareholders, after exercising their own independent business judgment, that the 2010 executive compensation, increasing the pay to defendants John F. Cassidy, Gary J. Wojtaszek, and Christopher J. Wilson (collectively, the "Executive Defendants"), did not serve their best interest as shareholder owners. Myles, Danielle "Experts Disagree on Validity of Say-on-Pay Lawsuits", *International Financial Law Review* (Aug. 2011), www.iflr.com/Article/2871185 Experts-disagree-on-validity-of-say-on-pay-lawsuits/html (quoting Professor Frank Partnoy, "A negative say-on-pay vote gives the court evidence that there's been a breach of fiduciary duty."), attached as Ex. 1 to the Declaration of Travis E. Downs III in

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[1] At the time the 2010 executive compensation was decided, the Cincinnati Bell Board consisted of defendants Phillip R. Cox, Bruce L. Byrnes, Jakki L. Haussler, Craig F. Maier, Alex Shumate, Lynn A. Wentworth, John M. Zrno, and John F. Cassidy. On May 3, 2011, Alan R. Schreiber, who is not a defendant, was added to the Board. *See* Cincinnati Bell, Inc., Current Report (Form 8-K) (May 5, 2011).

Support of Plaintiffs' Memorandum of Law in Opposition to Defendants Motion to Dismiss ("Downs Decl."); Morrissey, Daniel J. "Courts should curb executive pay", *The National Law Journal* (Aug. 15, 2011) (negative shareholder resolutions are "probative evidence that directors have violated their duties to act in the best interest of their companies' stockholders") Downs Decl., Ex. 2. Thus, the May 2011 shareholder vote is – from a factual perspective – compelling evidence that the Cincinnati Bell Board's decision to grant 54% to 83% increases to top executives' pay despite the Company's $63.1 million decline in net income and a negative shareholder annual return of 18.8%, was not in the best interests of the Company or its shareholders.

Normally, a board of directors is protected by the "business judgment rule" when making decisions about executive compensation. The business judgment rule is codified in Ohio under Ohio Rev. Code Ann. §1701.59(C) (2011) and presumes that a director in making a business decision "acted in good faith, in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation, or with the care that an ordinarily prudent person in a like position would use under similar circumstances." *See* Ohio Rev. Code Ann. §1701.59(c)(1). As part of that judgment, "a director, in determining what the director reasonably believes to be in the best interests of the corporation, ***shall*** consider the interests of the corporation's shareholders." Ohio Rev. Code Ann. §1701.59(E).[2] The business judgment rule is a rebuttable presumption that may be rebutted by a plaintiff with factual evidence that board members acted disloyally, *i.e.*, not in the best interests of the company or its shareholders. *See, e.g.*, *In re Nat'l Century Fin. Enters., Inv. Litig.*, 504 F. Supp. 2d 287, 312 (S.D. Ohio 2007).

The Cincinnati Bell Board breached its fiduciary duty of loyalty when it decided to approve these large pay hikes and whatever protection from liability the business judgment rule could have

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[2] Emphasis is added and citations and footnotes are omitted unless otherwise noted.

offered the Board before May 3, 2011, no longer applied once the results of the say-on-pay vote were revealed. The May 2011 shareholder vote – in which 66% of Cincinnati Bell's shareholders rejected the Board's 2010 executive pay hikes – is direct evidence that the Cincinnati Bell Board did not act in the best interests of shareholders because the pay raises contradicted the Company's pay-for-performance compensation policy, which purportedly requires executive compensation to be aligned with maximizing shareholder value. Specifically, as defendants represented, "[t]he guiding principles of the Company's compensation policies and decisions include aligning each executive's compensation with the Company's business strategy and ***the interests of our shareholders***." Cincinnati Bell Inc., Proxy Statement (DEF 14A) (March 21, 2011) ("Proxy Statement") at 20. Cincinnati Bell shareholders spoke through their vote and they said that the 2010 executive compensation was not aligned with their interests.

In light of this evidence, there can be no reasonable dispute as to whether the 2010 executive compensation was in the best interests of Cincinnati Bell shareholders. Thus, as a result of the Cincinnati Bell Board's decision to award massive executive pay raises, despite their failure to perform for Cincinnati Bell and its shareholders in 2010, plaintiff brought this shareholder derivative suit on behalf of nominal party Cincinnati Bell, alleging: (1) breach of loyalty by the Cincinnati Bell Board; (2) unjust enrichment by Cincinnati Bell's CEO and top executives; and (3) aiding and abetting by compensation consultant Towers Watson & Co.[3] *McCall v. Scott*, 239 F.3d 808, 816 (6th Cir. 2001) ("'The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management.'").

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[3] As the Court is aware, by stipulation of the parties, Towers Watson & Co. has been granted additional time to respond to the Complaint. Dkt. 19.

Defendants' only response is to claim that plaintiff should have made a pre-suit demand upon the Board and, in any event, the shareholder vote is meaningless because it is non-binding. They are wrong. First, a pre-suit demand is not required where a majority of the Board faces a substantial likelihood of liability for acting disloyally to the Company and its shareholders by granting excessive executive compensation in 2010 that was not pay-for-performance. Plaintiffs' well-pled and particularized allegations detail just such a breach of fiduciary duty by defendants here.

Second, neither Ohio, Delaware nor the United States Congress mandate (let alone suggest) that a court wholly disregard the outcome of a shareholder vote as meaningless – even if the vote is an advisory one.[4] *See, e.g.*, *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009) (considering the legal significance of a shareholder vote concerning a challenged transaction); *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170-71 (Del. 2006) (holding that it was proper to take judicial notice of a shareholder vote, as publicly available fact, reported by the company in a in a public filing). The advisory nature of the vote does not affect (nor should it) the Court's use of the ***results*** of that vote as ***evidence*** in determining whether defendants breached their duties. Indeed, Congress passed the say-on-pay provisions of the Dodd-Frank Act so that shareholders could be heard regarding executive compensation. The same shareholder voice, heard through the results of the say-on-pay vote, also put courts in a much better position to evaluate, with undisputed evidence, if a corporation's board of directors acted in the best interests of the true owners of the company – the shareholders. And, because the Verified Shareholder Derivative Complaint for Breach of

