



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

JOHN SOLAK, On Behalf of Himself
and All Other Similarly Situated
Stockholders of PAYLOCITY
HOLDING CORPORATION,

Plaintiff,

v.

STEVEN I. SAROWITZ, MARK H.
MISHLER, STEVEN R.
BEAUCHAMP, RONALD V.
WATERS III, ANDRES D. REINER,
JEFFREY T. DIEHL and PAYLOCITY
HOLDING CORPORATION,

Defendants.

C.A. No. _____

VERIFIED CLASS ACTION COMPLAINT

Plaintiff John Solak (“Plaintiff”), on behalf of himself and all other similarly situated stockholders of Paylocity Holding Corporation (“Paylocity” or the “Company”), brings this Verified Class Action Complaint (the “Complaint”) against (a) Paylocity and the members of its board of directors (the “Paylocity Board” or the “Board”) for declaratory relief relating to the Company’s violation of Sections 109(b) and 102(b)(6) of the Delaware General Corporation Law (“DGCL”) and (b) the members of the Board for breaching their fiduciary duties. The allegations of the Complaint are based on the knowledge of Plaintiff as to himself, and on information and belief, including the investigation of counsel and review of publicly available information, as to all other matters.

NATURE OF THE ACTION

1. This action involves blatant actions by members of the Board to unlawfully entrench themselves in office by passing a fee-shifting bylaw that is in direct conflict with the plain language of the DGCL.

2. On June 11, 2015, Delaware's House of Representatives overwhelmingly passed Senate Bill 75 ("S.B. 75") which, among other things, amended DGCL Section 109(b) to prohibit Delaware stock corporations from adopting and maintaining any fee-shifting provisions in their bylaws relating to internal corporate claims. Roughly two weeks later, on June 24, 2015, Delaware Governor Jack Markell signed S.B. 75 into law, which became effective August 1, 2015.

3. The adoption of Section 109(b) marked Delaware's ban on Delaware corporations from passing and enforcing bylaws that deterred stockholders from enforcing their rights. As anticipated, Section 109(b)'s prohibition on fee-shifting received an abundance of press from various reporters and legal scholars.¹

¹ Jeff C. Dodd and James Edward Maloney, "Delaware Passes Legislation Prohibiting Fee-Shifting Bylaws and Validating Exclusive Forum Selection Bylaws for Stock Corporations," American Bar Association – Business Law Today, Aug. 1, 2015, http://www.americanbar.org/publications/blt/2015/08/keeping_current.html (last accessed May 2, 2016); Michael Greene, "Delaware Fee-Shifting Bill Signed Into Law; Also Endorses Exclusive Forum Clauses," Bloomberg – BNA, Jun. 24, 2015, <http://www.bna.com/delaware-feeshifting-bill-n17179928834/> (last accessed May 2, 2016); Tom Hals, "Delaware Bans 'Loser-Pays' Rules In Corporate Class Actions," Reuters, Jun. 25, 2015, <http://www.reuters.com/article/delaware->

4. Despite Section 109(b)'s enactment and its widespread press, on February 2, 2016, more than six (6) months after Section 109(b) became effective, the Paylocity Board unilaterally adopted a fee-shifting bylaw that allows Paylocity to shift legal fees to its stockholders for actions relating to any "internal corporate claim" in direct violation of Section 109(b).

5. Additionally, the Fee-Shifting Bylaw further violates the express language of Section 102(b)(6). Pursuant to Section 102(b)(6), a Delaware corporation cannot impose "personal liability for the debts of the corporation on its stockholders" unless specifically provided in the corporation's certificate of incorporation. Tellingly, Paylocity's First Amended and Restated Certificate of Incorporation (the "Charter") contains no provision allowing for the shifting of legal fees to stockholders. Under 8 *Del. C.* § 242, to place such a provision in the certificate would require approval by both the Board and the Paylocity stockholders. A bylaw cannot impose liability on stockholders.

