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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, Plaintiffs, v.	CV No. 3:11-cv-00633-AC INDIVIDUAL DEFENDANTS' REPLY MEMORANDUM IN SUPPORT OF MOTION TO DISMISS

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.

TABLE OF CONTENTS

Page

I. PRELIMINARY STATEMENT 1

II. DISCUSSION 3

- A. A NEGATIVE "SAY-ON-PAY" SHAREHOLDER VOTE DOES NOT REBUT THE BUSINESS-JUDGMENT RULE 3
- B. PLAINTIFFS HAVE NOT MET THEIR BURDEN OF SHOWING THAT DEMAND IS EXCUSED 7
  - 1. Plaintiffs concede that all but one of Umpqua's eleven directors are independent 8
  - 2. The directors do not face a substantial likelihood of liability 9
    - a. The directors did not violate Umpqua's compensation policy 9
    - b. The directors do not face a substantial likelihood of liability because of the allegedly excessive amount of compensation 14
    - c. The Umpqua directors are further protected from a substantial likelihood of liability by the exculpatory provisions of Umpqua's Articles of Incorporation 15
  - 3. The Umpqua directors are protected by the business-judgment rule 17
  - 4. The June 2011 changes to Umpqua's compensation policies are not evidence of any prior wrongdoing 19
- C. PLAINTIFFS HAVE FAILED TO STATE A CLAIM FOR UNJUST ENRICHMENT 22

III. CONCLUSION 23

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TABLE OF AUTHORITIES

Page

CASES

*Air Prod. & Chem., Inc. v. Airgas, Inc.,*16
A3d 48, 55, 58, 121 n.477 (Del Ch 2011) 7

Aronson v. Lewis,
473 A2d 805 (Del 1984) 9, 18

Beam v. Stewart,
845 A2d 1040 (Del 2004) 8

Belova v. Sharp,
No. 07-299, 2008 US Dist LEXIS 19880, at *1 (D Or Mar. 13, 2008) 13, 15-16

Brehm v. Eisner,
746 A2d 244 (Del 2000) 5, 15, 18

Crandon Capital Partners v. Shelk,
219 Or App 16, 181 P3d 773 (2008) .... Passim

Emerald Partners v. Berlin,
726 A2d 1215 (Del 1999) ("*Emerald Partners II*") 16

Gagliardi v. TriFoods Int'l, Inc.,
683 A2d 1049 (Del Ch 1996) 6, 18

Highland Legacy Ltd. v. Singer,
No. Civ.A. 1566-N, 2006 WL 741939 (Del Ch Mar. 17, 2006) 14

Horbal v. Three Rivers Holdings, Inc.,
No. Civ.A. 1273-N, 2006 WL 668542 (Del Ch Mar. 10, 2006) 14

In re Affiliated Computer Servs., Inc.,
No. 2821-VCL, 2009 WL 296078 (Del Ch Feb. 6, 2009) 5

In re Citigroup Inc. S'holder Derivative Litig.,
964 A2d 106 (Del Ch 2009) 9

In re Citigroup, Inc. Sec. Litig.,
330 F Supp 2d 367 (SDNY 2004) 13

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TABLE OF AUTHORITIES
(continued)

Page

Kamen v. Kemper Fin. Servs., Inc.,
500 US 90, 111 S Ct 1711, 114 L Ed 2d 152 (1991) 8

Koon-to Pau v. Yosemite Park & Curry Co.,
39 F3d 1187, 1994 WL 609421 (9th Cir Nov. 3, 1994) 21

Malone v. Microdyne Corp.,
26 F3d 471 (4th Cir 1994) 21

McMunn v. ML & H Lumber,
247 Or 319, 429 P2d 798 (1967) 4

*Paramount Commc'ns Inc. v. Time Inc.,*Nos.10866, et al, 1989 WL 79880, at *30 (Del Ch
July 14, 1989)..7

Postorivo v. AG Paintball Holdings, Inc.,
Nos. 2991-VCP, 3111-VCP, 2008 WL 553205 (Del Ch Feb. 29, 2008)...............................18

Schneider v. Cal. Dep't of Corrections,
151 F3d 1194 (9th Cir 1998) 21

Stroud v. Grace,
606 A2d 75 (Del 1992) 13

Thomason v. Nachtrieb,
888 F2d 1202 (7th Cir 1989) 21

Tum-A-Lum Lumber v. Patrick,
95 Or App 719, 770 P2d 964 (1989)...22

TW Servs., Inc. v. SWT Acquisition Corp.,
Nos. 10427, 10298, 1989 WL 20290 (Del Ch Mar. 2, 1989) 6

Unocal Corp. v. Mesa Petroleum Co.,
493 A2d 946 (Del 1985) 4

Wood v. *Baum*,
953 A2d 136 (Del 2008) 16-17

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TABLE OF AUTHORITIES
(continued)

Page

STATUTES

15 USC § 78n-1(c) 3

ORS 60.077(2)(L) 18

ORS 60.261(2) 7

ORS 60.265 6

ORS 60.301(2) 6, 18

OTHER AUTHORITIES

Fed R Civ P 12(b)(6) 1, 16, 21

Fed R Civ P 23.1(b)(3) 7

Fed R Evid 407 20-21

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I. PRELIMINARY STATEMENT

The Individual Defendants, directors and officers of Umpqua Holdings Corporation ("Umpqua"), demonstrated in their opening memorandum that plaintiffs' complaint should be dismissed because plaintiffs: (1) failed to make a demand on the Umpqua directors before filing a derivative suit on Umpqua's behalf, as mandated by Oregon statute and the Federal Rules; (2) have not met the heavy burden to excuse this failure by showing that the board lacked independence or was self-interested in approving the executive compensation; and (3) failed to allege facts that rebut the presumption of the business-judgment rule and thus have not stated a claim under Fed R Civ P 12(b)(6).