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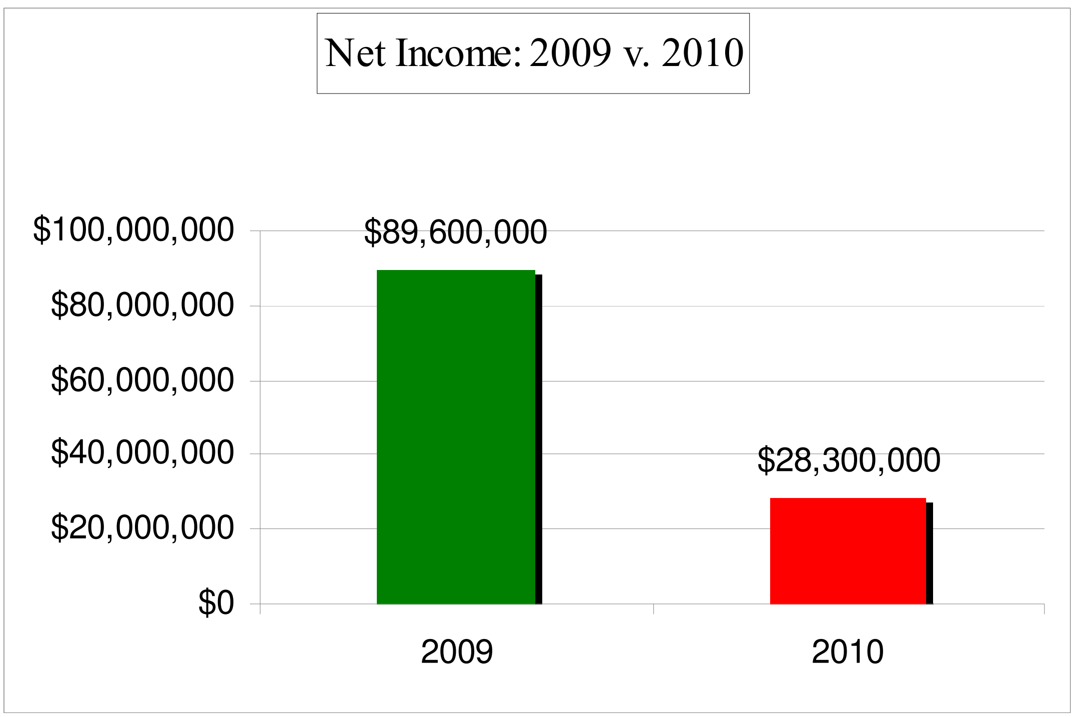
[4] Nor did the Dodd-Frank Act change the Court's duty to accept as true the well-pleaded allegations contained in the complaint and draw all reasonable inferences in favor of the nonmoving party when assessing a motion to dismiss. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007); *In re Ferro Corp. Deriv. Litig.*, 511 F.3d 611, 617 (6th Cir. 2008).

Fiduciary Duty of Loyalty, Aiding and Abetting and Unjust Enrichment (the "Complaint") (Dkt. No. 1) demonstrates that defendants did not do that here, the Motion should be denied.

II. FACTUAL BACKGROUND

The factual allegations of the Complaint are largely admitted and otherwise uncontestable. In 2010, Cincinnati Bell posted a $61.3 million decline in net income and a negative 18.8% annual shareholder return. ¶¶2, 28, 31.[5] The Company's 2010 net income applicable to common shareowners, earnings per share, and total shareholders' equity all materially declined as well. ¶28. Cincinnati Bell's negative performance is illustrated below:



[5] Unless otherwise noted, all "¶_" and "¶¶__" references are to the Complaint.

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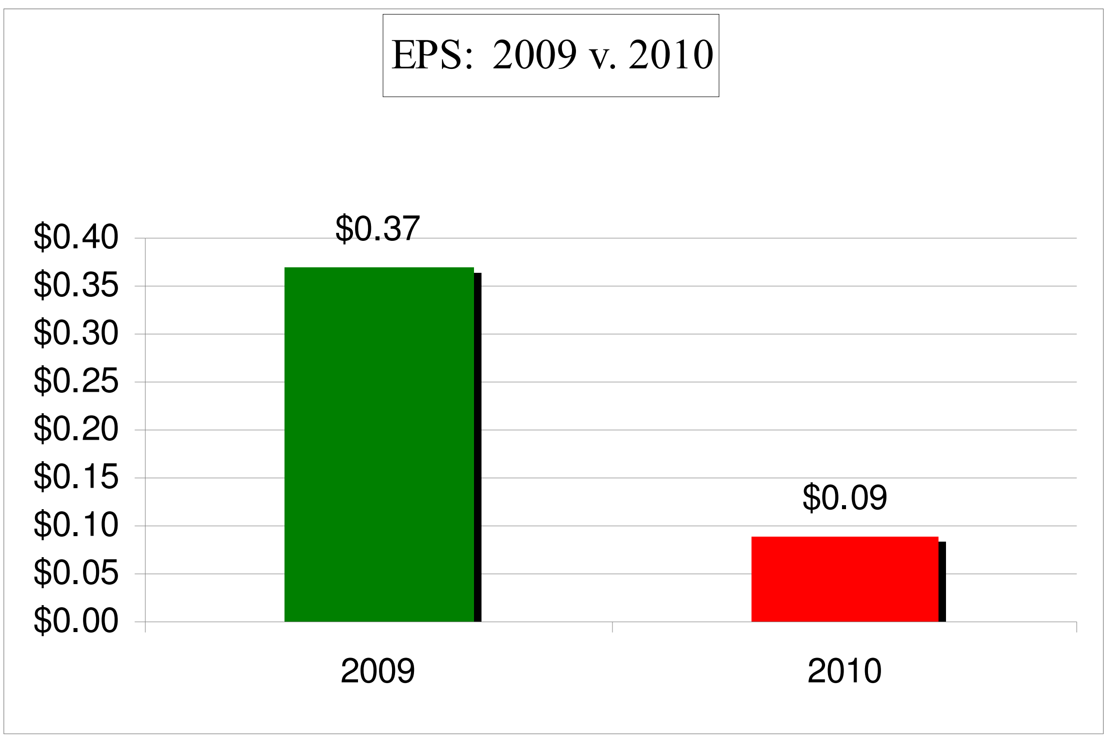

Id.

