UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

NECA-IBEW PENSION FUND (THE DECATUR PLAN), Derivatively on Behalf of Cincinnati Bell Inc.,	:	Case No. 1:11 CV 00451
Plaintiff,	:	Judge Timothy S. Black Magistrate Judge Wehrman
v.	:	**INDIVIDUAL DEFENDANTS' REPLY IN SUPPORT OF MOTION TO DISMISS**
PHILLIP R. COX, et al.,	:	
Defendants.	:	

Defendants Phillip R. Cox, Bruce L. Byrnes, Jakki L. Haussler, Craig F. Maier, Alex Shumate, Lynn A. Wentworth, John M. Zrno ("Independent Directors") and John F. Cassidy, Gary J. Wojtaszek, and Christopher J. Wilson ("Officer Defendants") (hereinafter all defendants are collectively referred to as "Individual Defendants") submit the following Reply in Support of their Motion to Dismiss.

I. INTRODUCTION

In their Motion to Dismiss and Memorandum in Support, the Individual Defendants demonstrated that the Complaint should be dismissed because (1) Plaintiff failed to plead particularized facts to show that pre-suit demand on the Board was excused; and (2) Plaintiff's allegations fail to support a claim that the Independent Directors breached their duty of loyalty and that the Officer Defendants were unjustly enriched.

Plaintiff's response can easily be summarized as follows: (1) Pre-suit demand is excused—and Plaintiff states a claim for breach of fiduciary duty—where the Independent Directors face a substantial likelihood of liability for acting disloyally to the Company, and (2) the May 2011 adverse shareholder say-on-pay vote—a non-binding, advisory vote—demonstrates that there is a substantial likelihood that the Independent Directors will be found to have breached their duty of loyalty to the Company. Plaintiff's argument is unfounded, and ignores Ohio statutory and case law concerning the fiduciary duties of directors, and ignores the specific language of the federal statute authorizing the non-binding, advisory, say-on-pay votes.

In Ohio, directors of corporations are provided broad and substantial protections for the decisions they make in discharging their duties. Ohio law provides that a director shall not be found to have violated the director's duty of loyalty unless it is proved by clear and convincing evidence that the director **has not** acted in good faith or in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation.[1] In an action such as this, which seeks damages from a director for allegedly breaching his or her fiduciary duties, Ohio law provides that a director will be liable **only** if it is proved by clear and convincing evidence that the director's action involved an act undertaken with **deliberate intent to cause injury to the corporation** or **with reckless disregard for the best interests of the corporation**.[2] Thus, even if the Court applies the "substantial likelihood of liability" test, Plaintiff must at a minimum plead particularized facts that demonstrate that the Independent Directors face a substantial likelihood of being found to have acted in bad faith or to have intentionally or recklessly caused injury to Cincinnati Bell. Plaintiff has failed to plead any facts, let alone particularized facts, to support a claim that, when the 2010 executive compensation was approved, the Independent Directors acted in bad faith or that they intentionally or recklessly harmed Cincinnati Bell.

Plaintiff's entire case hinges on its assertion that a May 2011 non-binding, advisory shareholder vote, pursuant to the Dodd-Frank Act, concerning 2010 executive compensation, not

[1] O.R.C. §1701.59(C)(1).
[2] O.R.C. §1701.59(D).

only does away with the well-recognized business judgment rule, but also is a sufficient "fact" to demonstrate that the directors face a **substantial likelihood** of liability under Ohio law. The Dodd-Frank Act, however, clearly and specifically provides that the shareholder vote may **not** be construed as overriding a decision of the Board nor may the vote be construed as implying any change to the Board's fiduciary duties. Thus, the 2011 shareholder vote cannot be construed as evidence that the Board acted in bad faith or intentionally or recklessly intended to cause harm to the Company in 2010, when it approved the named executive officers' compensation for 2010. Plaintiff has not shown and cannot show that the Board faces even a remote possibility of liability under Ohio law, let alone a substantial likelihood of liability. Thus, as a matter of law, Plaintiff has failed to demonstrate demand futility and has failed to state a claim under Ohio law. The Complaint should therefore be dismissed.

Finally, Plaintiff's unjust enrichment claims against the Officer Directors fail, because their compensation is governed by a written contract (and an unjust enrichment claim cannot proceed where an express contract exists) and because Plaintiff has failed to plead facts that show that the Officer Directors were unjustly enriched.

