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UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

Portland Division

PLUMBERS LOCAL NO 137 PENSION FUND and LABORERS' LOCAL #231 PENSION FUND, Derivatively on Behalf of UMPQUA HOLDINGS CORPORATION,

CV No. 3:11-cv-00633-AC

INDIVIDUAL DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS

Plaintiffs,

v.

RAYMOND P. DAVIS, BRADLEY F. COPELAND, RONALD L. FARNSWORTH, MARK P. WARDLOW, ALLYN C. FORD, PEGGY Y. FOWLER, STEPHEN M. GAMBEE, JOSE R. HERMOCILLO, WILLIAM A. LANSING, LUIS F. MACHUCA, DIANE D. MILLER, HILLIARD C. TERRY III, BRYAN L. TIMM, FRANK R.J. WHITTAKER, and PRICEWATERHOUSECOOPERS LLP,

Defendants,

-and-

UMPQUA HOLDINGS CORPORATION, an Oregon corporation,

Nominal Party.

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PRELIMINARY STATEMENT

This case presents two questions: (1) whether mere approval by directors of an executive compensation decision excuses the long-standing requirement that a shareholder must make demand on the corporation before filing a derivative action, and (2) whether plaintiffs' allegations have overcome the business judgment rule presumption by alleging executive compensation so excessive that no reasonable director would have approved it. Plaintiffs' Complaint should be dismissed for two independent reasons: (1) plaintiffs fail to adequately allege a proper excuse for their failure to make a pre-suit demand on the Umpqua Holdings Corporation Board of Directors as required by Fed R Civ P 23.1(b)(3) and by Oregon law, and (2) plaintiffs' Complaint fails to state a claim upon which relief can be granted, and therefore should be dismissed under Fed R Civ P 12(b)(6).

Both substantive Oregon law and the pleading requirements of Fed R Civ P 23.1(b)(3) require that any plaintiff attempting to maintain a derivative action on behalf of the corporation against directors and officers (i.e., the type of claim plaintiffs assert here) *must* plead either that he or she made a pre-suit demand on the board of directors to cause the corporation itself to bring the claims against individual directors and/or officers, or that there is a legally valid excuse for not having done so. Here, plaintiffs do not allege that they made any pre-suit demand; instead, they assert a series of supposed reasons why demand was excused. As shown herein, these purported excuses all fail under well-settled precedents. This action should be dismissed on this ground alone. *See* Section I, below.

In addition, and equally important, the Complaint fails to state a claim upon which relief may be granted. A shareholder's claim that a board of directors breached its duties by approving excessive compensation to corporate officers must allege that such compensation is so excessive that no reasonable person would have approved it. In this action, plaintiffs ignore this requirement and do not attempt to plead that Umpqua's executives received compensation at

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a legally "unreasonable" level. Instead, plaintiffs allege that a recent "say on pay" stockholder vote at Umpqua allows them to challenge otherwise-valid executive compensation on the grounds that the vote went against the company. This theory of plaintiffs', which has never been adopted by any court, is precluded by language in the same federal statute that required Umpqua to hold the "say on pay" vote in the first instance. This federal statute expressly provides that such "say on pay" votes "shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—(1) as overruling a decision by such issuer or board of directors; (2) to create or imply any change to the fiduciary duties of such issuer or board of directors; [or] (3) to create or imply any additional fiduciary duties for such issuer or board of directors * * * ." 15 USC § 78n-1(c) (Dodd-Frank Wall Street Reform and Consumer Protection Act). For these reasons, plaintiffs' Complaint should be dismissed under Fed R Civil P 12(b)(6). *See* Section II, below.

BACKGROUND

A. The Parties

Umpqua Holdings Corporation ("Umpqua") is an Oregon corporation with its executive offices located in Portland, Oregon. Umpqua is a bank holding company engaged primarily in the business of commercial and retail banking and the delivery of retail brokerage services. Compl. ¶ 10.

Umpqua's Board consists of eleven directors, all but one of whom are independent, i.e., have no employment relationships to Umpqua. Raymond P. Davis, Umpqua's president and chief executive officer, is the only member of Umpqua management on the Board. The other ten Umpqua director defendants are as follows:

- *Allyn C. Ford* serves as chairman of the board. Mr. Ford has served as a director since Umpqua's formation in 1999 and has also served as a director of Umpqua Bank for over 30 years. He is also president of Roseburg Forest Products.

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- *Peggy Y. Fowler* was elected to the Board in 2010. Ms. Fowler served as chief executive officer and president of Portland General Electric from April 2000 to December 31, 2008, and as co-CEO from January 2009 to March 1, 2009. Ms. Fowler was also chair of the PGE board from May 2001 until January 2004. In addition to her service on the Board, Ms. Fowler is a director of the Portland branch of the Federal Reserve Bank of San Francisco, the Hawaiian Electric Company, and PGE.

- *Stephen M. Gambee* was elected to the Board in 2006. Mr. Gambee is president, chief executive officer, and managing member of waste management businesses.

- *Jose R. Hermocillo* was elected to the Board in April 2009. Since 1998 Mr. Hermocillo has served as senior vice president and managing director of APCO Worldwide's office in Sacramento, California.

- *William A. Lansing* has served as a director since December 2001. Mr. Lansing previously served as a director of Independent Financial Network, Inc. Mr. Lansing is the retired president and chief executive officer of Menasha Forest Products Corporation, a position he held from 2001 to 2006. He is also the retired chairman of Torrent Energy Corporation. In addition to his service on the Board, Mr. Lansing is chairman of the board of Lone Rock Timber Company.

- *Luis F. Machuca* was elected to the Board in April 2010. Since January 2002 Mr. Machuca has been president and chief executive officer of Kryptiq Corporation. In addition to his service on the Board, Mr. Machuca serves on The Regence Group board of directors and the University of Portland Board of Regents.

- *Diane D. Miller* was elected to the Board in May 2005. She is also president and chief executive officer of Wilcox, Miller & Nelson, a human capital management firm.

- *Hilliard C. Terry III* was elected to the Board in April 2010. He is vice president and treasurer of Agilent Technologies, Inc.