In this same year of dismal company performance, the Cincinnati Bell Board decided to increase the compensation of the Company's CEO and top executives. ¶30. As a result of this decision, defendant Cassidy (Cincinnati Bell's CEO and a member of the Board) received $8,562,462 in total compensation for 2010, representing a 71.7% increase over 2009. ¶¶11, 30. Likewise, defendant Wojtaszek (Cincinnati Bell's CFO) received $2,074,427 in total compensation for 2010 – an 80.3% increase over 2009. ¶¶12, 30. And defendant Wilson (Cincinnati Bell's Vice President and General Counsel) received a 54% increase over 2009, providing him $1,421,794 in total compensation for 2010. ¶¶13, 30.

This increased pay at a time of decreased performance represented a stark departure from the pay-for-performance executive compensation policy adopted by the Cincinnati Bell Board. ¶27. The pay-for-performance policy, as represented to Cincinnati Bell shareholders, is designed to link executive pay with corporate performance by rewarding executives for superior performance and having negative consequences for underperformance. ¶¶27, 32. The Cincinnati Bell Board purported to follow this policy in deciding the 2010 executive compensation. *Id*.

Cincinnati Bell shareholders voted upon the 2010 executive compensation in the Company's first-ever say-on-pay vote during the May 3, 2011 annual shareholder meeting. ¶¶2, 35. Cincinnati Bell's shareholder base consists primarily of sophisticated institutional investors, such as Peninsula Capital Advisors, LLC; California Public Employees' Retirement System; and BlackRock Fund Advisors, that not only own millions of Cincinnati Bell's shares worth tens of millions of dollars, but who combined, oversee and manage trillions of dollars in assets. These institutional shareholders have financial interests in Cincinnati Bell that typically are significantly larger than the individual and/or collective financial interests of the Cincinnati Bell Board and/or its corporate managers. ¶34. These types of sophisticated institutional investors also have the experience and resources to independently evaluate whether executive compensation is in their best interests as Cincinnati Bell shareholders. *Id*.

The entire Cincinnati Bell Board recommended shareholder approval of the 2010 executive compensation in the March 21, 2011 Proxy Statement filed with the SEC. ¶¶32, 35. To support its decision, the Cincinnati Bell Board set forth all of the material factors it considered in deciding that increasing CEO and top executive pay in 2010. ¶33. In the Proxy Statement, the Cincinnati Bell Board stated that "a significant portion of the total compensation for each of our executives is directly related to the Company's earnings and revenues and other performance factors" and that the executive compensation is "tied to the achievement of specific short-term and long-term performance objectives, principally the Company's earnings, cash flow and the performance of the Company's common shares." ¶¶27, 32.

Cincinnati Bell reported the final results of the say-on-pay vote in a May 9, 2011 SEC filing on Form 8-K. ¶35. The results were staggering. Over 96.9 million shares voted against the 2010 executive compensation recommended by the Cincinnati Bell Board. In other words, approximately 66% of Cincinnati Bell's voting shareholders publicly stated that the 2010 executive compensation was ***not*** in their best interests.

III. ARGUMENT

A. The Complaint's Allegations Rebut the Business Judgment Rule and Sufficiently Demonstrate Demand Futility

Under both federal and Ohio law, a derivative action such as this one seeking to enforce a right that the corporation may properly assert but has failed to enforce, must allege with particularity any efforts by the plaintiff to obtain the desired action from the directors or the reasons for not doing so. Fed. R. Civ. P. Rule 23.1; Ohio R. Civ. P. Rule 23.1. However, a pre-suit demand is unnecessary when a majority of the board of directors is subject to a disqualifying interest. *McCall*, 239 F.3d at 826; *Drage v. P&G*, 119 Ohio App. 3d 19, 29 (1997). A director is subject to such a disqualifying interest when he faces a substantial likelihood of liability because there is reason to doubt that the challenged decision is the product of a valid exercise of business judgment. *In re*

Keithley Instruments, Inc. Deriv. Litig., 599 F. Supp. 2d 875, 891 (N.D. Ohio 2008) (citing *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993), and *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984)). Thus, by rebutting the presumption of the business judgment rule as to a majority of the board of directors, a plaintiff has established demand futility.

There is, at the very least, reason to doubt that the Cincinnati Bell Board's decision to award the 2010 executive compensation here was the product of a valid exercise of business judgment because it was not in the best interests of the Company's shareholders. By pleading with particularity that the Board breached its unremitting duty of loyalty, plaintiff has rebutted the business judgment rule. Accordingly, a majority of the Cincinnati Bell Board face a substantial likelihood of liability, and any demand upon them would be futile.

1. The Cincinnati Bell Board's Breach of Its Fiduciary Duty of Loyalty Strips It of Any Business Judgment Protection

To receive the protection of the business judgment rule, directors must faithfully discharge their unremitting duty of loyalty by always putting the interests of shareholders ahead of their personal interests and the interests of corporate managers. *Kelly v. Wellsville Foundry, Inc.*, No. 99-CO-27, 2000 WL 1809021, at *9 (Ohio App. Dec. 6, 2000); *see also In re Tyson Foods, Inc. Consol. S'holder Litig.*, No. 1106-CC, 2007 Del. Ch. LEXIS 120, at *10-*11 (Del. Ch. Aug. 15, 2007) ("Loyalty. Good faith. Independence. Candor. These are words pregnant with obligation. The Supreme Court did not adorn them with half-hearted adjectives. Directors should not take a seat at the board table prepared to offer only conditional loyalty, tolerable good faith, reasonable disinterest or formalistic candor.").[6] Indeed, a director's responsibilities to the interests of the corporation's