In their response, plaintiffs reveal that their entire theory of liability, their excuse for not making a presuit demand, and their attempt to rebut the business-judgment rule all rely on one single fact: that the directors approved the executive compensation plan—as recommended by Umpqua's independent Compensation Committee—and did not overturn their approval following a subsequent negative advisory vote by the shareholders. By alleging this one fact, plaintiffs contend that they have satisfied their burden to establish the directors' breach of loyalty and their "significant likelihood of liability," rebutted the business-judgment rule, and excused themselves from the presuit-demand requirement. But this ambitious argument flies in the face of Oregon statutes, established principles of corporate governance, overwhelming case law, and even the text of the very legislation that created the nonbinding "say on pay" advisory vote.

As evidenced by their memorandum in opposition (and as discussed more fully below), plaintiffs' arguments are without support and cannot withstand defendants' motion to dismiss. For instance:

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- Plaintiffs argue that the negative "say-on-pay" vote by Umpqua's shareholders strips defendants of the normal protections of the business-judgment rule and establishes a different legal standard for judging their conduct. Pl. Mem. at 2, 11-12. But this argument is contrary to the express language of the Dodd-Frank Act that created the "say-on-pay" vote, contravened by bedrock corporation law principles, and without support from even a single court. *See* Section II.A below.

- Plaintiffs assert that the directors face a "significant likelihood of liability" because they (a) failed to follow Umpqua's own preexisting "pay for performance" policies, and (b) claim that the payments are "irrational" and excessive. These contentions, however, must fail because, *first*, the complaint does not and cannot allege that the 2010 awards were made on any basis other than the Compensation Committee's view that Umpqua had performed well under the yardstick previously adopted and announced for measuring corporate performance (i.e., Operating Earnings Per Share); thus, plaintiffs are left with the argument that this yardstick should not have been selected, but that argument hardly suffices to establish a risk of personal liability. *Second*, the complaint's allegations that the compensation was unreasonably excessive are conclusory and utterly fail to meet the pleading standards necessary to permit such a claim to go forward. *See* Section II.B, below.

- Plaintiffs make conclusory contentions that the Umpqua directors breached their duty of loyalty, but provide no justification for such an assertion—particularly when plaintiffs concede that only one of Umpqua's eleven directors received any benefit from the challenged compensation. Therefore, plaintiffs have failed to make out a cognizable claim for breach of the duty of loyalty. *See* Section II.B.2.c, below.

- Finally, plaintiffs tell the Court that Umpqua "recently announced that its 2010 executive compensation was not closely linked with maximizing shareholder value" and that "the Umpqua Board stated that the ratification of the 2010 executive compensation plan was an unreasonable departure from their own guidelines." But at no time did the board actually make any such comments. Rather, these purported "representations" are nothing more than plaintiffs' characterization about how they want the Court to interpret the board action. They are based entirely on a distortion of the underwhelming fact that Umpqua's Compensation Committee made amendments to the 2011 equity grants—which in no way constitutes an "admission against interest" by defendants. *See* Section II.B.4, below.

As shown in more detail below, plaintiffs can allege no more than that they, and a plurality of Umpqua's shareholders, disagreed with the Umpqua board's judgments about how to

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structure an incentive compensation program for employees. They are entitled to that opinion. But they are not entitled to pursue a derivative claim seeking to impose personal liability for supposed wrongdoing—especially when they have utterly failed to satisfy the presuit-demand prerequisites or strict pleading requirements for derivative claims in this Court.

II. DISCUSSION

A. A NEGATIVE "SAY-ON-PAY" SHAREHOLDER VOTE DOES NOT REBUT THE BUSINESS-JUDGMENT RULE

Plaintiffs' core theory is that the negative "say-on-pay" vote, in and of itself, rebuts the presumption that Umpqua's directors are entitled to the protections of the business-judgment rule. Pl. Mem. at 2, 11-12. This theory flies in the face of the statute under which the "say-on-pay" vote was held. *See* Def. Mem. at 19.

The statutory language of the Dodd-Frank Act provides that "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). Thus, the vote cannot supply a basis for imposing liability on directors if it would not have existed prior to Dodd-Frank.

The key language here is that Congress has expressly provided that a negative "say-on-pay" vote "may not be construed * * * to create or imply any change to the fiduciary duties of such issuer or board of directors." If a negative "say-on-pay" vote changes the legal standard applicable to director conduct, it certainly "create[s]" or "impl[ies]" a "change to the fiduciary duties" of the board. Thus, when plaintiffs ask this Court to rule that Umpqua's

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directors are "stripped" of the protections of the business-judgment rule or that the vote "rebuts" the rule, they are contradicting the express command of Congress.[1]

For these reasons, the legal standard applicable to defendants' conduct with respect to incentive compensation is the Oregon business-judgment rule. The contours of the rule were discussed in detail in defendants' opening memorandum (pages 16-19). Nothing in plaintiffs' papers provides any basis for the Court to apply any other legal principles than those found in the leading case of *Crandon Capital Partners v. Shelk*, 219 Or App 16, 31, 181 P3d 773 (2008): "'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*.' *Unocal Corp. v. Mesa Petroleum Co.*, 493 A2d 946, 954 (Del 1985) * * * (internal quotation marks omitted; emphasis added)." *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'") (quoting *Jackson v. Nicolai-Neppach Co.*, 219 Or 560, 587, 348 P2d 9 (1959)). "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

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[1] It is worth noting that, contrary to plaintiffs' loose language (*see, e.g.*, Pl. Mem. at 8, 10), the negative position in the "say-on-pay" vote did not garner support by the majority of Umpqua shares. As reflected in the voting report attached as Exhibit A to plaintiffs' memorandum, 54.5 million shares voted against the nonbinding resolution endorsing the 2010 compensation. The company had 114.5 million shares outstanding as of January 31, 2011. Thus, the negative "say-on-pay" votes constituted less than a majority of the outstanding shares (as opposed to shares voted).