II. PLAINTIFF HAS NOT MET ITS BURDEN OF SHOWING THAT DEMAND IS EXCUSED

A. Plaintiff Has Failed To Plead Any Facts to Suggest—Let Alone Demonstrate—That The Independent Directors are Antagonistic, Adversely Interested, Or Involved in The Transactions Attacked

Plaintiff's Memorandum focuses primarily on Delaware cases concerning demand futility and largely ignores Ohio law. Plaintiff entirely ignores the leading Sixth Circuit precedent on demand futility under Ohio law.

In In re Ferro Corporation Derivative Litigation, 511 F.3d 611, 618 (6th Cir. 2008), the court held that, under Ohio law, plaintiffs "carry the burden of showing that 'the directors cannot exercise independent, unbiased judgment when determining whether to sue themselves.'" According to the Ferro court and Ohio law, "futility" means that "the directors' minds are closed to argument and that they cannot properly exercise their business judgment in determining whether the suit should be filed." Id. The Ferro court recognized that "courts have consistently rejected the idea that demand is always futile when the directors are targeted as the wrongdoers in the suit the shareholders wish the corporation to bring." Id. Finally, the Ferro court noted that "Ohio courts have found a demand presumptively futile 'where the directors are antagonistic, adversely interested, or involved in the transactions attacked." Id.

Plaintiff has pled no facts, let alone particularized facts, to show that the Independent Directors are antagonistic, adversely interested, or involved in the transactions attacked. Indeed, Plaintiff has not pled or asserted that ANY shareholder sought to discuss the issue of executive compensation with ANY Board member at ANY time, let alone that the Board spurned any overtures by the shareholders.[3] Accordingly, Plaintiff has failed to demonstrate demand futility under Ohio law.

B. Plaintiff Has Failed To Plead Facts Sufficient To Show That the Independent Directors Face a Substantial Likelihood of Liability For Approving the 2010 Executive Compensation

Plaintiff contends that, when a majority of directors face a substantial likelihood of liability for breaching their fiduciary duty of loyalty, their independence is doubtful, and pre-suit demand on the board is excused. (Plaintiff's Memorandum, pg. 20). The "substantial likelihood" test was first articulated by the Delaware Supreme Court in Aronson v. Lewis, 473 A.2d 805 (Del. 1984). Under Delaware law, a court in determining demand futility must decide

[3] The Proxy Statement provides instructions for communications with the Board of Directors, stating in pertinent part: "Shareholders or other interested parties may communicate with the Board, any individual director, the non-management directors as a group, or the director who presides at meetings of the non-management directors…All communications addressed to the Board or any identified director or directors will be forwarded to the identified person or persons." (Proxy Statement, pg. 63).

whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent; and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. Aronson, 473 A.2d at 814. Thus, the court "must make two inquiries, one into the independence and disinterestedness of the directors and the other into the substantive nature of the challenged transaction and the board's approval thereof." Id. As to the two-part test, the Aronson court said:

> However, the mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors, although **in rare cases** a transaction may be **so egregious on its face** that board approval **cannot meet the test of business judgment**, and **a substantial likelihood of director liability therefore exists**.

Aronson, 473 A.2d at 815 (emphasis added).

(1) This Is Not An Options Backdating Case

Plaintiff relies on several options backdating cases to support its position that demand is excused in this case. Backdating options is entirely unlike the ordinary-course decisions directors make concerning executive compensation. Backdating options is a deceptive practice. Electrical Workers Pension Fund, Local 103, I.B.E.W. ex rel. American Greetings Corp. v. Weiss, 2010 WL 597717, 2 (N.D. Ohio Feb. 17, 2010) ("Backdating options is a deceptive practice frequently used to conceal increased payments to corporate officeholders without having to report those payments to shareholders."); In re Zoran Corp. Derivative Litigation, 511 F.Supp.2d 986, 1019 (N.D. Cal. 2007) ("Any directors engaging in self-dealing and making misrepresentations to shareholders cannot be said to act in the corporation's best interest. Backdating is a form of fraud. In the face of such allegations, defendants simply cannot be said to have acted in the company's best interest.")(emphasis added); Belova v. Sharp, 2008 WL 700961 (D.Or. March 13, 2008) ("Backdating is a form of fraud under federal and state law.").