- *Bryan L. Timm* was elected to the Board in May 2005. Since 2008, Mr. Timm has been executive vice president and chief operating officer of Columbia Sportswear Company. Mr. Timm previously served as Columbia's chief financial officer and treasurer. Before joining Columbia, Mr. Timm held various accounting, internal audit, and financial positions with Oregon Steel

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Mills from 1991 to 1997 and was an accountant with KPMG LLP from 1986 to 1991.

- *Frank R. J. Whittaker* was elected to the Board in April 2009. Mr. Whittaker was vice president of operations for The McClatchy Company from September 1997 until his retirement on May 27, 2011. From 1985 to 1997, Mr. Whittaker was president and general manager of The Sacramento Bee.

See Umpqua Holdings Corp. Proxy Statement (Form DEF 14A) at 10-13 (Feb. 25, 2011).[1]

Umpqua's senior executive vice president and chief operating officer, Bradley F. Copeland, executive vice president and chief financial officer, Ronald L. Farnsworth, and executive vice president and chief credit officer, Mark P. Wardlow, are also named as defendants. Compl. ¶ 12-14.

Plaintiffs are two purported Umpqua shareholders seeking to sue the individual defendants for the benefit of Umpqua. Plaintiffs do not reveal how many Umpqua shares they own. Compl. ¶ 9.

B. Factual Background of Umpqua's Compensation Practices

The Umpqua Board's responsibilities with respect to executive compensation are carried out by the Compensation Committee. This committee consists entirely of independent directors. The committee met seven times in 2010. Proxy Statement at 29.

As set forth in Umpqua's Proxy Statement, the company's compensation philosophy is to pay competitive base salaries and to strongly reward performance. Proxy Statement at 30. Performance is measured against both financial and nonfinancial goals and

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[1] Liday Decl. Ex 1. On this motion, the Court may consider relevant portions of documents referred to in the Complaint, including portions of such documents not directly quoted or cited by plaintiffs. *See Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 US 308, 322, 127 S Ct 2499, 168 L Ed 2d 179 (2007) (on motion to dismiss under Rule 12(b)(6) courts "ordinarily examine * * * documents incorporated into the complaint by reference, and matters of which a court may take judicial notice"); *Am. Int'l Specialty Lines Ins. Co. v. KinderCare Learning Ctr., Inc.*, Nos. 07-672-KI, 07-978-KI, 2011 WL 1002172, at *3 (D Or Mar. 18, 2011) ("A document is not 'outside' the complaint if the complaint refers to it.").

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objectives set at the beginning of each year. Financial goals are based on an internal Operating Earnings Per Share ("OEPS") target. Nonfinancial goals include satisfactory performance on internal and external regulatory exams and audits, and achievement of the business and personal goals assigned to each executive. Proxy Statement at 31.

In 2010, Umpqua exceeded the previously-set minimum internal OEPS target, and Umpqua executives received a payout of incentive compensation tied to financial goals. Proxy Statement at 41. In addition, the Compensation Committee noted that the Umpqua management team achieved 2010 strategic goals for substantial progress in reducing problem credits, achieving organic deposit growth, strengthening capital and liquidity, making strategic acquisitions, and positioning Umpqua for growth as the economy recovers. Proxy Statement at 42. Umpqua also exited the U.S. Treasury's Capital Purchase Program ("CPP") in March 2010. The company's participation in CPP, and the compensation restrictions that participation imposed, substantially altered its compensation program in 2009 and 2010. Proxy Statement at 38.

C. Plaintiffs' Claims

Plaintiffs "seek to hold (i) the Umpqua Board liable for breach of fiduciary duty of loyalty; (ii) Umpqua's CEO and top executives liable for unjust enrichment; and (iii) PwC, its compensation consultant, liable for aiding and abetting breaches of fiduciary duty and breach of contract in connection with Umpqua's excessive 2010 executive compensation." Compl. ¶ 45.

With respect to breach of fiduciary duty, plaintiffs allege that the Umpqua Board's decisions to increase CEO and top executive compensation "were disloyal, irrational and unreasonable, and not the product of a valid exercise of business judgment." Compl. ¶ 3. The basis for this allegation is that Umpqua had a "negative 7.7% annual shareholder return in 2010." Compl. ¶¶ 2, 27. Plaintiffs also claim that the 2010 compensation violated Umpqua's

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compensation policy because, allegedly, "there was little, if any, meaningful relationship between Umpqua's executive pay and corporate performance." Compl. ¶ 32. In addition, plaintiffs allege that defendants "knew or should have known that the Umpqua Board's unanimous recommendation to Umpqua shareholders to approve the 2010 executive compensation was false and misleading when made * * * because the 2010 Proxy Statement omitted to disclose that the 2010 CEO and top executive pay hikes violated Umpqua's pay-for-performance policy, were excessive under the circumstances, and were not the product of a valid exercise of business judgment." Compl. ¶ 28. (Plaintiffs do not, however, assert a separate cause of action for misrepresentation.)

A key element of plaintiffs' claims is the fact that a majority of the shares voted on a "say on pay" resolution at Umpqua's April 19, 2011, annual meeting disapproved of the 2010 compensation.[2] Compl. ¶¶ 38-41. Plaintiffs claim that "[i]n light of the adverse shareholder vote, the presumption of business judgment surrounding the Umpqua Board's 2010 executive compensation decisions has been rebutted, and the burden of proof to demonstrate that the 2010 pay hikes did not violate the Umpqua Board's own pay-for-performance executive compensation policy and, in fact, were in the best interest of Umpqua now rests with the Umpqua Board." Compl. ¶ 43.

Plaintiffs chose not to make a pre-suit demand on the Board to bring these claims in the name of the corporation. Instead, plaintiffs claim that demand would have been futile and is therefore excused. Compl. ¶ 51. Plaintiffs allege that all of Umpqua's directors are

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[2] The proposed resolution was:

> "RESOLVED, that the Company's shareholders approve, on an advisory basis, the compensation of the named executive officers as described in the Proxy Statement for the 2011 Annual Meeting of Shareholders pursuant to the compensation disclosure rules of the SEC including the Compensation Discussion and Analysis, the 2010 Summary Compensation Table and the other related tables and narrative disclosure." Proxy Statement at 8.