Shareholders also voted on the frequency of Umpqua's "say-on-pay" vote: As *recommended* by the board, shareholders voted in support of holding "say-on-pay" votes annually. *See* Proxy Statement at 9, Decl. of Steven G. Liday in Sup. of Individual Defendants' Mot. to Dismiss, Exhibit 1; Pl. Mem. Ex. A at 4. Indeed, this was not even Umpqua's first "say-on-pay" vote. *See* Compl. ¶ 38. Shareholders had previously endorsed Umpqua's compensation policies by at least 91 percent of the shares voted. *See* Compl. ¶ 38.

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the honest belief that the action taken was in the best interests of the company.'" *Crandon*, 219 Or App at 31 (quoting *Aronson v. Lewis*, 473 A2d 805, 812 (Del 1984)).

Contrary to plaintiffs' contention, directors are not deprived of the protections of the business-judgment rule simply because shareholders later express disagreement with the board's decision. No case in Oregon (or Delaware) has ever so held.[2] The question is not whether shareholders agree with what the board has done. *See Brehm v. Eisner*, 746 A2d 244, 266 (Del 2000) ("Plaintiffs' sole argument appears to be that they do not agree with the course of action taken by the Board * * *. This will not suffice to create a reasonable doubt that the Board's decision * * * was the product of an exercise of business judgment.") (internal quotation marks and citation omitted);[3] *In re Affiliated Computer Servs., Inc.*, No. 2821-VCL, 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

[2] The Oregon courts look to Delaware precedent in applying Oregon's prelitigation demand requirement. *See Crandon*, 219 Or App at 29-30; *Sommers v. Lewis*, 641 F Supp 2d 1151, 1156 (D Or 2009) ("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.

[3] Plaintiffs claim that defendants' reliance on *Brehm* is misplaced because "the executive compensation at issue in *Brehm* was never rejected by a majority of shareholders" and because the Delaware Supreme Court remanded for further proceedings leading eventually to a trial. Plfs. Mem. at 14 n.16. Neither of these contentions distinguishes *Brehm*. *First*, as shown in this section, a nonbinding shareholder vote does not change the legal standard or erase the business-judgment rule. *Second*, *Brehm* was remanded with leave to replead so that plaintiffs could file an amended complaint. That new complaint survived a motion to dismiss because plaintiffs adequately pleaded facts "suggest[ing] that the Disney directors failed to exercise *any* business-judgment and failed to make *any* good faith attempt to fulfill their fiduciary duties to Disney and its stockholders," *In re Walt Disney Co. Derivative Litig.*, 825 A2d 275, 278 (Del Ch 2003) (emphasis added)—facts not alleged by plaintiffs in this case, and that plaintiffs in *Brehm* were ultimately unable to prove at trial. *See In re Walt Disney Co. Derivative Litig.*, 907 A2d 693 (Del Ch 2005), *aff'd*, 906 A2d 27 (Del 2006).

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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."); *Gagliardi v. TriFoods Int'l, Inc.*, 683 A2d 1049, 1053 (Del Ch 1996) ("that plaintiff regards the decision as unwise, foolish, or even stupid in the circumstances is not legally significant; indeed that others may look back on it and agree that it was stupid is legally unimportant").

There are certainly situations in which a board is bound by a shareholder vote—for example, in an election of directors or in connection with approval of a transaction as to which a statute requires a shareholder vote, such as a merger. But in the ordinary course, business decisions relating to the "business and affairs" of the corporation are the exclusive province of the board, *not* the shareholders. *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, subject to any limitation set forth in the articles of incorporation or in an agreement authorized by ORS 60.265."); *Crandon*, 219 Or App at 30 ("'the fundamental precept [is] that directors manage the business and affairs of corporations'") (quoting *Aronson*, 473 A2d at 812). That is why "say-on-pay" votes are advisory and nonbinding.

Corporations are not run by plebiscite when it comes to ordinary-course "business and affairs"—they are republican in character, in that the shareholders elect directors to run the business. *See TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290, at *8 n.14 (Del Ch Mar. 2, 1989) ("a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation").