Options backdating is entirely different than the ordinary-course executive compensation decisions involved in this case.

The Individual Defendants are aware of only one case applying Ohio law which has referenced the "substantial likelihood of liability" analysis adopted by the Aronson court. That case, In re Keithley Instruments, Inc. Derivative Litigation, 599 F.Supp.2d 875 (N.D. Ohio 2008), cited by both parties, is instructive. Keithley is an options backdating case. Looking to Delaware law, the court stated that, while the mere threat of personal liability is not sufficient to demonstrate disinterestedness, a reasonable doubt as to a director's disinterestedness is shown when the particularized allegations in the complaint present a substantial likelihood of liability on the part of the directors.

Referring again to Delaware law, the Keithley court gave further explanation concerning the "substantial likelihood of liability" analysis:

> Generally, to show that the potential for liability rises to a 'substantial likelihood,' the plaintiff must plead particularized facts '**detailing the precise roles that these directors played at the company, the information that would have come to their attention in these roles, and any indication as to why they would have perceived the [wrongdoing**].' '**Mere membership on a committee or board, without specific allegations as to defendants' roles or conduct, is insufficient to support a finding that the directors were conflicted.**'

Keithley, 599 F.Supp.2d at 895 (internal citations omitted) (emphasis added). Plaintiff in this case has failed to plead particularized facts concerning the role played by any of the Independent Directors, the information that would have come to their attention in their roles, and why the Independent Directors would have perceived the alleged wrongdoing when they voted in 2010 to approve the 2010 executive compensation.

In Keithley, the court began its discussion by summarizing the inherently wrongful nature of backdating stock options—the very issue which was involved in that case. The court stated:

> Stock options 'backdating' is a practice whereby a public company issues options on a particular date while **falsely recording** that the options were issued on an earlier date when the company's stock was trading at a lower price. The options are purportedly issued with an exercise price equal to the market price on the date of the option grant. But, in fact, because the grant dates **were falsified**, the options were 'in the money' when granted.

Keithley, 599 F.Supp.2d at 882.

The plaintiff in Keithley was able to plead a substantial number of particularized facts regarding the wrongful conduct of the director defendants. Of significance to the court was the fact that the plaintiffs were able to allege specific facts of substantial knowing misconduct by the board, including citation to an "outline" prepared by counsel to the Board's Special Committee investigating the options backdating scheme. The court stated:

> According to Plaintiffs, the Outline acknowledged that (1) certain option grants carried exercise prices that were lower than the stock price on the date those grants were approved by the Board; (2) the Board did not possess documentation to support the grant date and price regarding certain other grants; and (3) management exceeded its authority under the stock option plans (specifically, that Keithley and Plush, without any formal delegation of authority, were involved in selecting grant dates and exercise prices regarding the 2000, 2001 and 2002 options that were beneficial to themselves, despite the fact that the plans require the Compensation Committee (of which they were not members) to select and approve grants). (Compl. ¶ 9.) The Outline specifically stated that, "[o]n a few occasions between April 2000 and January 2003, discretionary stock option grant dates were selected based in part upon the price of the Company's stock on the grant date." (Compl. ¶ 59.)

Keithley, 599 F.Supp.2d at 887. The court concluded that the plaintiffs had "alleged the existence of backdated or otherwise manipulated options grants with particularity. The Outline commissioned at [Keithley's] behest essentially admits as much." Keithley, 599 F.Supp.2d at 899.

Unlike the plaintiff in Keithley, Plaintiff in this case has failed to plead any particularized facts showing intentional and knowing misconduct on the part of the Cincinnati Bell Board.

(2) Plaintiff Has Failed To Plead Facts To Show That The Company's CEO Dominated and Controlled the Board

In one sentence, on page 21 of Plaintiff's Memorandum, Plaintiff asserts: "Moreover, as the Company's CEO, he [Defendant Cassidy] holds substantial influence over the rest of the directors sufficient to raise a reasonable doubt as to their independence." Plaintiff's Complaint, however, pleads no facts, let alone particularized facts, to show that Mr. Cassidy dominated and controlled the Cincinnati Bell Board.