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[6] A determination of the contours of Ohio's corporate law, including the business judgment rule and demand futility, may be assisted by reference to Delaware case law as "Delaware courts are widely renowned and respected for their expertise in the area of business law." *Kelly*, 2000 WL

shareholders is codified in Ohio law, under Ohio Revised Code §1701.59(E), addressing the authority, liability and standard of care for directors of a corporation: "For purposes of this section, a director, in determining what the director reasonably believes to be in the best interests of the corporation, ***shall*** consider the interests of the corporation's shareholders . . . ." *See also The Corporate Director's Guidebook*, 33 Bus. Law. 1591, 1599-1600 (1978) ("By assuming his office, the corporate director commits allegiance to the enterprise and acknowledges that the best interests of the corporation and its shareholders must prevail over any individual interest of his own."). Thus, in fulfilling his or her duties to the corporation, a director ***must***, under Ohio statute, consider the interest of the corporation's shareholders. *Thompson v. Cent. Ohio Cellular, Inc.*, No. 68525, 1996 WL 492263, at *5 (Ohio App. Aug. 29, 1996); *Washington Penn Plastic Co., Inc. v. Creative Engineered Polymer Prod., LLC*, No. 5:06CV1224, 2007 WL 2509873, at *2 (N.D. Ohio Aug. 30, 2007) (stating that it is mandatory for a director to consider the interests of shareholders). Directors choosing to govern a corporation's affairs counter to shareholders' best interests – guided instead by the desire to serve themselves and the interests of corporate management – cannot seek refuge from their fiduciary breach in the protections of the business judgment rule. *Kelly*, 2000 WL 1809021, at *9; *Keithley*, 599 F. Supp. 2d at 902; *see also Pfeiffer v. Toll*, 989 A.2d 683, 707 (Del. Ch. 2010) ("***The duty of loyalty has paramount importance*** under Delaware law. Delaware's consistent corporate philosophy has been to grant deference to boards in exercising their authority to direct and oversee the business and affairs of the corporation, balanced by ***assiduous protection of the***

1809021, at *4; *see also, e.g.*, *Doe v. Malkov*, 2002 WL 31928645, at *5 (Ohio App. Dec. 31, 2002) (citing Delaware law); *Drage*, 119 Ohio App. 3d at 25 (same).

stockholders' right to . . . meaningful enforcement of fiduciary duties, with particular emphasis on the duty of loyalty.").[7]

The Cincinnati Bell Board did just that. By approving the 2010 executive compensation contrary to Cincinnati Bell's pay-for-performance policy, the Board failed to act in shareholders' best interests. ¶¶3-4, 36. After a year where shareholders suffered a ***negative 18.8%*** return on their shares, the Cincinnati Bell Board raised the compensation of the Company's top executives by ***54% to 83%***. ¶¶28, 30-31, 37. Further, the Board's 54% to 83% pay raises came in the same year that Cincinnati Bell lost money with a $61.3 million reduction in net income. ¶¶28, 31, 37. By doing so, the Board put the interests of the Company's top executives over those of shareholders in violation of the Board's fiduciary duty of loyalty. ¶¶3-4, 36.

Defendants incorrectly assert that the Complaint alleges a breach of the duty of loyalty simply because plaintiff believes that "a board of directors cannot award incentive payments to a company's executives in any year in which the company's stock price declined or net income declined." Defs.' Mot. at 21. This is not what plaintiff believes, nor is it what plaintiff alleges. Instead, the Complaint alleges that the Cincinnati Bell Board breached its duty of loyalty because the 2010 executive compensation (that did award incentive payments to the Company's executives in a year in which the Company's stock price and net income declined) was not in the best interests of

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[7] Defendants wrongly claim that plaintiff's must rebut the business judgment rule by "clear and convincing evidence" at the pleading stage. Defs.' Mot. at 19. This assertion confuses the applicable pleading standard with the burden of proof imposed by Ohio Rev. Code §1701.59(C). *Nat'l Cent.*, 504 F. Supp. 2d at 312 ("the business judgment rule imposes a burden of proof, not a burden of pleading"). Specifically, "the business judgment rule would impose on [p]laintiff[] a burden at trial to present evidence to rebut the presumption the rule imposes," but not an obligation "to plead operative facts in [the] complaint that would rebut the presumption." *Marsalis v. Wilson*, 149 Ohio App. 3d 637, 642 (2002). Notwithstanding, plaintiff is required by Fed. R. Civ. P. 23.1 and Ohio law to plead demand futility with particularity, and has done so. Fed. R. Civ. P. 23.1; Ohio Civ. R. 23.1. That particularity requirement, though, is far less stringent than the clear and convincing evidence standard defendants inappropriately seek at this early stage of the litigation.

the Company's shareholders. ¶¶3-4, 36, 42, 47. The evidence to support this allegation is the fact that shareholders said so by voting overwhelmingly against the 2010 executive compensation as not in their best interests. ¶¶2, 4, 35-36, 42, 47.

Unlike many cases where the best interests of shareholders may be amorphous or undefined, the shareholder vote here is direct and undisputed evidence. In fact, the vast majority of Cincinnati Bell shareholders – over 66% – demonstrated that the 2010 executive compensation was not in their best interests because it was grossly misaligned with the interests of the Company and its shareholders. Of course, this should not surprise defendants because Cincinnati Bell's dismal 2010 corporate performance cannot reasonably justify increases in executive compensation as high as 83%. *See* ¶30. Importantly, the 66% of voting Cincinnati Bell shareholders was not just some random collection of stockholders with "axes to grind" against the Cincinnati Bell Board and the Company's top executives. In fact, it was just the opposite. Sophisticated institutional investors like those who voted against Cincinnati Bell's 2010 executive compensation, owning tens of millions of Cincinnati Bell shares and managing trillions of assets combined, are well-versed in the intricacies of corporate governance and decision-making that is in the best interests of their shareholders, pensioners and employees.

It is also significant that the shareholder vote did not come with the benefit of hindsight or additional information that was unavailable to the Cincinnati Bell Board at the time they made their decision to grant the excessive compensation. Instead, all of the facts and data available to the Cincinnati Bell Board in awarding 54% to 83% raises to Cincinnati Bell's top executives was the ***same information available to shareholders the day they voted against it***. In fact, defendants spend several pages of their Motion describing the process they engaged in to determine the 2010 executive compensation. However, the entirety of this information is contained in the Compensation Discussion and Analysis included in the Proxy Statement recommending that shareholders approve the 2010 executive compensation. Surely, defendants do not repeat that information in their Motion to suggest that shareholders did not have all of the information necessary to make an informed decision concerning the 2010 executive compensation. If, however, that is the case, and the Proxy Statement omitted material information, then defendants have additionally breached their duty of loyalty (and candor) by failing to disclose all material facts surrounding a matter subject to shareholder vote. *See, e.g.*, *Tyson Foods*, 2007 Del. Ch. LEXIS 120, at *14 n.18 ("When directors speak out about their own compensation, or that of company managers, shareholders have a right to the full, unvarnished truth.").