corporatelaw-idUSL1N0ZB1JN20150625 (last accessed May 2, 2016); Benjamin Horney, "Del. Gov. Signs Controversial Fee-Shifting Ban Into Law," Law360, Jun. 25, 2015, <http://www.law360.com/articles/672429/del-gov-signs-controversial-fee-shifting-ban-into-law> (last accessed May 2, 2016); Kevin LaCroix, "Delaware Legislature Passes Fee-Shifting Bylaw Prohibition – What Questions Remain?", The D&O Diary, Jun. 14, 2015, <http://www.dandodiary.com/2015/06/articles/shareholders-derivative-litigation/delaware-legislature-passes-fee-shifting-bylaw-prohibition-what-questions-remain/> (last accessed May 2, 2016).

6. Although facially invalid and unenforceable, Paylocity's Fee-Shifting Bylaw is part of a concerted effort by Defendants (as defined herein) to mislead stockholders into believing that the Fee-Shifting Bylaw complies with Delaware law. Moreover, by adopting and continuing to maintain the Fee-Shifting Bylaw in violation of Delaware law, Paylocity's Board is breaching their fiduciary duties.

7. Through this Action, Plaintiff seeks to: (i) invalidate the Fee-Shifting Bylaw and (ii) have this Court enter an order requiring Defendants to promptly rescind the Fee-Shifting Bylaw.

THE PARTIES

8. Plaintiff is a stockholder of Paylocity and has been a stockholder of Paylocity at all relevant times alleged in this Complaint.

9. Defendant Steven I. Sarowitz ("Sarowitz") is the Chairman and founder of Paylocity and has been a director since 1997.

10. Defendant Mark H. Mishler ("Mishler") has been a director of the Company since 2013.

11. Defendant Steven R. Beauchamp ("Beauchamp") has been a director of the Company since 2007. He is also the Company's President and current Chief Executive Officer ("CEO").

12. Defendants Ronald V. Waters III ("Waters") has been a director of the Company since 2013.

13. Defendant Andres D. Reiner (“Reiner”) has been a director of the Company since 2014.

14. Defendant Jeffrey T. Diehl (“Diehl”) has been a director of the Company since 2008.

15. The defendants listed above are collectively referred to herein as the “Individual Defendants” or the “Board.”

16. Defendant Paylocity is a Delaware corporation incorporated in 2013. It is a cloud-based provider of payroll and human capital management (HCM), software solutions for medium-sized organizations, which have 20 to 1,000 employees. Paylocity has its corporate headquarters at 3850 N. Wilke Road, Arlington Heights, IL 60004. Paylocity’s common stock trades on the NASDAQ under the ticker symbol “PCTY.”

17. The Individual Defendants and Paylocity are referred to collectively here in as “Defendants.”

FACTUAL ALLEGATIONS

18. On June 24, 2015, Delaware enacted amendments to the DGCL (which became effective August 1, 2015) to prohibit stock corporations from adopting fee-shifting bylaws and charter provisions. The fee-shifting ban ended a controversy over whether Delaware corporations should be permitted to adopt rules enabling them, and their officers and directors, to recover their attorneys’ fees from

stockholder plaintiffs who pursued unsuccessful lawsuits for breaches of fiduciary duty or related claims.

19. Specifically, DGCL Section 109(b), as amended by S.B. 75, provides that:

(b) The bylaws [of a Delaware corporation] may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees. **The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title.** (emphasis added).

20. DGCL Section 115 defines “internal corporate claim” as:

claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.

21. This amendment closed a door that was previously opened by the Delaware Supreme Court in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 555 (Del. 2014), which held that “fee-shifting provisions in a non-stock corporation’s bylaws can be valid and enforceable under Delaware law.” Although the *ATP* decision specifically addressed non-stock corporations, the Court’s reasoning upholding the fee-shifting bylaw in that case appeared to be equally applicable to stock corporations, and many Delaware stock corporations began adopting fee-shifting provisions.