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For these reasons, the courts have consistently recognized that in managing the "business and affairs" of a company, a board is not required to follow the wishes expressed by a majority of shareholders, provided that the board acts in good faith. *See Air Prod. & Chem., Inc. v. Airgas, Inc.*, 16 A3d 48, 55, 58, 121 n.477 (Del Ch 2011) (upholding board conduct blocking a tender offer despite the court's belief that the majority of shareholders wished to tender their shares); *Paramount Commc'ns Inc. v. Time Inc.*, Nos. 10866 et al, 1989 WL 79880, at *30 (Del Ch July 14, 1989) ("That many, presumably most, shareholders would prefer the board to do otherwise than it has done does not * * * afford a basis to interfere with the effectuation of the board's business judgment."), *aff'd*, 571 A2d 1140 (Del 1989).[4]

B. PLAINTIFFS HAVE NOT MET THEIR BURDEN OF SHOWING THAT DEMAND IS EXCUSED

Under Oregon statute and the Federal Rules of Civil Procedure, "[a] complaint in a proceeding brought in the right of a corporation must allege with particularity the demand made, if any, to obtain action by the board of directors and either that the demand was refused or ignored or why a demand was not made." ORS 60.261(2); *see also* 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"). As discussed in defendants' opening memorandum, the presuit-demand requirement is

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[4] The case law that plaintiffs rely on addresses the general importance of the shareholder franchise in a director election. Of course, nothing in defendants' position on this motion detracts from the regard due to a shareholder franchise in circumstances (such as director elections and mergers) in which statutes provide that a shareholder vote is the controlling factor. Accordingly, plaintiffs' reliance on *IBS Fin. Corp. v. Seidman & Assocs., L.L.C.*, 136 F3d 940, 949 (3d Cir 1998), *Mainiero v. Microbyx Corp.*, No. 14228-NC, 1996 Del Ch LEXIS 107, at *7-8 (Del Ch Aug. 15, 1996), and *Blasius Indust., Inc. v. Atlas Corp.*, 564 A2d 651, 659 (Del Ch 1988), is misplaced.

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an important substantive principle that limits the ability of a shareholder to displace the statutory power of the board of directors to determine whether or not to assert claims on behalf of the corporation. *See, e.g.*, *Kamen v. Kemper Fin. Servs., Inc.*, 500 US 90, 96-97, 108-09, 111 S Ct 1711, 114 L Ed 2d 152 (1991); Def. Mem. at 7-9.

If a shareholder-plaintiff does not make demand on the board, a derivative action may proceed *only* if the plaintiffs allege "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." *Crandon*, 219 Or App at 30. Plaintiffs bear the burden of showing why demand is excused. *See id.*; *Beam v. Stewart*, 845 A2d 1040, 1048-49 (Del 2004) ("The key principle upon which this area of our jurisprudence is based is that the directors are entitled to a *presumption* that they were faithful to their fiduciary duties. In the context of presuit demand, the burden is upon the plaintiff in a derivative action to overcome that presumption.") (footnote omitted).

1. Plaintiffs concede that all but one of Umpqua's eleven directors are independent.

Ten of Umpqua's eleven directors—including all five of the directors on the Compensation Committee—are not members of Umpqua management. Only *one* director (Mr. Davis, Umpqua's CEO) is alleged to have received any incentive compensation of the kind challenged in the complaint. Indeed, plaintiffs concede that the ten nonmanagement directors are independent. In plaintiffs' counsel's own words: "Rather than making any claims grounded in interpersonal relationships, the complaint here alleges every member of the Umpqua Board to be interested because, as in *Lynch* and *Ryan*, each directly engaged in incriminating conduct, *i.e.,*

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deciding to approve this excessive 2010 executive compensation despite an utter lack of performance." Pl. Mem. at 16.

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

As shown in defendants' opening memorandum, "the mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors" for purposes of determining whether demand is excused. *Aronson*, 473 A2d at 815. Rather, "demand 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.'" *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A2d 106, 121 (Del Ch 2009) (quoting *Aronson*, 473 A2d at 815); *see* Def. Mem. at 12-13.

a. The directors did not violate Umpqua's compensation policy.

Plaintiffs claim that "the entire Umpqua Board is prima facie liable for a breach of loyalty by approving excessive executive compensation for Umpqua's CEO and top executives in violation of the express terms of the Board's executive compensation pay-for-performance policy." Pl. Mem. at 15.[5] But plaintiffs' conclusory allegations (Compl. ¶¶ 3, 32) fail to provide any basis for showing a "substantial likelihood" that any director will be liable for anything.

There are no facts pleaded supporting the claim that Umpqua's Compensation

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[5] The 2010 executive compensation challenged by plaintiffs consisted of the following: salary, bonus, stock awards, option awards, nonequity incentive plan compensation, and other compensation such as matching 401(k) contributions, and in the case of Mr. Davis, changes in pension value and nonqualified deferred compensation earnings. Proxy Statement at 48; *see* Compl. ¶ 37.

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Committee or board "violated" its previously adopted policy. That policy was described in Umpqua's 2011 Proxy Statement and, in pertinent part, provided that Umpqua desired to reward executives for good performance *and* that the board had adopted the yardstick of Operating Earnings Per Share ("OEPS") as the measure of Umpqua's financial performance for these purposes. As set forth on page 41 of the Proxy Statement:

> "As in the past, the Compensation Committee considered a variety of possible performance areas and determined that the following performance categories would focus these executives on objectives that would benefit shareholders:
>
> - corporate financial targets—measured by operating earnings per share fully diluted (OEPS);
> - leadership and cultural competencies;
> - regulatory and compliance goals; and
> - personal and business unit goals (for all except Mr. Davis)."

And as reflected on page 42 of the Proxy Statement: "The Company emphasizes objective performance benchmarks for annual incentive compensation, as measured by fully diluted operating earnings per share, and achievement of compliance and regulatory goals, as measured by ratings achieved in regulatory examinations and internal audit and compliance reviews."