In defending the executive compensation decision, defendants also argue that the appropriate metrics used to increase executive pay in 2010 were the target goals for earnings before interest, taxes, depreciation, and amortization ("EBITDA") and revenue. Defs.' Mot. at 10-11, 22. Notwithstanding the fact that this factual argument is inappropriate at the motion to dismiss phase, defendants' assertion misses the mark. As a threshold matter, it is important to note that the target goals for EBITDA and revenue were each set far lower than the actual EBITDA and revenue achieved by Cincinnati Bell in years prior. With regard to EBITDA, the target goal of $460 million was lower than the Company's actual EBITDA for the years 2009 ($470.2 million), 2008 ($478.2 million), and 2007 ($473 million). *See* Cincinnati Bell Inc., Annual Report (Form 10-K) (Feb. 20, 2011). The same is true for revenue, where the target goal of $1,332.0 million was lower than the Company's actual revenue for 2009 ($1,336.0 million), 2008 ($1,403.0 million), and 2007 ($1,348.6 million). *Id*. at 25. From this, it seems that the Cincinnati Bell Board set a very low bar for awarding executive compensation in 2010. Moreover, the metrics used by the Cincinnati Bell Board in approving the 2010 executive compensation were disclosed to shareholders in the Proxy Statement, and were rejected by shareholders when they rejected the 2010 executive compensation premised upon those metrics.

Defendants do not refute (nor can they) that the result of the shareholder vote is evidence of what is in the best interests of Cincinnati Bell's shareholders. Instead, defendants allot a considerable amount of space in their brief discussing the advisory nature of the shareholder vote under the Dodd-Frank Act. Defs.' Mot. at 4-6, 20. What defendants fail to recognize – and hope the Court will follow suit – is the evidentiary value of the shareholder vote as a ***fact***, separate and apart from the legal significance bestowed upon it by Congress or the SEC. *See* Downs Decl. Ex. 1, at 1 ("They note that fiduciary duties fall within states' jurisdiction, and so the text of the Dodd-Frank federal statute is not dispositive to the claims."). The advisory nature of the say-on-pay provision under the Dodd-Frank Act is of no moment because the result of the vote itself is evidence that the decision by the Cincinnati Bell Board to reward the Company's CEO and other top executives for "performance" that provided a decline in net income of negative $63.1 million and an annual return for the shareholders of negative 18.8% was not in the best interests of Cincinnati Bell or its stockholders. Whether the vote was mandatory and advisory under the Dodd-Frank Act or occurred for some other reason is of no consequence to the evidentiary value of the result of the vote and its statement of shareholders' interests regarding the 2010 executive compensation. Downs Decl., Ex. 1, at 1 (quoting Professor Frank Partnoy, "A negative say-on-pay vote gives the court evidence that there's been a breach of fiduciary duty."). The vote, as evidence, rebuts any presumption of business judgment protection for the Board as it demonstrates at least a reasonable doubt that the Board's actions were in the shareholders' best interests. *See Keithley*, 599 F. Supp. 2d at 891; *Ryan v. Gifford*, 918 A.2d 341, 345-55 (Del. Ch. 2007) (excusing demand where allegations raised reason to doubt whether granting backdated executive stock options was a valid exercise of business judgment and not a breach of loyalty); *Weiss v. Swanson*, 948 A.2d 433, 447-48 (Del. Ch. 2008) (same); *Edmonds v. Getty*, 524 F. Supp. 2d 1267, 1276-77 (W.D. Wash. 2007) (same).

Moreover, plaintiff's reliance on the result of the shareholder vote as evidence reflects the well-settled principle that directors do not have *carte blanche* to make executive compensation decisions that are not in the best interests of shareholders. *See* Ohio Rev. Code §1701.59(E); *In re Citigroup, Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 138-39 (Del. Ch. 2009) ("'there is an outer limit' to the board's discretion to set executive compensation, 'at which point a decision of the directors on executive compensation is so disproportionately large as to be unconscionable and constitute waste'"); *see also Kelly*, 2000 WL 1809021, at *9; *Tyson*, 2007 Del. Ch. LEXIS 120, at *10-*11; *In re Viacom Inc. S'holder Deriv. Litig.*, No. 602527/05, 2006 N.Y. Misc. LEXIS 2891, at *21-*22 (N.Y. Sup. Ct. June 26, 2006) (same).

Consideration by this Court of the vote as evidence of the shareholders' best interests is not barred by the Dodd-Frank Act, as considering the vote itself does not create new or altered existing fiduciary duties of corporate directors. When Congress enacted advisory say-on-pay votes, it intended to give shareholders an efficient mechanism for expressing their views on whether the corporation's executive compensation is in the best interests of shareholders. The Dodd-Frank Act contemplated that the result of a say-on-pay vote would be a referendum on whether the executive compensation paid by the board of directors to top executives of the corporation actually serves the best interests of shareholders. *See Congressional Research Service, Dodd-Frank: Executive Compensation*, CRS-R41319 (2011) ("Concern about shareholder value, corporate governance, and the economic and social impact of escalating pay for corporate executives has led to discussions, particularly over the past few years, regarding the practices of paying these executives.").

This conclusion flows naturally from both the text of the say-on-pay law as well as its legislative history. For example, the Dodd-Frank say-on-pay law expressly states that not less than every three years proxy materials "shall include a separate resolution subject to shareholder vote to approve the compensation of executives." Dodd-Frank Act §951(a)(1). The House Conference

Report makes clear that these provisions were "designed to address shareholder rights and executive compensation." H.R. Conf. Rep. No. 111-517, at 872 (2010); *see also* S. Rep. No. 111-176, at 55-56 (2010) (explaining that say-on-pay provisions address concerns that "investors need more protection; shareholders need a greater voice in corporate governance"). Thus, even a cursory review of the text of the statute indicates that the result of a say-on-pay vote is supposed to serve as a referendum on whether the executive compensation is in the best interests of shareholders, as owners of the corporation. *See* S. Rep. No. 111-176, at 133 (2010) ("Nonbinding shareowner votes on pay [were meant to] serve as a direct referendum on the decisions of the compensation committee and . . . offer a more targeted way to signal shareowner discontent than withholding votes from committee members.").