A controlled director is one who is dominated by another party, whether through close personal or familial relationship or through force of will. A director may also be deemed "controlled" if he or she is beholden to the allegedly controlling entity, as when the entity has the direct or indirect unilateral power to decide whether the director continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss might create a reason to question whether the director is able to consider the corporate merits of the challenged transaction objectively. Keithley, 599 F.Supp.2d at 892 (citing Telxon Corp. v. Meyerson, 802 A.2d 257, 264 (Del.2002)) (rejecting plaintiff's domination and control assertions, where plaintiff "pleaded no particularized facts demonstrating that Keithley controls any individual director, let alone the entire Board.").

The mere allegation that a director is dominated and controlled does not raise a reasonable doubt as to his or her independence. In re Affiliated Computer Services, Inc. Shareholder Litigation, 2009 WL 296078 at *9 (Del. Ch. Feb. 6, 2009). Rather, the party pleading demand futility must advance particularized factual allegations from which the court can infer board members who approved the transaction are acting at the direction of the allegedly dominating individual, such that their discretion would be sterilized. Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993).

Plaintiff has not and cannot plead facts to support its contention (asserted for the first time in Plaintiff's Memorandum) that Mr. Cassidy dominated or controlled or exerted undue influence over any member of the Cincinnati Bell Board.[4]

(3) The Compensation Committee and the Board Did Not Violate the Company's Compensation Policies

The Proxy Statement clearly and thoroughly sets forth the process by which the Compensation Committee and the Board arrive at compensation decisions. (See, Proxy Statement, pg. 32-60). Plaintiff now acknowledges—as it must—that the metrics relied upon by the Compensation Committee in determining bonuses are different than those set forth in Plaintiff's Complaint. The Compensation Committee uses EBITDA and Revenues as the objective measures of performance in determining whether and to what extent to award incentive payments under the Company's incentive plans. Plaintiff, however, chooses to focus on net income and earnings per share, because those two metrics declined in 2010 over 2009. (Plaintiff's Memorandum, pg. 13).

With respect to the fact that the Compensation Committee chose to use EBITDA and Revenue as the objective performance metrics, Plaintiff's only response is its assertion that the Compensation Committee "set a very low bar" for EBITDA and Revenue goals, since the goals

[4] The Company has a long-standing policy that the positions of Chairman of the Board and Chief Executive Officer should be held by separate persons. The Company believes this structure is in the best interest of the shareholders because it facilitates the Board's oversight of management, allows the independent directors to be more actively involved in setting agendas and establishing priorities for the work of the Board, and is consistent with the principles of good corporate governance. (Proxy Statement, pg. 7).

for 2010 were lower than the actual EBITDA and Revenue numbers for the prior three years. (Id.). Plaintiff has not pled—or even suggested in its Memorandum—that the Compensation Committee or the Board violated the Company's compensation policies by using EBITDA and Revenue as the objective performance metrics upon which bonuses were determined or that they violated the terms of the Company's compensation policies by setting the objective targets at levels slightly lower than previous years' actual numbers.

Plaintiff has not alleged that the Compensation Committee's use of EBITDA and Revenues is egregious or irrational. At best, Plaintiff simply contends that two metrics not used by the Company for 2010 executive compensation decisions, net income and earnings per share, showed declines in 2010 over 2009. However, the Company's Form 10-K for 2010 (relied upon and cited by Plaintiff in its Memorandum) makes clear why the Company's net income and earnings per share numbers were lower in 2010 than 2009 (despite EBITDA, Revenues, and Operating Income having increased over 2009):

> Net income of $28.3 million decreased by $61.3 million and diluted earnings per share of $0.09 decreased by $0.28 versus 2009 as a result of increased expense associated with the CyrusOne acquisition and debt refinancing, losses on extinguishment of debt and acquisition-related expenses.[5]

(Cincinnati Bell Form 10-K for 2010, pg. 26). In other words, the net income and earnings per share declines were one-time events associated with debt refinancing and the cost of acquiring the CyrusOne data center business. Rather than demonstrating that the Company performed dismally or atrociously in 2010, the net income and earnings per share declines were one-time events resulting from strategic initiatives undertaken to strengthen the Company for the long-term (i.e., acquiring CyrusOne and refinancing the Company's debt).

[5] As a result of the Company's debt refinancing completed in 2009 and 2010, the Company now has no bond or bank debt maturities until 2015, and approximately 90% of its debt maturities are due in 2017 and after. (Cincinnati Bell Form 10-K for 2010, pg. 26).