Plaintiffs do not and cannot allege that the 2010 incentive compensation challenged in this complaint was not the result of a reasoned decision by Umpqua's Compensation Committee that OEPS had improved in the relevant period, and thus that senior management was entitled to pay-for-performance incentive compensation at the levels granted.[6]

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[6] As the Proxy Statement reflects at page 42:

> "In January 2011, the Compensation Committee reviewed 2010 operating and personal results against the incentive plans for each of the named executive

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Nor can plaintiffs allege that the choice of OEPS as the yardstick is irrational or self-interested. All they can do is to say that they would have chosen a different criterion, and that shareholders were unhappy with the result of using this particular yardstick. Such a difference of opinion does not provide a basis for a finding that independent directors of Umpqua face a "substantial likelihood" of personal liability for choosing OEPS and applying it.

The Proxy Statement sets forth the analysis of the challenged compensation in six pages of detailed discussion. *See* Proxy Statement at 37-42. Focusing entirely on a metric of their own making—"annual shareholder return"—plaintiffs assert the conclusory allegation that defendants violated Umpqua's pay-for-performance policies because, they claim, "there was little, if any, meaningful relationship between Umpqua's executive pay and corporate performance." Compl. ¶ 32. But plaintiffs' attempt to manufacture a "violation" of Umpqua's compensation policies by substituting "annual shareholder return" in place of the OEPS yardstick actually used by the board is insufficient in light of the sections of the Proxy Statement that plaintiffs ignored. Plaintiffs have not even acknowledged the actual process followed by the Committee in making the compensation decisions, including its choice of criteria for awarding incentive compensation described in the Proxy Statement, let alone alleged that any of the specified criteria were violated.

Likewise, plaintiffs' attempt to manufacture a "substantial likelihood" of personal liability based on supposed disclosure violations is also unavailing. The directors face no substantial likelihood of liability from these claims. Plaintiffs assert that defendants "falsely

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officers. The Committee determined that the Company's actual OEPS for 2010 met the minimum target range for a partial payout of the financial component."

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represented to Umpqua's shareholders in the 2011 Proxy Statement that Umpqua followed a pay-for-performance executive compensation policy." Compl. ¶ 15; *see also* Compl. ¶ 32. But plaintiffs' complaint fails to identify *any* actual factual omissions or misrepresentations in the relevant sections of the Proxy Statement. *See* Proxy Statement at 38-43.[7] The Proxy Statement told shareholders that Umpqua had a pay-for-performance policy; stated that this policy would reward executives depending on how the board viewed Umpqua's financial performance as judged by the yardstick of OEPS; and disclosed that the 2010 awards were based on this policy and this criterion. There were no omissions or misstatements, and plaintiffs cannot create one after the fact by imposing their own measure different from the measure selected by the directors and disclosed in the Proxy Statement.[8]

Plaintiffs' allegations that the directors failed to disclose that the compensation "was irrational and unreasonable under the circumstances, and was not a valid exercise of business judgment," are just the sort of conclusory allegations that courts reject as a reason for excusing presuit demand. *See* Def. Mem. at 21-22.[9] It is blackletter law in the securities

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[7] To the extent that plaintiffs may be suggesting that Umpqua was not forthright about disclosing its performance based on stock-market returns, plaintiffs' insinuation is unpersuasive, since this information (i) is set forth on page 29 in Umpqua's Form 10-K filing with the SEC for the year ending December 31, 2010, and (ii) is a matter of public record.

[8] *See Seinfeld v. O'Connor*, 774 F Supp 2d 660, 667 (D Del 2011) (dismissing disclosure claim because plaintiffs' conclusory allegations and implausible interpretations of defendants' proxy statement did not comport with what the proxy statement actually said).

[9] Contrary to plaintiffs' contention, *Brown v. Brewer*, No. CV 06-3731-GHK (SHx), 2010 WL 2472182, at *24 (CD Cal June 17, 2010), is apt and persuasive precedent for dismissing plaintiffs' claims. The court addressed "allegedly omitted details," favorably cited precedent to the effect that "'self-flagellation' omissions are not material" and do not state a cause of action as a matter of law, and ultimately held that because the "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." *Id.*

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disclosure context that issuers are not required to "self-flagellate" themselves by adopting plaintiffs' conclusory labels ("irrational," "unreasonable"), when the issuer itself has a good-faith belief to the contrary. *See 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.").

Plaintiffs' attempted reliance on option-backdating cases is also misplaced. These cases themselves make it plain that stock option backdating was an inherently deceptive practice, which, if adequately pleaded, did subject the directors to a substantial likelihood of liability. As Judge Mosman of this Court stated in *Belova v. Sharp*, No. 07-299, 2008 US Dist LEXIS 19880, at *1 (D Or Mar. 13, 2008): "Backdating is a form of fraud under federal and state law." Options backdating is a "rare case" of a practice that courts have found to be "egregious on its face."[10] Options backdating is a far cry from the ordinary-course compensation decisions that

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Moreover, regardless of the survival of some of the plaintiff's claims in *Brown*, there can be no doubt that judgment was granted in the defendants' favor on the plaintiff's allegations that the defendants should have engaged in "self-flagellating" disclosure.

[10] *See Ryan v. Gifford*, 918 A2d 341, 355-56 (Del Ch 2007) (quoting *Aronson*, 473 A2d at 815):

> "A director who approves the backdating of options faces at the very *least* a substantial likelihood of liability, if only because it is difficult to conceive of a context in which a director may simultaneously lie to his shareholders (regarding his violations of a shareholder-approved plan, no less) and yet satisfy his duty of loyalty. Backdating options qualifies as one of those 'rare cases [in which] a transaction may be so egregious on its face that board approval cannot meet the

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plaintiffs challenge in this action. The decision of a committee of independent directors to use OEPS, as opposed to other possible criteria such as stock-market returns, as a basis for awarding incentive compensation is simply not "egregious on its face."[11]

b. The directors do not face a substantial likelihood of liability because of the allegedly excessive amount of compensation.