The legislative history of the Dodd-Frank say-on-pay law also confirms that say-on-pay tests whether the corporation's executive compensation is in shareholders' best interests. As the Senate Banking Report states "shareholders, as the owners of the corporation, have a right to express their opinion collectively on the appropriateness of executive pay." *Id.* In fact, the Senate Banking Report explains that the say-on-pay provision was adopted in response to an economic crisis in which "corporate executives received very high compensation despite the very poor performance by their firms," a situation which describes exactly the actions of the Cincinnati Bell Board here. *Id.*

Defendants also attempt to undermine the shareholder vote by arguing that its consideration as evidence requires some change or amendment to directors' fiduciary duties and the business judgment rule. Defs.' Mot. at 20. This is incorrect. Plaintiff does not seek to overrule the decision by the board of directors, change the fiduciary duties owed by the board of directors or create additional fiduciary duties. Instead, plaintiff challenges the 2010 executive compensation as a breach of the directors' unremitting fiduciary duty of loyalty, which existed, as defendants would agree, decades prior to the enactment of the Dodd-Frank Act. Ohio Rev.Code Ann. §1701.59(B);

Radol v. Thomas, 772 F.2d 244, 256 (6th Cir. 1985); Defs.' Mot. at 19. The shareholder vote rejecting the 2010 executive compensation serves as evidence to support plaintiff's challenge and to move this action past defendants' motion to dismiss.[8] Ultimately, beyond the pleading stage, this challenge is one to which defendants may respond with evidence of their own.

Under similar circumstances involving executive compensation, courts do not hesitate to hold faithless fiduciaries accountable. For example, in *Keithley* 599 F. Supp. 2d 875 (N.D. Ohio 2008), the court found that improper executive compensation had been paid using stock options that violated the company's compensation plan. *Id.* at 899. In its analysis of the directors' misconduct, the court held that "the members of the Compensation Committee that approved those options . . . are subject to a substantial likelihood of liability for purposes of demand futility." *Id.* at 902.[9] Thus, contrary to defendants' contention that "mere approval" is not sufficient to excuse demand, directors who engage in executive compensation decisions that breach their fiduciary duty of loyalty face a disabling interest rendering demand futile.

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[8] Defendants cite *Worth v. Huntington Bancshares, Inc.*, 43 Ohio St.3d 192, 197, 540 N.E.2d 249 (1989); *Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. Raines*, 534 F.3d 779, 791 (D.C. Cir. 2008), and *Jannett v. Gilmartin*, No. HNT-L-341-05, 2006 WL 2195819 (N.J. Super. L. July 21, 2006), as support for the courts' typical deference to executive compensation decisions by boards of directors. Unlike the instant case, the cases cited by defendants suffered from a lack of evidence, direct or otherwise, that the executive compensation was contrary to shareholders' best interest. Moreover, as demonstrated *infra* at 17-19, courts are more than willing to review an executive compensation decision when there is reason to doubt the presumption of business judgment on the part of the board of directors. *See, e.g.*, *Citigroup*, 964 A.2d at 138-39; *Viacom*, 2006 N.Y. Misc. LEXIS 2891, at *21-*22; Downs Decl., Ex. 3, Ralph Ferrara & Stacy Puente "Who Tore a Hole in the Golden Parachute? Say-on-Pay in a Post-Bailout World", *Bloomberg Law Reports*, Vol. 5, No. 9 (2011) ("Recent court opinions and financial reform legislation reflect a growing distrust in the decision-making authority of corporate boards of directors . . . .").

[9] The court in *Keithley* ultimately held that demand was not futile as to a majority of the board because the applicable statute of limitations barred claims against one of the former members of the compensation committee, and thus, he did not face a substantial likelihood of liability. 599 F. Supp. 2d at 907. This distinction is irrelevant to the Court's determination in the instant case as defendants have not raised any challenges to the Complaint based upon any statute of limitations.

The decision by the Delaware Chancery Court in *Ryan*, 918 A.2d 341, is also instructive. In *Ryan*, the board of directors approved executive compensation in violation of the terms of its stated executive compensation policy and simultaneously made false representations to shareholders regarding the compensation. Rejecting the director's arguments regarding demand futility, the court concluded that because the directors granted the executive stock options on terms inconsistent with the company's executive stock option program (similar to the Cincinnati Bell Board's deviation from its own policy to link executive compensation to maximizing shareholder value), the *Ryan* board breached its fiduciary duty of loyalty. *Id.* at 355-56. The *Ryan* court also found the directors' misconduct so egregious that it stripped them of the protections afforded by the business judgment rule. *Id.*

Several courts reached this same result numerous times and permitted cases involving backdating of executive stock option compensation that breached the fiduciary duty of loyalty to survive motions to dismiss. *Tyson*, 919 A.2d at 592-93; *Edmonds*, 524 F. Supp. 2d at 1276-77 (finding that directors faced a substantial likelihood of liability for their roles in approving executive stock option compensation in violation of compensation plans); *Conrad v. Blank*, 940 A.2d 28, 40 (Del. Ch. 2007) (same); *Weiss*, 948 A.2d at 441 (same); *In re Zoran Corp. Deriv. Litig.*, 511 F. Supp. 2d 986, 1008 (N.D. Cal.) (same); *Belova v. Sharp*, 07-299 MO, 2008 U.S. Dist. LEXIS 19880 (D. Or. Mar. 13, 2008) (same); *In re F5 Networks Inc., Deriv. Litig.*, 207 P.3d 433, 439 (Wash. 2009) (same); *In re CNET Networks, Inc.*, 483 F. Supp. 2d 947, 958 (N.D. Cal. 2007) (same); *Plymouth County Ret. Ass'n v. Shroeder*, 576 F. Supp. 2d 360, 373 (E.D.N.Y. 2008) (same); *In re Maxim Integrated Prods.*, 574 F. Supp. 2d 1046, 1061 (N.D. Cal. 2008) (same).