Plaintiff also asserts that "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." (Plaintiff's Memorandum, pg. 13). This is not true.

The say-on-pay vote simply asked shareholders to vote for or against the following:

> **RESOLVED**, that the <u>compensation</u> paid to the Company's named executive officers, as disclosed pursuant to Item 402 f Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.

(Proxy Statement, pg. 20, underline added).

About 50 million shareholders voted in favor of the resolution and about 96 million opposed it. From this, Plaintiff draws the conclusion that a majority of shareholders rejected the <u>performance metrics</u>, by way of the say-on-pay vote. The say-on-pay vote rejected the <u>compensation</u> paid to the named executive officers. In fact, the shareholders on the VERY SAME DAY voted overwhelmingly in FAVOR of the 2011 Short-Term Incentive Plan, which provides for the very same <u>performance metrics</u> as in the prior Short-Term Incentive Plan. (See, SEC Report on Form 8-K, dated May 9, 2011, attached as Exhibit C to Individual Defendants' Motion to Dismiss).

(4) *<u>Brehm</u> and <u>Walt Disney</u> Provide No Support For Plaintiff's Case*

Plaintiff cites the Walt Disney-Michael Ovitz executive compensation dispute in support of its claim that the Independent Directors breached their duty of loyalty by allegedly awarding excessive compensation to the Officer Defendants. (Plaintiff's Memorandum, pg. 19-20). <u>In re Walt Disney Company Derivative Litigation</u>, 906 A.2d 27 (Del. 2006) involved a severance payment of <u>$140 million</u> to Ovitz, after he had worked for Disney for only <u>15 months</u>. <u>See</u>, <u>Campbell v. Potash Corporation of Saskatchewan, Inc.</u>, 238 F.3d 792, 801 (6^{th} Cir. 2001).

In Campbell, the Sixth Circuit noted that the Delaware Supreme Court found that the $140 million severance payment to Ovitz for 15 months of work only "pushes the envelope of judicial respect for the business judgment of directors in making compensation decisions." Campbell, 238 F.3d at 801. The Sixth Circuit went on to state:

> If the Ovitz severance payment, which included $39 million in cash, only pushes the envelope under Delaware law, then the smaller sum here spread across three executives with longer tenure at their company is well within the confines respected by the business judgment rule.

Id. As in Campbell, the compensation payments involved in this case—individually and collectively—paid to 3 officers (2 of whom have a substantial tenure with the Company) do not come close to the $39 million cash payment/$140 million total award made to Ovitz by the Walt Disney Company. Accordingly, such payments are, as in Campbell, "well within the confines respected by the business judgment rule."

III. AN ADVERSE SAY-ON-PAY VOTE DOES NOT REBUT THE PRESUMPTION OF THE BUSINESS JUDGMENT RULE

The heart of Plaintiff's case is its contention that the non-binding, advisory shareholder say-on-pay vote "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." (Plaintiff's Memorandum, pg. 14). According to Plaintiff, "[t]he 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." (Plaintiff's Memorandum, pg. 21).

Before turning to the enormous protections provided the Independent Directors by the Ohio Revised Code, it is worth re-emphasizing that the say-on-pay vote occurred over a year **after** the Compensation Committee and the Board approved the 2010 executive compensation.

In late 2009 and early 2010, the Board's Compensation Committee set the pay for the Company's named executive officers for 2010, and at the same time, the Compensation Committee recommended the pay for the Company's Chief Executive Officer for 2010, which pay was approved by the Independent Directors. (See, Proxy Statement, pg. 42, explaining the timing of the compensation decisions for 2011; the same process was followed for 2010 compensation). Thus, the 2010 executive compensation was established at the beginning of the year, before the year-end financial results were known. Moreover, even if one were to assume that the non-binding, advisory say-on-pay vote is probative evidence of what is in the shareholders' best interests (as alleged by Plaintiff), the Independent Directors did not have the benefit of that vote until May **2011**, well **after** the 2010 executive compensation was set and approved. The Proxy Statement makes this clear:

> The say-on-pay vote is advisory and, therefore, not binding on the Company, the Compensation Committee or the Board of Directors. Our Board of Directors and our Compensation Committee value the opinions of our shareholders and to the extent that there is any significant vote against the named executive officer compensation as disclosed in this Proxy Statement, we will consider our shareholders' concerns and the Compensation Committee will evaluate whether any actions are necessary to address those concerns.