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disqualified from considering demand because they allegedly "face[] a substantial likelihood of liability and [are] interested in the outcome of this action," Compl. ¶ 51, and also because they allegedly "demonstrated [their] hostility towards the relief sought in the action" by first recommending that shareholders approve the 2010 executive compensation, and "then ratifying their own prior decisions to award the 2010 compensation by not rescinding it after a majority negative vote." Compl. ¶ 53.[3]

ARGUMENT

Plaintiffs have failed to meet the requirement in Fed R Civ P 23.1(b)(3) that they plead particularized facts showing demand futility. This Court should dismiss the Complaint on that basis alone. Equally, plaintiffs have failed to state a claim upon which relief may be granted, and thus their Complaint should be dismissed under pursuant to Fed R Civ P 12(b)(6).

I. DISMISSAL IS REQUIRED BECAUSE PLAINTIFFS HAVE FAILED TO MEET THE PLEADING STANDARDS FOR DERIVATIVE SUITS.

To proceed with a derivative action under Fed R Civ P 23.1(b)(3), plaintiffs must "state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors * * *; and (B) the reasons for not obtaining the action or not making the effort." In addition, because demand requirements are substantive rather than merely procedural, this Court must measure the sufficiency of plaintiffs' allegations against the substantive law of Oregon's pre-suit demand requirement. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 US 90, 96-97, 108-09, 111 S Ct 1711, 114 L Ed 2d 152 (1991) (substantive state-law demand requirement incorporated into Fed R Civ P 23.1); *Potter v. Hughes*, 546 F3d 1051, 1054 n.1 (9th Cir 2008) ("Rule 23.1 imposes only a pleading requirement with regard to demand; the substantive demand requirement is an issue of state law."); *Potter*, 546 F3d at 1055 ("Pursuant to Rule 23.1, a

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[3] Plaintiffs also separately allege that demand on Mr. Davis is excused because he is CEO of Umpqua and received the challenged compensation. Compl. ¶ 54.

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putative derivative plaintiff can initiate a derivative action only if he or she makes an adequate demand on the Board under applicable state law."); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F3d 970, 989-90 (9th Cir 1999) (federal courts look to the law of the state of incorporation for the circumstances under which demand would be futile); *Sommers v. Lewis*, 641 F Supp 2d 1151, 1156 (D Or 2009) ("Demand futility is determined under the law of the company's incorporating state—in this case, Oregon.").

Oregon law is clear that a shareholder seeking to bring a derivative suit on behalf of a corporation must first demand that the board of directors address the alleged harm. *See* ORS 60.261(2); *Crandon Capital Partners v. Shelk*, 219 Or App 16, 29-30, 181 P3d 773 (2008). This requirement recognizes the primacy of the board in managing the affairs of the corporation, including possible litigation. *See* ORS 60.301(2) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, the board of directors * * *"); *Crandon*, 219 Or App at 30 n.8; *Kamen*, 500 US at 101.

If a shareholder does not make demand on the board, Fed R Civ P 23.1(b)(3) and Oregon law alike require that the shareholder plead with particularity the reasons why demand would have been futile under state law. As the Oregon Court of Appeals set forth in *Crandon*:

> "To excuse noncompliance with the prelitigation demand requirement, a plaintiff must be able to articulate particularized facts showing that there is a reasonable doubt either that (1) the directors are disinterested and independent for purposes of responding to the demand or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. If either prong is satisfied, demand is excused." 219 Or App at 30.[4]

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[4] The Oregon courts look to Delaware in applying Oregon's prelitigation demand requirement. *See Crandon*, 219 Or App at 29-30; *Sommers*, 641 F Supp 2d at 1156 ("Oregon law is undeveloped in this area, so the parties look to Delaware law."). Delaware cases concerning derivative claims have been cited with approval and relied on by the Oregon courts that have addressed similar issues. *See, e.g.*, *Crandon*, 219 Or App at 29-30.

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As the Oregon Court of Appeals explained:

> "'The rationale of Rule 23.1 is two-fold. On the one hand, it would allow a plaintiff to proceed with discovery and trial if the plaintiff complies with this rule and can articulate a reasonable basis to be entrusted with a claim that belongs to the corporation. On the other hand, the rule does not permit a stockholder to cause the corporation to expend money and resources in discovery and trial in the stockholder's quixotic pursuit of a purported corporate claim based solely on conclusions, opinions or speculations.'" *Crandon*, 219 Or App at 30 (quoting *Brehm v. Eisner*, 746 A2d 244, 255 (Del 2000)).

And as the Delaware Supreme Court also explained:

> "'The demand requirement serves a salutary purpose. First, by requiring exhaustion of intracorporate remedies, the demand requirement invokes a species of alternative dispute resolution procedure which might avoid litigation altogether. Second, if litigation is beneficial, the corporation can control the proceedings. Third, if demand is excused or wrongfully refused, the stockholder will normally control the proceedings.'" *Brehm*, 746 A2d at 255 (quoting *Grimes v. Donald*, 673 A2d 1207, 1216 (Del 1996) (discussing pleading requirement for a derivative action)).[5]

Plaintiffs have not made demand on the Umpqua Board, and do not allege that they have done so. Thus, if they are to proceed with this action, they must allege particularized facts sufficient to create a reasonable doubt that a majority of the directors are not independent and disinterested, *see Beam v. Stewart*, 845 A2d 1040, 1049 (Del 2004), or that the challenged director conduct was not a valid exercise of business judgment. *See Wood v. Baum*, 953 A2d 136 (Del 2008). If the Court concludes that the Complaint fails to do this, the Complaint should be dismissed. *See Potter*, 546 F3d at 1058-59 (affirming dismissal of purported derivative action for failure to meet Fed R Civ P 23.1 pleading requirements).

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[5] Both the Model Business Corporation Act and the American Law Institute's Principles of Corporate Governance require demand in all cases. *See* Model Bus Corp Act § 7.42; ALI, Principles of Corp Governance § 7.03 (1994).

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A. Plaintiffs Fail to Allege Facts Raising a Reasonable Doubt That the Majority of the Umpqua Board Is Independent and Disinterested.