Like compensating executives using backdated stock options in violation of corporate policies, Cincinnati Bell shareholders have stated that awarding top executives with pay increases at a time when the Company and its shareholders are losing money is not in shareholders' or the

Company's best interests. Cincinnati Bell follows a pay-for-performance policy that ties executive compensation to performance, and thus, the Company and shareholders expect that, under this policy, pay increases will only be awarded to top executives when the Company is performing positively. Specifically, as defendants represented, "[t]he guiding principles of the Company's compensation policies and decisions include aligning each executive's compensation with the Company's business strategy and the interests of our shareholders." Proxy Statement at 20. In 2010, Cincinnati Bell suffered significantly, and the decision of the Board to raise executive compensation despite this fact violated that policy and the duties owed to the Company and its shareholders by the Board. *See Citigroup*, 964 A.2d at 138-39 (finding that award of multimillion dollar severance package to CEO responsible for major losses raised a reasonable doubt that the decision was the product of a valid exercise of business judgment); *Viacom*, 2006 N.Y. Misc. LEXIS 2891, at *21-*22 (holding that executive compensation awarded in a year of significant losses was not protected by the business judgment rule). Thus, just as in the cases cited above, the Board's decision to grant the excessive 2010 executive compensation represents a breach of the Cincinnati Bell Board's fiduciary duty of loyalty because it is a decision that is contrary to the best interests of the Company or its shareholders.

Another executive compensation case, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), relied upon by defendants in their brief (Defs.' Mot. at 18), actually supports plaintiff's argument. As an initial matter, the plaintiffs in *Brehm*, unlike plaintiff here, did not demonstrate with direct or circumstantial evidence that the challenged compensation was not in the best interest of shareholders. Even without the probative value of a shareholder vote, plaintiffs' claims survived dismissal and proceeded to summary judgment, and eventually to trial. Importantly, in *Walt Disney*, the court presciently noted that the result might be different for a similar present-day pay package approved in "an era that has included the Enron and WorldCom debacles, and the resulting legislative focus on corporate governance." *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 697 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006). Indeed, the *Walt Disney* court's prediction has been borne out by the enactment of the Dodd-Frank Act in the wake of the 2008 financial crisis.

Taken as true, the particularized facts set forth in the Complaint rebut the presumption that the Cincinnati Bell Board acted in the shareholders' best interests when it approved the 2010 executive compensation. The facts alleged sufficiently demonstrate that: (1) the Cincinnati Bell Board breached its duty of loyalty by ignoring shareholders' best interests and increasing 2010 executive pay in violation of its pay-for-performance executive compensation policy; (2) the business judgment presumption does not protect defendants for breaches of their duty of loyalty; and (3) therefore, defendants face a significant likelihood of liability.

2. Pre-Suit Demand Is Unnecessary Because the Cincinnati Bell Board Is Not Disinterested

A pre-suit demand on a company's board of directors is unnecessary when a shareholder plaintiff can sufficiently allege that there is a reason to doubt that a majority of the board of directors is disinterested. *In re FirstEnergy S'holder Deriv. Litig.*, 320 F. Supp. 2d 621, 624 (N.D. Ohio 2004); *Keithley*, 599 F. Supp. 2d at 890. As courts applying both Ohio and Delaware law recognize, when a majority of a board's directors face a substantial likelihood of liability for breaching their fiduciary duty of loyalty, their independence is doubtful. *FirstEnergy*, 320 F. Supp. 2d at 624 (recognizing that a pre-suit demand is unnecessary where a majority of the directors face a sufficiently substantial threat of personal liability to compromise their ability to act impartially on a pre-suit demand); *Keithley*, 599 F. Supp. 2d at 890 (same); *Zoran*, 511 F. Supp. 2d at 1617 (same); *F5 Networks*, 207 P.3d at 439 (same); *In re MRV Commc'ns, Inc.*, No. CV 08-3800 GAF, 2010 U.S. Dist. LEXIS 46946, at *16 (C.D. Cal. May 10, 2010) (same); *Maxim*, 574 F. Supp. 2d at 1060-061 (same).

Here, as demonstrated *infra*, the Cincinnati Bell Board is liable for a breach of loyalty by approving excessive executive compensation for Cincinnati Bell's CEO and top executives in violation of the terms of the Board's pay-for-performance executive compensation policy. The decision of the Board to award the 2010 executive compensation is not protected by the presumption of the business judgment rule as evidenced by the negative shareholder vote. Accordingly, the Cincinnati Bell Board's conduct in approving the 2010 executive compensation subjects them to a substantial likelihood of liability and they are not disinterested for purposes of demand futility.

Additionally, Cincinnati Bell's CEO, defendant Cassidy, is not disinterested. Defendant Cassidy is the recipient of much of the excessive compensation that is the subject of this lawsuit. ¶¶11, 30, 43. Defendant Cassidy's receipt of the excessive compensation at issue here renders him interested in the outcome of the litigation and raises a reasonable doubt about his ability to objectively consider a pre-suit demand. *Ryan*, 918 A.2d at 356 ("Plaintiff alleges that three members of a board approved backdated options, and another board member accepted them. These are sufficient allegations to raise a reason to doubt the disinterestedness of the current board and to suggest that they are incapable of impartially considering demand.").[10] Defendants admit to as much in their Motion. Defs.' Mot. at 15-16. Moreover, as the Company's CEO, he holds substantial influence over the rest of the directors sufficient to raise a reasonable doubt as to their independence. *See In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 984 (Del. Ch. 2007) (excusing demand on nine member board where complaint alleged board allowed CEO and major shareholder to enrich selves at the expense of other shareholders).

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[10] *Cf. MRV*, 2010 U.S. Dist. LEXIS 46946, at *13 ("A number of cases have held that the acceptance of backdated options creates reasonable doubt to the disinterestedness of particular directors."); *Conrad*, 940 A.2d at 38 ("the two directors who allegedly received backdated options . . . are clearly not disinterested"); *Maxim*, 574 F. Supp. 2d at 1060 (same); *Zoran*, 511 F. Supp. 2d at 1003 (same).

Defendants also seem to argue that demand is not futile as to a majority of the Board because the 2010 executive compensation decision rested solely within the responsibility of the Compensation Committee, and not the entire Cincinnati Bell Board. Defs.' Mot. at 19. Although plaintiff alleges that the entire Board was responsible for the 2010 executive compensation decision, it makes no difference for purposes of demand futility. To establish demand futility, plaintiff must allege that a majority of the Board cannot appropriately decide whether to bring a lawsuit on behalf of the Company. Assuming *arguendo*, that the Compensation Committee is solely responsible for the 2010 executive compensation decision, demand is still futile as to a majority of the Board as the five members of the Compensation Committee constitute a majority of the eight directors on the Cincinnati Bell Board. Defs.' Mot. at 8 ("The Board's Compensation Committee consists of five Board members . . . ."), 15 ("Seven of Cincinnati Bell's eight directors – including all five members of the Compensation Committee.").