(Proxy Statement, pg. 20) (emphasis added).

It is also worth re-emphasizing that corporate decisions are made by the board of directors, not by a vote of shareholders. Paramount Commc'ns Inc. v. Time Inc., 1989 WL 79880, * 30 (Del. Ch. July 14, 1989) ("The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm."), aff'd, 571 A.2d 1140 (Del.1990); TW Servs ., Inc. v. SWT Acquisition Corp., 1989 WL

20290, at *8 n. 14 (Del. Ch. Mar. 2, 1989) ("While corporate democracy is a pertinent concept, a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation, subject however to a fiduciary obligation.").

Where a complaint asserts essentially that the shareholders would have done something different than the board, it should be dismissed because such allegations do not rebut the presumption of the business judgment rule. See, e.g., In re Affiliated Computer Services, Inc. Shareholder Derivative Litigation, 2009 WL 296078 at * 10 (Del. Ch. Feb. 6, 2009) ("The business judgment rule, however, is not rebutted by Monday morning quarterbacking. In the absence of well-pleaded allegations of director interest or self-dealing, failure to inform themselves, or lack of good faith, the business decisions of the board are not subject to challenge because in hindsight other choices might have been made instead.").

Contrary to Plaintiff's suggestion, the non-binding, advisory shareholder vote does not in any way suggest that the Independent Directors breached their duty of loyalty to the Company. Plaintiff cites to a portion of O.R.C. §1701.59(E), which provides that, in determining what a director reasonably believes to be in the best interests of the **corporation**, the director shall consider the interests of the corporation's **shareholders**. What Plaintiff fails to note is that O.R.C. §1701.59(E) further provides that, in determining what a director reasonably believes to be in the best interests of the **corporation**, the director may also consider a number of **other** factors, including (a) the interests of the corporation's employees; (b) the economy of the state and the nation; and (c) the long term as well as the short-term interests of the corporation and its shareholders.

Thus, under Ohio law, in determining what is in the best interests of the **corporation**, a director may consider factors other than just what is in the best interest of the **shareholders**. See, Electrical Workers Pension Fund v Weiss, 2010 WL 597717 (N.D. Ohio Feb. 17, 2010) (O.R.C. §1701.59(E) provides for "the discretion of directors to consider factors other than the interests of shareholders and the interests of the corporation."); Abrahamson v. Waddell, 63 Ohio Misc.2d 270, 624 N.E.2d 1118 (C.P. 1992) ("In determining what they believe to be in the best interest of the corporation, in addition to considering the interest of the corporation's shareholders, directors are expressly authorized by statute to consider other factors, such as community and societal considerations and the long-term as well as the short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation."). Nevertheless, the Company did believe it was acting in the best interests of its shareholders by using the EBITDA and revenue metrics, because it believes investors use those metrics to evaluate the financial performance of the Company and because those metrics indicate the level of success of the Company's strategy to sustain operating cash flows and profitability. (Proxy Statement, pg. 36).

Moreover, in an action such as this, where a plaintiff seeks damages from a director, a director will be liable only if it is proved by clear and convincing evidence that the director's act was undertaken with deliberate intent to cause injury to the corporation or with reckless disregard for the best interests of the corporation. O.R.C. §1701.59(D); Weiss, 2010 WL at *6 ("[A]lthough violations of federal laws, rules, and regulations may be the basis for a breach of fiduciary duty, the burden is still on the plaintiff to demonstrate under Ohio law and by clear and convincing evidence, that the alleged violations were committed knowingly or recklessly and that they harmed the corporation.").

Accordingly, under Ohio law, when determining what is in the best interests of the **corporation**, a director must consider the shareholders' interests and may consider a number of other factors in determining what the director reasonably believes is the best interest of the **corporation**. Further, the director will only be held liable for breaching his duty if it is shown by clear and convincing evidence that the director did not act in good faith, and in an action for damages, a director will only be held liable if plaintiff proves by clear and convincing evidence that the director **intentionally** or **recklessly** sought to harm the corporation. Clearly, the 2011 non-binding, advisory vote is not sufficient evidence to demonstrate that the Independent Directors acted in bad faith or that they intentionally or recklessly sought to harm the Company in 2010 when the 2010 named executive officers' compensation was approved.