As the Delaware Supreme Court stated in *Brehm*, the issue of independence and disinterestedness in a purported derivative action is whether a majority of the board is "incapable, due to personal interest or domination and control, of objectively evaluating a demand, if made, that the Board assert the corporation's claims that are raised by plaintiffs or otherwise remedy the alleged injury." 746 A2d at 257. "In order to show lack of independence, the complaint of a stockholder- plaintiff must create a reasonable doubt that a director is not so beholden to an interested director * * * that his or her discretion would be sterilized." *Beam*, 845 A2d at 1050 (internal quotation marks and citation omitted); *see also Blasband v. Rales*, 971 F2d 1034, 1048 (3d Cir 1992) ("When lack of independence is charged, a plaintiff must show that the Board is either dominated by an officer or director who is the proponent of the challenged transaction or that the Board is so under his influence that its discretion is sterilized.") (internal quotation marks, alterations, and citations omitted).

Plaintiffs' Complaint does not adequately plead a lack of independence of a majority of the Umpqua directors. Ten of the eleven directors—including all five of the directors on the Compensation Committee—are nonmanagement directors. Of the eleven directors, only *one*—Mr. Davis—is alleged to have received any incentive compensation of the kind challenged in the Complaint. Plaintiffs have not alleged that any of the outside directors are dominated or controlled by, or beholden to, Mr. Davis. Thus, plaintiffs have not pleaded any particularized facts to reasonably create doubt about the independence of the Umpqua Board. *See Silicon Graphics*, 183 F3d at 990 (complaint lacking particularized facts demonstrating that majority of board members personally benefited from challenged conduct or were dominated by director who did benefit from conduct fails to establish reasonable doubt that the board was independent and disinterested).

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Likewise, plaintiffs' effort to excuse demand on the ground that a majority of the Umpqua directors have a disabling "interest" with respect to the claims must be rejected. To excuse demand, plaintiffs must plead facts showing that a *majority* of the Board suffers from an alleged conflict of interest. *See Beam*, 845 A2d at 1049. Mr. Davis is the only director alleged to have received any of the incentive compensation that is challenged in this action. Thus, this is not a case in which demand can be excused because a majority of the Board is alleged to have been personally interested in the challenged transaction. *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A2d 808, 821 (Del Ch 2005) (noting that "no issue" of self-interest exists because directors did not stand on both sides of transaction or receive any personal financial benefit), *aff'd*, 906 A2d 766 (Del 2006).

Absent the ability to allege any genuine conflict of interest, plaintiffs resort to arguments that the full Board approved the compensation and that the directors could face personal liability as a result. Both these arguments are totally unavailing under well-established precedent.

1. Demand is not excused merely because the directors approved the 2010 executive compensation.[6]

Plaintiffs' allegation, Compl. ¶ 53, that the Umpqua Board has "demonstrated its hostility towards the relief sought in the action" by first recommending that shareholders approve the 2010 executive compensation, and "then ratifying their own prior decisions to award the 2010 compensation by not rescinding it after a majority negative vote," is not sufficient to excuse demand. It is well established that "mere directorial approval of a transaction, absent particularized facts supporting a breach of fiduciary duty claim, or otherwise establishing the

[6] While the Complaint assumes (and alleges) that the compensation being challenged was approved by the entire Board, as the Umpqua Proxy Statement states (and as the Court may take judicial notice on this motion), executive compensation decisions were delegated by the Board to the Compensation Committee. *See, e.g.,* Proxy Statement at 29, 37, 40-42.

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lack of independence or disinterestedness of a majority of the directors, is insufficient to excuse demand." *Aronson v. Lewis*, 473 A2d 805, 817 (Del 1984). As the Delaware Supreme Court explained in *Aronson*, the law cannot be "that any board approval of a challenged transaction automatically connotes 'hostile interest' and 'guilty participation' by directors, or some other form of sterilizing influence upon them. Were that so, the demand requirements of our law would be meaningless * * *" *Aronson*, 473 A.2d at 814. Thus, "where mere approval of corporate action, absent self-interest or other indication of bias, is the sole basis for establishing [a] director's wrongdoing and hence for excusing demand on them, plaintiff's suit should ordinarily be dismissed." *Potter*, 546 F3d at 1059 (internal quotation marks and citations omitted) (applying California law).

2. The directors do not face a substantial likelihood of liability.

Plaintiffs' allegation that the "entire Umpqua Board faces a substantial likelihood of liability and is interested in the outcome of this action" is also insufficient to excuse demand. Compl. ¶ 51.

"[T]he mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors * * *" *Aronson*, 473 A2d at 815; *see also Wood*, 953 A2d at 141. Likewise, merely naming directors as defendants is not enough to excuse demand. *See Spiegel v. Buntrock*, 571 A2d 767, 774 n.14 (Del 1990) ("[T]he fact that all directors are named as defendants in a derivative complaint is not determinative of their lack of independence."); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A2d 106, 121 (Del Ch 2009) ("Demand is not excused solely because the directors would be deciding to sue themselves."). As the Delaware Court of Chancery has recently held:

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> "[D]emand will be excused based on a possibility of personal director liability only in the rare case when a plaintiff is able to show director conduct that is 'so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists.'" *Citigroup*, 964 A2d at 121 (quoting *Aronson*, 473 A2d at 815).

While plaintiffs make allegations that the Umpqua executives did not deserve the compensation that the Board awarded them for 2010, those allegations are not sufficient to give rise to an inference that the directors face a substantial likelihood of liability. There are no pleadings showing director conduct that is "egregious on its face." Plaintiffs' claims concerning the amount of compensation paid to Umpqua executives are classic claims of corporate waste. In order to prevail on a waste claim, a plaintiff must show that compensation was so high and so unjustified as to "lie beyond the range at which any reasonable person might be willing to trade." *Brehm*, 746 A2d at 263 (internal quotation marks and citation omitted).