Finally, plaintiffs also allege that defendants face liability because the 2010 compensation is allegedly "irrational" and "unreasonably excessive." *See, e.g.*, Compl. ¶¶ 3 (compensation was "disloyal, irrational and unreasonable, and not the product of a valid exercise of business judgment"), 15-24 (each alleging that the 2010 "pay hikes [were] irrational and unreasonable"), 27, 37, 45, 46.

Such claims are classic claims of corporate waste, regardless of how plaintiffs might seek to characterize them. *See Highland Legacy Ltd. v. Singer*, No. Civ.A. 1566-N, 2006 WL 741939, at *7 (Del Ch Mar. 17, 2006) (absent well-pleaded allegations that directors were grossly negligent, uninformed, or financially interested in the transaction, excessive compensation claim "[a]t best * * * alleged a weak claim of corporate waste"); *Horbal v. Three Rivers Holdings, Inc.*, No. Civ.A. 1273-N, 2006 WL 668542, at *4 (Del Ch Mar. 10, 2006)

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test of business judgment, and a substantial likelihood of director liability therefore exists.'"

[11] Moreover, demand was excused in many of the backdating cases that plaintiffs cite because the majority of directors were themselves recipients of the allegedly illicit option grants, *see, e.g.*, *In re Maxim Integrated Prods., Inc.*, 574 F Supp 2d 1046, 1060 (ND Cal 2008) (majority of directors received allegedly backdated options); *In re MRV*, No. 08–03800, 2010 US Dist LEXIS 46946, at *14 ("five of the seven directors * * * actually received alleged backdated stock options"); *In re Zoran Corp. Derivative Litig.*, 511 F Supp 2d 986, 1008 (ND Cal 2007) ("six of eight board members at the time of the complaint received backdated stock options"), further distinguishing those cases from this one, in which it is uncontested that ten of Umpqua's eleven directors did not receive any part of the challenged compensation.

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(claim of excessive compensation "implicates, if anything, a classic allegation of self-dealing or waste"); *cf. Brehm*, 746 A2d at 264 ("Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business-judgment rule.").

Accordingly, plaintiffs' claims of "excessive" compensation do not subject the directors to any risk of liability because plaintiffs do not allege particularized facts sufficient to create a reasonable doubt that compensation was "beyond the range at which any reasonable person" might be willing to pay. *Brehm*, 746 A2d at 263 (internal quotation marks and citation omitted); *see also* Def. Mem. at 13-14. On the contrary, the "reasonableness" of the Compensation Committee's determinations is apparent from the detailed description of their reasoning, contained on pages 37 through 42 of the Proxy Statement.

c. The Umpqua directors are further protected from a substantial likelihood of liability by the exculpatory provisions of Umpqua's Articles of Incorporation.

As set forth in defendants' opening memorandum, another reason that the Umpqua directors are not subject to a substantial likelihood of liability is that they are protected by the exculpation provisions of Umpqua's Restated Articles of Incorporation from liability for any conduct except breaches of loyalty, acts or omissions that are not in good faith or that involve intentional misconduct or a knowing violation of the law, unlawful distributions to shareholders, and transactions in which the director derived an improper personal benefit. *See* Def. Mem. at 15-16.

While plaintiffs cite Judge Mosman's statement in *Belova*, 2008 US Dist LEXIS 19880, at *22-23, that an exculpatory provision is "an affirmative defense that will not dispose of

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a matter at the pleading stage," defendants respectfully submit that this statement is not controlling here because (i) Judge Mosman was speaking in the context of a 12(b)(6) motion to dismiss the underlying claim itself, as opposed to deciding a demand-excused argument; and (ii) a decision of the Delaware Supreme Court after *Belova* makes it clear that courts should consider exculpation clauses when deciding whether directors face a substantial likelihood of liability in a demand-futility assessment.

In *Belova*, the Court relied on the Delaware Supreme Court decision *Emerald Partners v. Berlin*, 726 A2d 1215, 1223-24 (Del 1999) ("*Emerald Partners II*"), for the principle that exculpatory provisions are in the nature of affirmative defenses and would not suffice to dismiss a cause of action for breach of the duty of care on a motion brought under Fed R Civ P 12(b)(6). A few months after *Belova* was decided, however, the Delaware Supreme Court affirmed dismissal of a derivative claim for failure to establish demand futility, holding that "[w]here directors are contractually or otherwise exculpated from liability for certain conduct, 'then a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts.'" *Wood* v. *Baum*, 953 A2d 136, 141 (Del 2008) (quoting *Guttman* v. *Huang*, 823 A2d 492, 501 (Del Ch 2003)). Thus, it is clear that *in the demand-futility context*, this Court may take the exculpatory provisions of Umpqua's Articles into account when assessing whether the directors face a substantial likelihood of liability in this action.