Plaintiff acknowledges—as it must—that the specific language of the Dodd-Frank Act provides that the shareholder say-on-pay vote **<u>shall not be binding</u>** on the company or its board of directors, and the shareholder vote **<u>may not</u>** be construed (1) as overruling a decision by the company or its board of directors; (2) to create or imply **any change** to the fiduciary duties of such company or its board of directors; (3) to create or imply any additional fiduciary duties for the company or its board of directors; or (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation. 15 U.S.C. § 78n-1(c).

The Committee on Banking, Housing, and Urban Affairs set forth its view of the say-on-pay provision in the Legislative History, stating:

> The Committee believes that **shareholders**, as the owners of the corporation, have a right to express their **opinion** collectively on the appropriateness of executive pay. **The vote must be tabulated and reported, but the result is not binding on the board or management**.

S. Rep. No. 111-176, at 134 (2010) (emphasis added).[6]

Conscious of the prohibitions set forth in the Act, Plaintiff simply asserts that it "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." (Plaintiff's Memorandum, pg. 16). This simply is not true.

The entire objective of this suit is to override the Board's approval of the 2010 executive compensation (which Plaintiff's counsel hopes will result in an award of their fees in the case), by way of "disgorgement or otherwise restricting the disposition/exercise of improvidently awarded 2010 executive compensation." (Prayer For Relief, paragraph C). The sole basis for seeking to override the Board's approval of the 2010 executive compensation is the 2011 Dodd-Frank say-on-pay vote. The Act, however, makes clear that such vote may not be construed as overruling a decision by the company or the board.

Similarly, contrary to Plaintiff's assertions in its Memorandum, Plaintiff does seek to use the vote to imply a change to the fiduciary duties of the Board. Plaintiff unambiguously contends at various points in its Memorandum that "whatever protection from liability the business judgment rule could have offered the Board before May 3, 2011 no longer applied once the results of the say-on-pay vote were revealed" and 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." (Plaintiff's Memorandum, pg. 3, 21). Plaintiff thus is trying to use the say-on-pay vote to strip the Board of the protection of the business

[6] Plaintiff cites as "legislative history" portions of the Committee Report which quote from witness testimony. Statements by witnesses, however, do not constitute legislative history. Wolff v. Moore, 104 F.Supp.3d 892, 902 (S.D. Ohio 2000) ("Statements by witnesses at hearings are not significant indicators of legislative intent, but rather reflect the biases and beliefs of the individual witnesses.") citing Kelly v. Robinson, 479 U.S. 36, 51 n.13 (1986) ("We acknowledge that a few comments in the hearings … may suggest that the language bears the interpretation…. We decline to accord any significance to these statements."); Dunn McCambell Royalty Interest, Inc. v. Nat'l Park Service, 964 F.Supp. 1125, 1137 (S.D. Tex. 1995) ("Statements by individual legislators or witnesses during legislative debates or hearings are not determinative of legislative intent.").

judgment rule, a fundamental concept of a director's fiduciary duties. The Act, however, clearly provides that the vote may not be construed as implying **any change** to a director's fiduciary duties.

IV. PLAINTIFF'S COMPLAINT FAILS TO STATE A CLAIM FOR UNJUST ENRICHMENT.

To establish unjust enrichment, a plaintiff must show the following: (1) a benefit conferred upon defendant by plaintiff, (2) knowledge by defendant of the benefit, and (3) the acceptance or retention by defendant of the benefit under circumstances that make it inequitable for defendant to retain and benefit without payment of its value. DavCo Acquisition Holding, Inc. v. Wendy's Intern., Inc., 2008 WL 755283, 11 (S.D. Ohio 2008). As to the third element, it is not sufficient that the defendant gain an enrichment; the enrichment must be unjust. Id. Because a plaintiff pursuing an unjust enrichment claim is seeking equitable remedies, the plaintiff must show a superior equity so that it would be unconscionable for the defendant to retain the benefit. Id.