In *Iwasaki v. Iwasaki Bros.,* 58 Or App 543, 547, 649 P2d 598 (1982), the Oregon Court of Appeals considered a claim by shareholders that "other shareholders [were] plundering the corporation by means of excessive salaries." The *Iwasaki* court held that Oregon law recognized that if "the allegedly excessive salary seems more a product of business judgment than an attempt to siphon off profits," stockholders cannot recover on a claim for supposedly improper compensation payments. 58 Or App at 547-48. Thus, if the compensation is within the realm of business judgment—i.e., if it "can be attributed to *any rational business purpose*"[7]—plaintiffs' claim fails, and so does the argument that otherwise independent directors are "interested" because they face potential liability for their conduct.

Accordingly, in a purported derivative claim, "[t]o excuse demand on the grounds of waste, the complaint must allege particularized facts sufficient to create a reasonable doubt that the board authorized action on the corporation's behalf on terms that no person of ordinary,

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[7] *Crandon*, 219 Or App at 31 (internal quotation marks and citation omitted).

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sound business judgment could conclude represents a fair exchange." *Highland Legacy Ltd. v. Singer*, No. Civ.A. 1566-N, 2006 WL 741939, at *7 (Del Ch Mar. 17, 2006). This is an "extreme test" that "is rarely satisfied, because if a reasonable person could conclude the board's action made business sense, the inquiry ends and the complaint will be dismissed." *Id*. (internal quotations marks and citation omitted). In *Highland Legacy*, the complaint did not allege that the consultants who received the allegedly wasteful payments were hired for an improper purpose or that they did not perform the tasks for which they were hired. Rather, the complaint merely alleged that the firms were overcompensated. The court dismissed the complaint, stating that such a claim "falls far short of meeting the stringent requirements of the waste test." *Id*. Likewise, plaintiffs do not allege that the Umpqua executives did not perform the tasks for which they were hired. The Complaint merely alleges that the executives were overcompensated; therefore, the Complaint should be dismissed.

Plaintiffs' Complaint also fails to allege particularized facts sufficient to support their claim that the Umpqua Board breached its fiduciary duty of loyalty. The duty-of-loyalty allegations are reflected in Complaint ¶¶ 26-28, 58. These allegations simply repeat plaintiffs' claims that the compensation paid was excessive and that it supposedly violated Umpqua's policies, and also claim that the directors breached a duty by failing to disclose that the compensation violated the policy. None of these allegations adequately pleads a potential violation of the directors' duty of loyalty.

A duty-of-loyalty claim requires either a personal financial conflict[8] or that the

[8] A director's duty of loyalty may be implicated when "a business transaction involve[s] either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally." *Cede & Co. v. Technicolor, Inc.*, 634 A2d 345, 362 (Del 1993). As noted above, however, only one of Umpqua's eleven directors is alleged to have received any personal benefit from the 2010 compensation decisions, and there are no allegations that the other directors are beholden to this allegedly self-interested director. *See* Section I.A, *supra*. The alleged self-interest of a single director is insufficient to impugn the loyalty of the entire board. *See Cede & Co.*, 634 A2d at 363 ("This Court has never held that one director's colorable interest in a challenged transaction is sufficient, without more, to deprive a *board* of the protection of the business judgment rule presumption of loyalty.").

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directors "knowingly and completely failed to undertake their responsibilities." *Lyondell Chem. Co. v. Ryan*, 970 A2d 235, 243-44 (Del 2009). Plaintiffs' conclusory allegation that the director defendants "knew or should have known that increasing 2010 CEO and top executive pay * * * was unreasonably excessive" by virtue of their "access to Umpqua's internal information," Compl. ¶ 27, does not offer any particularized facts supporting an inference that the directors consciously disregarded their duties. *See Wood*, 953 A2d at 42-43 (it is "well-settled Delaware law" that courts will not infer that directors had a culpable state of mind based on allegations that they "should have been aware"). Furthermore, "Delaware law on this point is clear: board approval of a transaction, even one that later proves to be improper, without more, is an insufficient basis to infer culpable knowledge or bad faith on the part of individual directors." *Wood*, 953 A2d at 142; *see* Compl. ¶ 37. Thus, the Complaint fails to properly allege that the directors face a substantial risk of liability from the breach-of-loyalty claim.

In addition to plaintiffs' pleading deficiencies, another reason that the directors cannot face a substantial risk of liability from claims other than alleged breach of the duty of loyalty is found in Umpqua's Restated Articles of Incorporation. These articles, as permitted by statute, exculpate Umpqua's directors from monetary damages for any conduct except the following: breaches of loyalty; acts or omissions not in good faith; conduct that involves intentional misconduct or a knowing violation of the law; unlawful distributions to shareholders; and transactions from which the director derived an improper personal benefit.[9] *See* ORS 60.047(2)(d). "'[A] serious threat of [director] liability may only be found to exist if [plaintiffs plead] a *non-exculpated* claim against the directors based on particularized facts.'" *Wood*, 953

[9] Liday Decl. Ex 2. Federal courts consider such exculpation clauses in corporate charters without converting a Rule 23.1 motion to dismiss for failure to make demand into a motion for summary judgment. *See, e.g.*, *In re Pfizer, Inc. Derivative Sec. Litig.*, 307 F App'x 590 (2d Cir 2009); *Rahbari v. Oros*, 732 F Supp 2d 367 (SDNY 2010); *Baca v. Crown*, No. CV 09-1283-PHX-SRB, 2010 WL 2812697 (D Ariz Jan. 8, 2010); *Playford v. Lowder*, 635 F Supp 2d 1303 (MD Ala 2009); *In re MIPS Techs., Inc. Derivative Litig.*, No. C-06-06699 RMW, 2008 WL 3823726 (ND Cal Aug. 13, 2008); *In re Coca-Cola Enters., Inc. Derivative Litig.*, 478 F Supp 2d 1369, 1374-75 (ND Ga 2007).

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A2d at 141 (quoting *Guttman v. Huang*, 823 A2d 492, 501 (Del Ch 2003)); *see also Citigroup,* 964 A2d at 124-25 (same); *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A2d 1268, 1270 (Del Ch 1995) ("When the certificate of incorporation exempts directors from liability, the risk of liability does not disable them from considering a demand fairly unless particularized pleading permits the court to conclude that there is a substantial likelihood that their conduct falls outside the exemption.").