22. In the wake of *ATP*, members of the Corporation Law Council (“CLC”) of the Delaware State Bar Association expressed concern that fee-shifting provisions would deter stockholders from enforcing their rights in the courts, since “few stockholders will rationally be able to accept the risk of exposure to millions of dollars in attorneys’ fees to attempt to rectify a perceived corporate wrong, no matter how egregious.”

23. CLC drafted a memorandum titled “Explanation of Council Legislative Proposal” which details CLC’s reasons supporting its recommendation to pass Section 109(b). The most notable reasons supporting CLC’s recommendation include the following:

- “Fee-Shifting Provisions Will Make Stockholder Litigation, Even if Meritorious, Untenable”
- “Because the consequences of any corporate decision affect investors only commensurately with the scope of their investments, few stockholders will rationally be able to accept the risk of exposure to millions of dollars in attorneys’ fees to attempt to rectify a perceived corporate wrong, no matter how egregious.”
- “Fee-shifting provisions will curtail the development of the common law of corporations”
- “Courts already have sufficient tools to address and deter litigation of limited merit. These tools include:
 1. Motions to dismiss, which enable the court to terminate litigation at the outset, before expensive discovery proceedings, where the complaint lacks merit on its face.

2. Rule 11, which permits a court to impose on a litigant and/or its counsel the litigation costs, including attorneys' fees, opponents incur when the litigant has brought claims without adequate investigation or legal analysis.
3. Judicially developed doctrines of fee shifting where the court finds that a litigant has conducted itself either before or during litigation in deliberate disregard of the legitimate interests of others.
4. Determining whether or not the plaintiff is an appropriate representative of other stockholders, which is often critical in litigation brought as class or derivative actions; courts can evaluate any number of factors to determine whether the litigant and its counsel are appropriately advancing the interests of the corporation and/or other stockholders in pursuing the litigation.
5. Disapproving settlements of class or derivative actions, including where the case lacked merit from the outset, or imposing limitations on settlement terms.
6. Determining whether and how much stockholder plaintiffs' attorneys will be paid; courts can limit or refuse compensation to counsel for stockholders for cases lacking merit."

24. Despite the unambiguous language of Section 109(b) and the extensive media coverage² that followed, on February 2, 2016, the Paylocity Board adopted the Fee-Shifting Bylaw which states as follows:

8.2 Extra-Forum Claims. To the fullest extent permitted by law, in the event that (A) any current or former stockholder of the corporation acting as such ("Claiming Party") initiates, joins or asserts any Action in a court, tribunal or other arbitral or judicial body, in each case other than in a Chosen Court (an "Extra-Forum Claim"), or offers substantial assistance to, or has a

² See *infra* footnote 1.

direct financial interest in (other than simply in such person's capacity as a stockholder of the corporation), any Extra-Forum Claim against the corporation and/or any current or former director, officer, employee or agent of the corporation (collectively, an "Aligned Party"), (B) the corporation does not consent in writing to waive applicability of this bylaw to a specified Extra-Forum Claim and (C) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Extra-Forum Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the corporation and any such Aligned Party the greatest amount permitted by law of all fees, costs and expenses of every kind and description (including but not limited to, all reasonable attorneys' fees and other litigation expenses) that the parties may incur in connection with such Extra-Forum Claim."

25. Because the Fee-Shifting Bylaw shifts legal fees onto stockholders in "any Action," which would encompass an internal corporate claim, the Fee-Shifting Bylaw directly violates Section 109(b).

26. In addition to Section 109(b), the Fee-Shifting Bylaw also violates Section 102(b)(6) of the DGCL. Section 102(b)(6) states as follows:

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:

(6) A provision imposing personal liability for the debts of the corporation on its stockholders to a specified extent and upon specified conditions; otherwise, the **stockholders of a corporation shall not be personally liable for the payment of the corporation's debts** except as they may be liable by reason of their own conduct or acts. (emphasis added).

27. Paylocity's Charter contains no provision permitting for the shifting of attorneys' fees to its stockholders. A bylaw, unilaterally adopted by the Board,

cannot impose the obligation of debt onto stockholders. For these reasons the Fee-Shifting Bylaw violates Section 102(b)(6).