Therefore, because a majority of the membership of the Cincinnati Bell Board (seven of the eight directors) faces a substantial likelihood of personal liability based on their decision to award under served executive compensation increases despite the Company's poor financial performance in 2010, the Complaint sufficiently alleges demand futility.

B. The Complaint States Actionable Claims of Unjust Enrichment

Contrary to defendants' arguments here, the Complaint also adequately alleges unjust enrichment against defendants Cassidy, Wojtaszek, and Wilson. Under Ohio law, a claim for unjust enrichment requires: (1) a benefit conferred upon the defendant; (2) knowledge by defendant of the benefit; and (3) retention of the benefit in circumstances where it would be unjust to do so without payment. *Nat'l Cent.*, 2006 WL 469468, at *15 (citing *Hiram College v. Courtad*, 162 Ohio App. 3d 642, 646 (Ohio App. 2005)). Defendants rightfully do not challenge that defendants Cassidy, Wojtaszek, and Wilson were conferred a benefit through the 2010 executive compensation or that they have knowledge of the benefit. Nor do defendants challenge that the defendants Cassidy, Wojtaszek, and Wilson have retained this benefit.

Instead, defendants argue that because Cincinnati Bell's CEO and top executives "render[ed] services," plaintiff cannot maintain a claim for unjust enrichment against them. Defs.' Mot. at 23. They are wrong. Defendants Cassidy, Wojtaszek, and Wilson were unjustly enriched when they were granted pay increases under the Company's pay-for-performance policy despite their failure to perform. Cincinnati Bell and its shareholders suffered a loss by paying out undeserved and unwarranted compensation to executives whose "services" resulted in a decline in net income of $63.1 million and an annual shareholder return of negative 18.8%. As demonstrated *infra*, the excessive compensation paid to these defendants was the result of a breach of the Cincinnati Bell Board's duty of loyalty. These facts are sufficient at this stage of the litigation to support a claim for unjust enrichment. *See Jackson Nat'l. Life Ins. Co. v. Kennedy*, 741 A.2d 377, 394 (Del. Ch. 1999) (stating that once the facts alleged were sufficient to allege a breach of fiduciary duty, "it [was] axiomatic" that plaintiffs had also sufficiently pleaded a claim for unjust enrichment).

The civil suits against former HealthSouth Corporation CEO Richard Scrushy, *Scrushy v. Tucker*, 955 So. 2d 988 (Ala. 2006), and *In re HealthSouth Corp. S'holders Litig.*, 845 A.2d 1096 (Del. Ch. 2003), *aff'd* 847 A.2d 1121 (Del. 2004), are instructive. During his tenure as CEO, Scrushy received bonus payments based on HealthSouth's financial statements that later proved to be false and extinguished a loan made to him by the company. *Scrushy*, 955 So.2d at 1003-5; *HealthSouth*, 845 A.2d at 1100-2. Any services he rendered as CEO did not discourage both courts from finding that plaintiffs demonstrated that Scrushy was unjustly enriched. *Scrushy*, 955 So.2d at 1012; 845 A.2d at 1110. Moreover, as the court explained in *HealthSouth*:

> "Restitution is permitted even when the defendant retaining the benefit is not a wrongdoer. Restitution serves to deprive the defendant of benefits that in equity and good conscience he ought not to keep, even though he may have received those

> benefits honestly in the first instance, and even though the plaintiff may have suffered no demonstrable losses."

845 A.2d at 1105. Other courts have reached a similar conclusion regarding defendants who are unjustly enriched by executive compensation in violation of fiduciary duties. *See Zoran*, 511 F. Supp. 2d at 1018-1019 (upholding unjust enrichment claims against defendants who rendered services for company); *Alaska Elec. Pension Fund v. Olofson*, No. 08-2344-CM, 2009 U.S. Dist. LEXIS 46564, at *28 (D. Kan. June 3, 2009) (same). Defendants argument, at best, is an affirmative defense to a claim of corporate waste that plaintiff does not assert here.

Defendants also contend that plaintiff's claim for unjust enrichment cannot survive given the employment contracts defendants Cassidy, Wojtaszek, and Wilson had with Cincinnati Bell at the time they were unjustly enriched. Defs.' Mot. at 22-23. Again, defendants are wrong. First, this factual affirmative defense is premature at the pleading stage. Second, the challenged executive compensation was not the result of the employment agreements between defendants Cassidy, Wojtaszek, and Wilson and the Company. Indeed, the pay increases were not required or mandated under those contracts. At the most, these contracts provided that the Cincinnati Bell Board could grant defendants Cassidy, Wojtaszek, and Wilson incentive pay, if they so choose, pursuant to the compensation plans in place at the Company, *i.e.*, pay-for-performance. The Cincinnati Bell Board's actual decision to do so despite their poor performance is separate and distinct from the terms of any employment contract. *See Scrushy*, 955 So.2d at 1008-9 (upholding finding of unjust enrichment where contract only provided "opportunity to earn" additional bonus compensation).

Even if the compensation fell within the scope of Cincinnati Bell's CEO and top executives' employment agreements, plaintiff's claim still survives. A claim for unjust enrichment "may also be maintained despite the existence of an express contract where there is evidence of fraud, bad faith, or illegality." *MMK Group, LLC v. SheShells Co., LLC*, 591 F. Supp. 2d 944, 965-66 (N.D. Ohio 2008) (citing *Wolfer Enterprises v. Overbrook Dev. Corp.*, 132 Ohio App. 3d 353, 357 (1999)). The

Complaint alleges that the Cincinnati Bell Board acted disloyally, *i.e.*, in bad faith in granting the 2010 executive compensation that unjustly enriched defendants Cassidy, Wojtaszek, and Wilson. Thus, defendants' arguments fail, and plaintiff sufficiently states a claim for unjust enrichment.

IV. CONCLUSION

Accordingly, defendants' Motion should be denied in its entirety. Alternatively, leave for amend should be granted. *See Morse v. McWhorter*, 290 F.3d 795, 799-800 (6th Cir. 2002).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on August 22, 2011, I authorized the electronic filing of the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List, and I hereby certify that I caused to be mailed the foregoing document or paper via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

I certify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on August 22, 2011.

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