None of the allegations plaintiffs make concerning the Board's ten independent directors remotely suggest that any of them could conceivably face liability that would not be exculpated by the charter and statute. Nothing they are alleged to have done—i.e., approving compensation according to their view of management performance and their chosen yardstick of operating earnings per share—comes close to being a knowing violation of law, bad-faith conduct or conduct from which they received an improper personal benefit.

B. Plaintiffs Fail to Allege Facts Raising a Reasonable Doubt That the Executive Compensation Was the Product of a Valid Business Judgment.

"The business judgment rule is a 'presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" *Crandon*, 219 Or App at 31 (quoting *Aronson*, 473 A2d at 812). "'A hallmark of the business judgment rule is that a court will not substitute its judgment for that of the board if the latter's decision can be attributed to *any rational business purpose*.'" *Crandon*, 219 Or App at 31 (*quoted in Unocal Corp. v. Mesa Petroleum Co.*, 493 A2d 946, 954 (Del 1985) (emphasis in *Crandon*)); *see also McMunn v. ML & H Lumber*, 247 Or 319, 323-24, 429 P2d 798 (1967) ("a court of equity will not interfere with the exercise of business discretion by the directors and officers of a company") (internal quotation marks and citation omitted).

Thus, "as a general matter, a party seeking to avoid the prelitigation demand

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requirement must plead facts sufficient to rebut the business judgment rule presumption." *Crandon*, 219 Or App at 31. "Specifically, the plaintiffs must plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision." *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A2d at 824 (internal quotation marks and citation omitted). As the Delaware Chancery Court has stated: "This is a high standard to satisfy. * * * '[A] plaintiff who seeks to excuse demand through [this test] . . . faces a task closely akin to proving that the underlying transaction *could not have been* a good faith exercise of business judgment.'" *Postorivo v. AG Paintball Holdings, Inc.*, Nos. 2991-VCP, 3111-VCP, 2008 WL 553205, at *8 (Del Ch Feb. 29, 2008) (quoting *In re infoUSA, Inc. S'holders Litig.*, 953 A2d 963, 972 (Del Ch 2007)).

1. Executive compensation is a matter within the business judgment of the board of directors.

Executive compensation is squarely within the realm of decisions that are protected by the business judgment rule. *See* ORS 60.077(2)(L) (every corporation has the "power to * * * [d]efine directors', officers', employees' and agents' duties, *fix their compensation* and lend them money and credit") (emphasis added); ORS 60.301(2) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, the board of directors * * *."); *Iwasaki*, 58 Or App at 547-48 (compensation decision within business judgment of directors); *see also, e.g.*, *Brehm*, 746 A2d at 263 ("It is the essence of business judgment for a board to determine if a particular individual warrants large amounts of money, whether in the form of current salary or severance provisions.") (internal quotation marks and citations omitted)); *Lewis v. Hirsch*, No. CIV. A. 12,532, 1994 WL 263551, at *3 (Del Ch June 1, 1994) ("executive compensation is a matter ordinarily left to the business judgment of a company's board of directors"); *Haber v. Bell*, 465

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A2d 353, 359 (Del Ch 1983) ("generally directors have the sole authority to determine compensation levels and this determination is protected by the presumption of the business judgment rule").

The presumption that Umpqua's executive compensation is the product of valid business judgment is further enhanced by the fact that the Board's responsibilities with respect to executive compensation are carried out by a Compensation Committee of independent nonmanagement directors. *See Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A2d 772, 799 (Del Ch 2004) ("Informed decisions regarding employee compensation by independent boards are usually entitled to business judgment rule protection."); *Orban v. Field*, No. 12820, 997 WL 153831, at *10 (Del Ch Apr. 1, 1997) ("Where, as here, a payment decision has been approved by a majority of disinterested directors, it is entitled to the protection of the business judgment rule.").

Plaintiffs' theory is apparently that directors cannot approve incentive compensation in a year in which the stock price of the company declines. *See, e.g.*, Compl. ¶ 27. But that theory is not sufficient to state a claim. *See Prod. Res.*, 863 A2d at 799 (that executives "received substantial salaries during a period when NCT was performing poorly would not, without more, ordinarily sustain a claim"). Directors are entitled to manage a company for the long run. There is nothing improper in a board's considering corporate interests over the long term and taking actions to create durable, long-term wealth for its shareholders. *See Paramount Commc'ns, Inc. v. Time Inc.*, 571 A2d 1140, 1154 (Del 198990).

More specifically, plaintiffs' Complaint ignores the actual policy adopted and administered by the Umpqua Compensation Committee. The financial "performance" element of the compensation policy is designed around a specific yardstick, Umpqua's Operating Earnings Per Share (OEPS). Proxy Statement at 31. This is a measure of corporate financial performance

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different from "annual shareholder return." Yet plaintiffs' Complaint attempts to base their claims on the notion that the Committee could not approve pay for executives based on the actual yardstick—OEPS—and had to use a different yardstick that plaintiffs chose out of a dozen other possibilities. There is not and could not be an allegation that a "pay for performance" approach using Operating Earnings Per Share is so irrational as to indicate a failure to exercise business judgment. Saying that OEPS-based compensation was paid during a year in which "annual shareholder return" was negative is an insufficient basis on which to rebut the business judgment presumption.

2. The nonbinding, advisory shareholder vote under the Dodd-Frank Act does not "rebut" the business judgment rule.

Plaintiffs' principal contention is that the negative "say on pay" vote, in and of itself, rebuts the presumption that the directors' decisions with respect to compensation were valid exercises of business judgment.[10] Plaintiffs' Complaint thereby tries to do exactly what the Dodd-Frank Act says its "say on pay" provision does *not* do. Indeed, the Dodd-Frank Act explicitly states that such votes "shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—(1) as overruling a decision by such issuer or board of directors; (2) to create or imply any change to the fiduciary duties of such issuer or board of directors; [or] (3) to create or imply any additional fiduciary duties for such issuer or board of directors * * *." 15 USC § 78n-1(c). Thus, nothing about the "say on pay" vote changes the law governing directors' fiduciary duties, and—most importantly—the vote cannot supply a basis for imposing liability on directors if it would not have existed prior to Dodd-Frank.