28. In complete disregard to Section 109(b) and 102(b)(6), the Board adopted the Fee-Shifting Bylaw and thus breached their fiduciary duties to stockholders. Even assuming *arguendo*, that the Board did not knowingly adopt the Fee-Shifting Bylaw in violation of Section 109(b), the Board was nevertheless not fully informed and was grossly negligent in adopting the Fee-Shifting Bylaw.

29. While the Fee-Shifting Bylaw violates Sections 109(b) and 102(b)(6) and is unenforceable as a matter of Delaware law, the Individual Defendants nonetheless are continuing to breach their fiduciary duties by failing to rescind the Fee-Shifting Bylaw in light of Section 109(b). In other words, through its inaction, the Board is creating unnecessary confusion among Paylocity stockholders as to the invalidity of the Fee-Shifting Bylaw.

30. Accordingly, Plaintiff seeks (1) declaratory relief finding the Fee-Shifting Bylaw invalid, (2) relief requiring Defendants to rescind the Fee-Shifting Bylaw and (3) injunctive relief requiring Defendants to publicly acknowledge to the Company's stockholders that the Fee-Shifting Bylaw is invalid as a matter of Delaware law.

CLASS ACTION ALLEGATIONS

31. Plaintiff brings this action pursuant to Rule 23 of the Rules of the Delaware Court of Chancery, individually and on behalf of all other holders of Paylocity common stock (except Defendants herein and any persons, firm, trust, corporation or other entity related to or affiliated with them and their successors in interest) who are or will be threatened with injury arising from Defendants' wrongful actions, as more fully described herein (the "Class").

32. This action is properly maintainable as a class action.

33. The Class is so numerous that joinder of all members is impracticable. The Company has thousands of stockholders who are scattered throughout the United States. As of January 29, 2016, Paylocity had 50,956,284 shares of common stock outstanding.

34. There are questions of law and fact common to the Class including, *inter alia*, whether:

- a. The Fee-Shifting Bylaw violates Section 109(b) of the DGCL;
- b. The Fee-Shifting Bylaw violates Section 102(b)(6) of the DGCL;
- c. The Individual Defendants breached their fiduciary duties by invoking the Fee-Shifting Bylaw;
- d. The Individual Defendants breached their fiduciary duties by failing to rescind the Fee-Shifting Bylaw; and

- e. Plaintiff and the other members of the Class will be damaged irreparably by Defendants' conduct.

35. Plaintiff is committed to prosecuting the action and has retained competent counsel experienced in litigation of this nature. Plaintiff's claims are typical of the claims of the other members of the Class, and Plaintiff has the same interests as the other members of the Class. Plaintiff is an adequate representative of the Class.

36. The prosecution of separate actions by individual members of the Class would create the risk of inconsistent or varying adjudications with respect to individual members of the Class that would establish incompatible standards of conduct for Defendants or adjudications with respect to individual members of the Class that would as a practical matter be disjunctive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests.

37. Defendants have acted, or refused to act, on grounds generally applicable to, and causing injury to, the Class and, therefore, injunctive relief on behalf of the Class, as a whole, is appropriate.

COUNT I

CLAIM AGAINST ALL DEFENDANTS FOR DECLARATORY RELIEF RELATING TO VIOLATION OF DGCL 109(b)

38. Plaintiff repeats and realleges each and every allegation above as if set forth in full herein.

39. DGCL Section 109(b), as amended by S.B. 75, provides that:

(b) The bylaws [of a Delaware corporation] may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees. *The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title.* (emphasis added).

40. DGCL Section 115 defines “internal corporate claims” as:

claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.

41. Paylocity’s Fee-Shifting Bylaw improperly shifts fees to current and former stockholders in violation Section 109(b) and therefore is unenforceable and void as a matter of law.

42. Plaintiff and the Class are entitled to an order declaring that the Fee-Shifting Bylaw is invalid, unlawful, null, void, and of no further effect.