The rule of decision on this motion should be governed by *Wood* rather than *Belova* and *Emerald Partners II* because the rationale of *Emerald Partners II* extends only to cases in which a plaintiff has successfully pleaded not only a claim for breach of fiduciary duty,

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but a claim for a *nonexculpated* breach of fiduciary duty, i.e., a breach of the duty of loyalty (as opposed to a breach of the duty of care). As discussed elsewhere in this memorandum and in defendants' opening memorandum, plaintiffs have not successfully pleaded the elements of *any* fiduciary breach, but in any case, they have certainly not successfully pleaded the elements of a breach of the duty of loyalty. A claim for breach of the duty of loyalty exists in cases in which the defendants are alleged to have caused themselves to receive an improper personal benefit from the corporation, e.g., when corporate decision-makers have a personal conflict of interest and stand on both sides of a transaction.[12] Here, none of the five members of the Compensation Committee is alleged to have received any of the challenged incentive compensation. Accordingly, plaintiffs have not made out a claim for breach of the duty of loyalty, and thus have not made out a claim for any nonexculpated breach of duty; the exculpation provision in the Umpqua charter thus, under *Wood v. Baum*, does have the effect of providing an additional, independent reason showing that the individual defendants do not face a "substantial likelihood of liability."

3. The Umpqua directors are protected by the business-judgment rule.

Having failed to allege facts to show that the directors were not independent and disinterested, or that they face a substantial likelihood of liability, the sole avenue left to plaintiffs whereby they may proceed with this action derivatively is open only if they have "articulate[d] particularized facts showing that there is a reasonable doubt * * * [that] the challenged transaction was otherwise the product of a valid exercise of business judgment."

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[12] *See Cede & Co. v. Technicolor, Inc.*, 634 A2d 345, 362 (Del 1993) (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").

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Crandon, 219 Or App at 30; *see also Aronson*, 473 A2d at 814. "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)); *see also* Def. Mem. at 16-19.

As shown above in Section A, plaintiffs' claim that the business judgment of the Umpqua board is "rebutted" by the "say-on-pay" vote has no support in law. Likewise, for the reasons discussed above in Section B.2.b, plaintiffs' conclusory allegations that the 2010 compensation was "excessive" do not rebut the business-judgment protections. Indeed, the law is well settled that compensation decisions are quintessential business decisions entrusted to the judgment of directors and protected by the business-judgment rule. The Oregon Business Corporation Act itself provides that "[a]ll corporate powers shall be exercised by * * * the board of directors" and that every corporation has the "power to * * * [d]efine directors', officers', employees' and agents' duties, *fix their compensation* and lend them money and credit." ORS 60.301(2); ORS 60.077(2)(L) (emphasis added). And in *Brehm*, the Delaware Supreme Court stated: "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." 746 A2d at 263 (internal punctuation and citations omitted); *see also Gagliardi*, 683 A2d at 1051 ("a court, acting responsibly, ought not to subject a corporation to the risk, expense and delay of derivative litigation, simply because a shareholder asserts, even sincerely, the belief and judgment that the corporation wasted corporate funds by paying far too much");

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Def. Mem. at 17-18.[13]

4. The June 2011 changes to Umpqua's compensation policies are not evidence of any prior wrongdoing.

In June 2011, the Compensation Committee of Umpqua's board made certain adjustments to Umpqua's restricted stock and option grants. These changes, which applied to restricted stock and options awarded to executives in January 2011, added vesting conditions based on "stock price and dividend performance" to the preexisting time-vesting conditions. Thus, the Committee modified the 2011 grants so that they would vest in whole or in part only if Umpqua's total shareholder return achieves specified targets relative to a regional bank stock total return index. Umpqua noted that the Compensation Committee's actions were "in keeping with [its] stated commitment to take shareholder input seriously." Pl. Mem. Ex. B at 2 (Umpqua Holdings Corp., Form 8-K, at 2 (June 20, 2011)).

Plaintiffs completely mischaracterize both the facts and the law relating to these amendments. Thus, plaintiffs claim that "Umpqua recently announced that its 2010 executive

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[13] Plaintiffs highlight a comparison of compensation for 2010 and 2009, but the Compensation Committee believed that the comparison of those two years needed to be viewed in broader context:

> "Mr. Davis's base salary was flat between January 2007 and 2010, as Mr. Davis recommended that he receive no salary increases during that period and the Compensation Committee agreed that was appropriate; 2009 is an inappropriate year with which to compare 2010 CEO compensation because it takes it out of context. In 2009, CEO compensation appropriately decreased 28% as Umpqua experienced a loss that year; Umpqua returned to profitability in 2010 and greatly strengthened its capital and liquidity; [t]hat improved performance was recognized by the Compensation Committee and Mr. Davis' total compensation in 2010 increased 16% over 2008."

Pl. Mem. Ex. A at 4 (Umpqua Holdings Corp., Form 8-K, at 4 (Apr. 22, 2011)). In any event, the fact that an executive's compensation may have increased substantially from one year to the next is, by itself, not evidence of "excessiveness," "irrationality," or any kind of wrongdoing by the directors who approved the increase based on their good faith and due care.

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compensation was not closely linked with maximizing shareholder value" and assert that "in a filing with the Securities and Exchange Commission ("SEC") on June 20, 2011, the Umpqua Board stated that the ratification of the 2010 executive compensation plan was an unreasonable departure from their own guidelines." Pl. Mem. at 3.

The *only* basis that plaintiffs cite for these wildly inaccurate claims is Umpqua's June 20, 2011, Form 8-K filing with the SEC describing the June 2011 amendments. But as discussed below, the Form 8-K says nothing remotely like what plaintiffs claim. *See* Pl. Mem. Ex. B at 2 (Umpqua Form 8-K, at 2).