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[10] *See* Compl. ¶ 43 ("In light of the adverse shareholder vote, the presumption of business judgment surrounding the Umpqua Board's 2010 executive compensation decisions has been rebutted.").

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II. PLAINTIFFS FAIL TO STATE A CLAIM ON WHICH RELIEF MAY BE GRANTED.

Plaintiffs purport to assert two causes of action against the Umpqua defendants: (1) a breach-of-loyalty claim against the Umpqua directors and (2ii) an unjust enrichment claim against Umpqua's CEO and top executives. *See* Compl. ¶¶ 45, 56-60, 68-69. To the extent that plaintiffs also include allegations of waste and misrepresentation in their fiduciary duty cause of action, *see* Compl. ¶¶ 26-28, 32, 51, 58, those allegations likewise fail to state a claim for relief. Thus, the Complaint should be dismissed under Fed R Civ P 12(b)(6).

A. The Complaint Fails to State a Claim For Breach of the Fiduciary Duty of Loyalty.

Plaintiffs' allegations fail to state a claim for breach of loyalty for the same reasons that, as discussed above, plaintiffs' allegations fail to provide a basis for excusing demand. *See* Section I.B.2, *supra*.

In an apparent effort to give some plausibility to their duty-of-loyalty claims, plaintiffs allege in their complaint that defendants supposedly made misleading statements (without actually pleading a claim of misrepresentation). Thus, plaintiffs allege that defendants "falsely represented to Umpqua's shareholders in the 2011 Proxy Statement that Umpqua followed a pay-for-performance executive compensation policy in 2010 when, in fact, it did not," Compl. ¶ 15, and that the directors breached their "duty of candor"[11] "by concealing that the 2010 executive compensation violated the executive compensation policy, was irrational and unreasonable under the circumstances, and was not a valid exercise of business judgment." Compl. ¶ 58.

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[11] The "duty of candor" is not a separate fiduciary duty, but rather refers to the responsibility of directors, as part of their fiduciary duties, not to mislead shareholders. *See Pfeffer v. Redstone*, 965 A2d 676, 684 (Del 2009) ("the duty of disclosure is not an independent duty, but derives from the duties of care and loyalty") (internal quotation marks, alteration, and citation omitted).

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These allegations neither state a valid claim for misrepresentation nor allow plaintiffs' duty-of-loyalty claim to survive.

Umpqua's compensation philosophy and process for determining compensation were fully disclosed in the 2011 Proxy Statement. *See* Proxy Statement at 29-36. Plaintiffs' Complaint ignores the substantial portion of the Proxy Statement setting forth the metrics of Umpqua's incentive compensation and discussing and analyzing the Compensation Committee's specific decisions regarding the 2010 incentive compensation. *See* Proxy Statement at 41-42. Plaintiffs allege no facts whatsoever to support their conclusory assertion that the 2010 compensation decisions "violated" Umpqua's policies. For example, plaintiffs do not claim that the accomplishments relied on by the Compensation Committee were not in fact achieved; nor do plaintiffs explain how the 2010 compensation was purportedly inconsistent with the financial yardsticks described in the Proxy Statement as the ones Umpqua considers relevant. Thus, plaintiffs fail to state a claim on which relief may be granted with respect to any allegations of "misrepresentation." *See Loudon v. Archer-Daniels-Midland Co.*, 700 A2d 135, 140 (Del 1997) ("[I]t is inherent in disclosure cases that the misstated or omitted facts be identified and that the pleading not be merely conclusory.").[12]

Further, plaintiffs' allegation (Compl. ¶ 58) that the board should have disclosed that the compensation "was irrational and unreasonable under the circumstances, and was not a valid exercise of business judgment," adds nothing to the sustainability of plaintiffs' Complaint. Plaintiffs' cannot bootstrap themselves past pleading requirements by asserting an alleged breach

[12] Plaintiffs' assertion that "there was little, if any, meaningful relationship between Umpqua's executive pay and corporate performance," and their comparison of Umpqua's 2010 compensation to its allegedly negative annual shareholder return, *see* Compl. ¶¶ 32-36, in no way supports plaintiffs' allegations that Umpqua has made any misleading statements about compliance with its compensation policies. As the Proxy Statement clearly reflects, the measure of financial performance relevant to the incentive compensation program is operating earnings per share—not stock price. *See* Proxy Statement at 31. Plaintiffs may disagree with the yardstick chosen by Umpqua, but that does not mean that Umpqua violated its own policies or misrepresented what it was doing.

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of company policy, and then faulting the directors for failing to "confess" the supposed breach. The law is clear that "directors' duty of disclosure does not oblige them to characterize their conduct in such a way as to admit wrongdoing." *Loudon*, 700 A2d at 143; *see also Stroud v. Grace*, 606 A2d 75, 84 n.1 (Del 1992) ("to comport with its fiduciary duty to disclose all relevant material facts, a board is not required to engage in 'self-flagellation' and draw legal conclusions implicating itself in a breach of fiduciary duty"); *In re Citigroup, Inc. Sec. Litig.*, 330 F Supp 2d 367, 377 (SDNY 2004) ("Plaintiff's allegation that Citigroup's failure to disclose that its revenues were derived from 'unsustainable and illegitimate sources' violated section 10(b) is likewise unavailing, for the federal securities laws do not require a company to accuse itself of wrongdoing.").

As the United States District Court for the Central District of California recently held in *Brown v. Brewer*, No. CV 06-3731-GHK (SHx), 2010 WL 2472182, at *23-24 (CD Cal June 17, 2010) when "purported material omissions are nothing more than the building blocks of Plaintiff's fiduciary duty claim" those "allegedly omitted details are not necessarily *facts*, but rather factual *allegations*, and unless and until judgment is granted in Plaintiff's favor, their omission from the Proxy simply could not have been material." S*ee also Ash v. LFE Corp.*, 525 F2d 215, 220 (3d Cir 1975) ("proxy statement did not violate Rule 14a-9 when it failed to disclose a legal theory with which the corporation did not agree and which was never called to its attention"); *In re PHLCORP Sec. Tender Offer Litig.*, 700 F Supp 1265, 1269 (SDNY 1988) (so long as the relevant underlying facts are disclosed, the securities laws do not require characterization of transactions with pejorative nouns or adjectives).