43. Plaintiff has no adequate remedy at law.

COUNT II

CLAIM AGAINST ALL DEFENDANTS FOR DECLARATORY RELIEF RELATING TO VIOLATION OF DGCL 102(b)(6)

44. Plaintiff repeats and realleges each and every allegation above as if set forth in full herein.

45. DGCL § 102(b)(6) permits a corporation's certificate of incorporation to contain:

A provision imposing personal liability for the debts of the corporation on its stockholders to a specified extent and upon specified conditions; otherwise, the stockholders of a corporation shall not be personally liable for the payment of the corporation's debts except as they may be liable by reason of their own conduct or acts.

46. The Paylocity's Charter does not contain any provision imposing on its stockholders personal liability for debts of the corporation. Under 8 *Del. C.* § 242, to place such a provision in the certificate would require approval by both the Board and the Paylocity stockholders. A bylaw cannot unilaterally impose liability on the stockholders.

47. Paylocity's Fee-Shifting Bylaw is inconsistent with § 102(b)(6), Paylocity's Charter and Delaware law and policy on limited liability of stockholders. It purports to impose personal liability on Plaintiff for Company debts to a specified amount ("all fees costs and expenses of every kind and description") and upon specified conditions ("offers substantial assistance to, or has a direct financial

interest in . . . any Extra-Forum Claim against the corporation and/or any current or former director, officer, employee, or agent of the corporation”

48. Plaintiff and the Class are entitled to an order declaring that the Fee-Shifting Bylaw is invalid, unlawful, null, void, and of no further effect.

49. Plaintiff and the Class have no adequate remedy at law.

COUNT III

CLAIM FOR BREACH OF FIDUCIARY DUTY AGAINST THE INDIVIDUAL DEFENDANTS

50. Plaintiff repeats and realleges each and every allegation above as if set forth in full herein.

51. The Individual Defendants, as Paylocity directors and/or officers, owe the Class the utmost fiduciary duties of care and loyalty. By virtue of their positions as directors and/or officers of Paylocity and/or their exercise of control and ownership over the business and corporate affairs of the Company, the Individual Defendants have, and at all relevant times had, the power to control and influence and did control and influence and cause the Company to engage in the practices complained of herein. Each of the Individual Defendants was required to, *inter alia*: (a) use their ability to control and manage Paylocity in a fair, just and equitable manner and (b) act in the furtherance of the best interests of Paylocity and its stockholders.

52. The Individual Defendants failed to fulfill their fiduciary duties by, *inter alia*, (i) invoking the unlawful Fee-Shifting Bylaw six months after the adoption of Section 109(b) and (ii) failing to correct and rescind the Fee-Shifting Bylaw.

53. By failing to rescind the Fee-Shifting Bylaw, the Individual Defendants are improperly misleading and coercing stockholders into believing that the Fee-Shifting Bylaw is valid and enforceable under Delaware law. Thus, the Individual Defendants are currently causing harm to Paylocity stockholders.

54. In addition, because the Board chose to invoke the Fee-Shifting Bylaw and represent to stockholders that it will shift legal fees in certain situations, the Board is now obligated to be forthright and candid about the invalidity of the Fee-Shifting Bylaw.

55. Plaintiff and the Class have no adequate remedy at law.

RELIEF REQUESTED

WHEREFORE, Plaintiff demands judgment as follows:

A. Declaring the Fee-Shifting Bylaw invalid, unlawful, null, void, and of no further effect;

B. Finding the Paylocity Board liable for breaching their fiduciary duties owed to the Class;

C. Rescinding the Fee-Shifting Bylaw;

- D. Certifying the proposed Class;
- E. Awarding Plaintiff the costs and disbursements of this Action, including attorneys', accountants', and experts' fees; and
- F. Awarding such other and further relief as is just and equitable.

Dated: May 5, 2016

ANDREWS & SPRINGER LLC

By: /s/ Peter B. Andrews

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