Plaintiff claims that the Officer Defendants "were unjustly enriched when they were granted pay increases under the Company's pay-for-performance policy despite their failure to perform." (Plaintiff's Memorandum, pg. 23). Plaintiff however has failed to plead any facts to support a claim that any of the Officer Defendants' failed to perform their duties and responsibilities, let alone that it would be unconscionable for them to retain their agreed-upon compensation. Plaintiff has not alleged that the Officer Defendants did not render services to the Company. Rather, Plaintiff merely alleges that "[u]nder the circumstances—the dismal financial performance of the Company—it would be unjust to allow defendants Cassidy, Wojtaszek and Wilson to retain" their compensation for 2010. (Compl., par. 59). Plaintiff has not cited any authority for the proposition that an executive is unjustly enriched simply because he or she receives compensation during a year in which the company's shareholders are unhappy with the company's financial performance.

Moreover, Plaintiff's reliance on the HealthSouth Corporation cases is misplaced. In re HealthSouth Corp. Shareholders Litigation, 845 A.2d 1096 (Del. Ch. 2003), involved a company buyback of a loan made to the company's chairman and chief executive officer, Richard Scrushy. Scrushy extinguished the loan by giving the company shares in company stock valued in the stock market at the amount remaining on the loan. The stock, however, was greatly overvalued, due to materially misleading financial statements, for which Scrushy was responsible. The court concluded that Scrushy was responsible for overseeing the preparation of accurate and reliable financial statements, and the company relied upon the integrity of the market price for its stock in order to establish the value of Scrushy's shares. HealthSouth, 845 A.2d at 1105-1106. The court held that, through "conscious wrongdoing, negligent oversight of his subordinates, or innocent failure to catch the misdeeds or inaccuracies of his underlings," Scrushy "was undoubtedly enriched" when his shares were bought back by the company "at a price inflated by the false financial statements he had signed." HealthSouth, 845 A.2d at 1106. There are no such facts asserted in this case.[7]

Under Ohio law, in the absence of fraud, illegality, or bad faith, a party may not recover under the theory of unjust enrichment when an express contract covers the same subject. DavCo Acquisition Holding, Inc. v. Wendy's Intern., Inc., 2008 WL 755283, 11 (S.D. Ohio 2008). Plaintiff does not dispute that, in Ohio, unjust enrichment operates in the ***absence*** of an express contract. Gallo v. Westfield National Insurance Co., 2009 WL 625522 (Cuyahoga App. March 12, 2009). The Officer Defendants' employment agreements set forth, among other things, the

[7] Indeed, in each of the cases Plaintiff cites, the executives were also the subject of a claim for breach of fiduciary duty or were alleged to have been directly involved in wrongful or improper conduct (such as the back dating of stock options).

executive's base salary, bonus opportunities, entitlement to participate in the Company's benefit and pension plans, and entitlement to receive equity awards and post-termination benefits and obligations. (Proxy Statement, pg. 49). Thus, Plaintiff's unjust enrichment claim fails as a matter of law. Patterson v. Rite Aid Corp Hdqtrs., 752 F.Supp.2d 811, 817-818 (N.D. Ohio 2010) (citing Ohio cases which hold that unjust enrichment cannot exist where there is a valid and enforceable written contract).

Plaintiff attempts to avoid dismissal by asserting that it has raised a claim for breach of fiduciary duty against the Board. (Plaintiff's Memorandum, pg. 24-25). That, however, is precisely the reason why this exception does not apply. While Plaintiff has asserted (in entirely conclusory fashion) that the Board acted in bad faith, Plaintiff has not raised any claim for breach of fiduciary duty against the Officer Defendants and has not alleged any conduct on the part of these defendants that would constitute bad faith, fraud, or illegality. Because Plaintiff has not alleged that the Officer Defendants' receipt of 2010 compensation was illegal or constituted bad faith or fraud, the exception for fraud, bad faith, or illegality does not apply and Plaintiff's unjust enrichment claim should be dismissed.

Plaintiff's unjust enrichment claim also fails because Plaintiff has failed to allege any facts that would suggest that the Officer Defendants were unjustly enriched. Accordingly, Plaintiff's claim for unjust enrichment fails as a matter of law and should be dismissed.

V. CONCLUSION

For the foregoing reasons, the Individual Defendants respectfully request the Court grant their Motion to Dismiss.

Respectfully submitted,

/s/ Grant S. Cowan

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CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of September, 2011, a copy of the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system which will send notification of such filing to all attorneys of record.

/s/ Grant S. Cowan

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