Furthermore, plaintiffs' disclosure allegations also add nothing to their Complaint because they fail to plead materiality or injury.[13] As the Delaware Supreme Court has stated:

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[13] As the Oregon Supreme Court recently reiterated: "The essential elements of a common-law fraud claim are: the defendant made a material misrepresentation that was false; the defendant did so knowing that the representation

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"To survive a motion to dismiss, the plaintiffs must provide some basis for a court to infer that the alleged violations were material. For example, a pleader must allege that facts are missing from the statement, identify those facts, state why they meet the materiality standard and how the omission caused injury." *Malpiede v. Townson*, 780 A2d 1075, 1086-87 (Del 2001). Indeed, plaintiffs have not alleged that the alleged misrepresentations caused any harm whatsoever. *See* Compl. ¶¶ 46-48. This defect in plaintiffs' Complaint is not surprising given that the shareholder vote went against the Board's recommendation, and because the vote was, in any event, nonbinding.

B. The Complaint Fails to State a Claim for Waste.

To adequately plead a claim that Umpqua's 2010 executive compensation constituted waste, plaintiffs must plead facts sufficient to show that "the underlying transaction was totally undirected to a valid corporate purpose." *Haber*, 465 A2d at 359. At a minimum, a litigable challenge to executive compensation requires "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." *Brehm*, 746 A2d at 263 (internal quotation marks and citation omitted). If "any reasonable person might conclude that the deal made sense, then the judicial inquiry ends." *In re Lear Corp. S'holder Litig.*, 967 A2d 640, 656 (Del Ch 2008) (internal quotation marks and citation omitted). The Complaint comes nowhere close to meeting this rigorous standard. As the Proxy Statement reflects, there were numerous reasons for the 2010 executive compensation awards, including Umpqua's financial and nonfinancial performance over the past year and the need to attract, motivate, and retain employees. Proxy Statement at 30.[14]

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was false; the defendant intended the plaintiff to rely on the misrepresentation; the plaintiff justifiably relied on the misrepresentation; and the plaintiff was damaged as a result of that reliance." *Strawn v. Farmers Ins. Co.*, 350 Or 336, 351-52, __ P3d __ (2011).

[14] Oregon law regarding claims of corporate waste is consistent with Delaware law. For example, in *Iwasaki*, 58 Or

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C. The Complaint Fails to State a Claim for Unjust Enrichment.

To state a claim for unjust enrichment against the Umpqua executives as a basis for imposing a constructive trust, *see* Compl. ¶¶ 68-69 and Prayer for Relief ¶ C, plaintiffs must allege facts demonstrating: (1) that property or a property interest that rightfully belongs to them was taken or obtained by someone else under circumstances that were wrongful or inequitable; (2) that the person who now possesses the property is not a bona fide purchaser for value and without notice; and (3) "'strong, clear and convincing evidence,' that the property in the hands of that person, *i.e.*, the property upon which [they] seek[] to impose a constructive trust, in fact is the very property that rightfully belongs to [them], or is a product of or substitute for that property." *Tupper v. Roan*, 349 Or 211, 223, 243 P3d 50 (2010) (en banc) (quoting *Clearwater v. Wagner*, 272 Or 491, 495-96, 537 P2d 532 (1975)).

While a breach of fiduciary duty may in certain circumstances constitute a "wrongful circumstance," *see Tupper*, 349 Or at 223, plaintiffs have not adequately pleaded a breach of fiduciary duty. *See* Section II.A, *supra*. Thus, plaintiffs have also failed to adequately plead unjust enrichment. *See Tum-A-Lum Lumber v. Patrick*, 95 Or App 719, 721, 770 P2d 964 (1989) ("In order to state a claim for unjust enrichment, a complaint must contain allegations showing that the 'enrichment' was 'unjust.' The mere fact that a benefit was conferred is insufficient."). It is clear (and plaintiffs do not allege otherwise) that the Umpqua officers performed services for the company. Thus, plaintiffs' allegations also fail to adequately plead that the officers are not bona fide recipients of the compensation. The allegations are therefore insufficient to state an unjust enrichment claim as a basis for a constructive trust.

Plaintiffs' allegations are also insufficient to state a claim for any of the other

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App at 548, the Oregon Court of Appeals found that the allegedly excessive compensation was not actionable because it was the product of the board's business judgment.

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extraordinary equitable and injunctive relief they seek under their unjust enrichment cause of action. To establish ordinary unjust enrichment under Oregon law, i.e., a quasi-contract action to recover the value of a benefit conferred, a plaintiff "must establish that (1) the plaintiff conferred a benefit on the defendant; (2) the defendant was aware that it had received a benefit; and (3) under the circumstances, it would be unjust for the defendant to retain the benefit without paying for it." *Winters v. County of Clatsop*, 210 Or App 417, 421, 150 P3d 1104 (2007). When a complaint attempts to allege that an employee has received "unjust" amounts of compensation from a corporation, the pleadings must meet the same standard that Oregon law requires when a complaint attempts to plead that the directors authorizing such compensation payments have breached their duties. *See Iwasaki*, 58 Or App at 548 (there is no breach of duty if compensation is "more a product of business judgment than an attempt to siphon off profits"). Thus, the unjust enrichment claim fails for the same reasons that plaintiffs' excessive compensation, breach-of-duty, and waste allegations fail.

CONCLUSION

For the foregoing reasons, the Complaint should be dismissed in its entirety.

DATED this 27th day of June, 2011.

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by the following indicated method or methods on the date set forth below:

☒ **CM/ECF system transmission.**

☒ **E-mail.** As required by Local Rule 5.2, any interrogatories, requests for production, or requests for admission were e-mailed in Word or WordPerfect format, not in PDF, unless otherwise agreed to by the parties.

☒ **Facsimile communication device (to Mr. O'Hara only).**

- ☐ **First-class mail, postage prepaid.**
- ☐ **Hand-delivery.**
- ☐ **Overnight courier, delivery prepaid.**

DATED this 27th day of June, 2011.

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