Plaintiffs' misuse of the June 2011 amendments must be rejected for three independent reasons. *First*, Umpqua's adjustments to its compensation plans and policies are not any kind of admission that the preexisting compensation arrangements were flawed or in conflict with Umpqua's policies or against the interests of shareholders. The statements in Umpqua's Form 8-K are not "admissions against interest" because they "admit" nothing damaging to defendants. *Second*, plaintiffs' argument about the June amendments is not based on anything in their complaint, and is therefore not an appropriate basis for an argument against defendants' motion to dismiss. *Finally*, plaintiffs ignore Fed R Evid 407, which excludes consideration of after-the-fact "subsequent measures" as evidence of negligence or "culpable conduct."

(1) Not an admission—The Form 8-K states that following the nonbinding advisory "say-on-pay" vote, "and in keeping with our stated and ongoing commitment to take shareholder input seriously, our Compensation Committee has taken action to more closely link executive compensation to stock price and dividend performance." Pl. Mem. Ex. B at 2 (Umpqua Form 8-K, at 2). Nothing about this statement suggests that the 2010 compensation was wrongful, or that the 2010 compensation was, as plaintiffs characterize it, an "unreasonable departure" from Umpqua's previously adopted policies and guidelines. To the contrary, the

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adjustments to restricted stock awards and options announced in the Form 8-K simply reflect the addition of further criteria for a portion of 2011 executive compensation. To "more closely link" is not to "admit" there was anything improper or wrongful about prior practices.

(2) Outside the pleadings—New allegations in an opposition brief are irrelevant for purposes of a motion to dismiss. As the Ninth Circuit stated in *Schneider v. Cal. Dep't of Corrections*, 151 F3d 1194, 1197 n.1 (9th Cir 1998): "In determining the propriety of a Rule 12(b)(6) dismissal, a court *may not* look beyond the complaint to a plaintiff's moving papers, such as a memorandum in opposition to a defendant's motion to dismiss." *See also Thomason v. Nachtrieb*, 888 F2d 1202, 1205 (7th Cir 1989) ("It is a basic principle that the complaint may not be amended by the briefs in opposition to a motion to dismiss, nor can it be amended by the briefs on appeal.").

(3) Inadmissible—Defendants disagree with plaintiffs that the June 2011 adjustments amount to conduct admitting prior wrongdoing by "fixing" it. But even if plaintiffs' argument is assumed at face value, it fails: "Subsequent remedial measures" are excluded by Fed R Evid 407, which provides that "evidence of the subsequent measures is not admissible to prove negligence [or] culpable conduct." *See Koon-to Pau v. Yosemite Park & Curry Co.*, 39 F3d 1187, 1994 WL 609421 (9th Cir Nov. 3, 1994) (excluding evidence of new policy forbidding bikers to ride on trail after fatal accident); *see also Malone v. Microdyne Corp.*, 26 F3d 471, 480 (4th Cir 1994) (subsequently filed SEC Form 10-K inadmissible as evidence that disclosures should have been made sooner).

If anything, the changes to the 2011 grants and the related Umpqua Form 8-K show that the Compensation Committee is responsive to shareholders' concerns. There is no small irony in plaintiffs' clamoring for directors to heed a nonbinding shareholder vote, and then attempting to use the Compensation Committee's responsiveness against them. Note that this also undercuts plaintiffs' argument that prelitigation demand would have been futile.

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C. PLAINTIFFS HAVE FAILED TO STATE A CLAIM FOR UNJUST ENRICHMENT

Plaintiffs' memorandum concedes (as it must) that a prerequisite to any unjust-enrichment claim is a wrongful or inequitable taking. Pl. Mem. at 20. Since plaintiffs have failed to plead a cognizable claim that there was anything wrongful about the 2010 executive compensation, the unjust-enrichment claim fails as well. *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."); Def. Mem. at 24-25.[14]

As defendants showed in their opening memorandum, under Oregon law a necessary element of any unjust-enrichment claim is conduct that either is "wrongful or inequitable" or done under circumstances in which "it would be unjust for the defendant to retain the benefit." There is no adequate pleading here that normal-course compensation payments, approved by a Compensation Committee consisting wholly of independent directors, were "unjust," "wrongful or inequitable." In order to make such a pleading, plaintiffs would have to allege essentially the same elements that constitute breach of fiduciary duty or corporate waste—not a mere disagreement over the appropriate size of an executive's compensation, but conduct amounting to actual wrongdoing. In sum, plaintiffs' efforts to plead their claims under the rubric of unjust enrichment are as flawed as their attempts to plead a breach of fiduciary duty.

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[14] Plaintiffs' reliance on *Belova* is again misplaced. In *Belova*, the court found that the complaint adequately pleaded an options-backdating scheme involving sufficient allegations of breach of fiduciary duty and corporate waste. In this case, however, because plaintiffs have failed to allege facts that, if proved, would constitute "wrongful or inequitable" conduct by defendants, the claim of unjust enrichment must fail.

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III. CONCLUSION

For the foregoing reasons, the complaint should be dismissed in its entirety.[15]

DATED this 25th day of August, 2011.

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[15] Although plaintiffs ask the Court for leave to amend if it grants defendants' motion, plaintiffs have not indicated how they could cure the fatal defects in their pleadings identified by defendants. Under these circumstances, defendants respectfully submit that any dismissal should be without leave to amend. *See Johnson v. Lucent Technologies Inc.*, ___ F3d ___, 2011 WL 3332368, at *9-10 (9th Cir Aug. 4, 2011) (affirming dismissal without leave to amend where plaintiff "failed to alert the court as to what new facts he would have alleged").

I hereby certify that I served the foregoing individual defendants' reply memorandum in support of motion to dismiss on:

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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.

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DATED this 25th day of August, 2011.

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