IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MILTON PFEIFFER, derivatively on behalf of HEALTHWAYS, INC.,	)	
Plaintiff,	)	
v.	)	C.A. No. 7831-VCP
BEN LEEDLE, JR., JAY BISGARD, JOHN BALLANTINE, THOMAS CIGARRAN, MARY JANE ENGLAND, C. WARREN NEEL, WILLIAM NOVELLI, WILLIAM O'NEIL, JR., ALISON TAUNTON-RIGBY, and JOHN WICKENS,	)	
Defendants,	)	
and	)	
HEALTHWAYS, INC., a Delaware Corporation,	)	
Nominal Defendant.	)	

MEMORANDUM OPINION

Submitted: August 1, 2013
Decided: November 8, 2013

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William M. Lafferty, Esq., D. McKinley Measley, Esq., MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware; Wallace W. Dietz, Esq., W. Brantley Phillips, Jr., Esq., Joseph B. Crace, Jr., Esq., BASS BERRY & SIMS PLC, Nashville, Tennessee; *Attorneys for Defendants.*

PARSONS, Vice Chancellor.

This derivative action involves a shareholder challenge to a corporate executive's receipt of stock options under a shareholder approved stock incentive plan. The defendant directors of the corporation allegedly breached their fiduciary duties by approving stock option grants to a company executive that exceeded the maximum number of stock options that could be granted to that individual under the corporation's stock incentive plan. The plaintiff alleges further that the executive who received the excessive stock option grants breached his fiduciary duties and was unjustly enriched by accepting the allegedly unauthorized stock options.

The defendants have moved to dismiss the complaint in its entirety for failure to make demand and for failure to state a claim upon which relief can be granted.

Having considered the parties' briefs and heard argument on the motion, I conclude that the defendants' motion to dismiss should be denied in its entirety.

I. BACKGROUND[1]

A. The Parties

Plaintiff, Milton Pfeiffer, is a shareholder of Nominal Defendant Healthways, Inc. ("Healthways" or the "Company"), and has been a Healthways shareholder at all times relevant to this action.

Nominal Defendant Healthways, a Delaware corporation, implements programs designed to reduce direct healthcare costs and health-related costs associated with the loss

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[1] Unless otherwise indicated, the facts recited in this Memorandum Opinion are based on the allegations in the plaintiff's complaint, documents integral to or incorporated in the complaint, or facts of which the Court may take judicial notice.

of employee productivity by helping individuals to adopt or maintain healthy behaviors, reduce health-related risk factors, and optimize care for identified health conditions.

Defendants Ben Leedle, Jr., Jay Bisgard, John Ballantine, Thomas Cigarran, Mary Jane England, C. Warren Neel, William Novelli, William O'Neil, Jr., Alison Taunton-Rigby, and John Wickens (together, "Defendants" or the "Board") are members of Healthways's Board of Directors. Defendant Leedle currently serves as President of the Company. Defendant Cigarran is a founder of the Company and has served as Chairman of the Board, President, and CEO.

Defendants England, Novelli, O'Neil, and Taunton-Rigby comprised the Board's compensation committee (the "Compensation Committee") at all relevant times.

B. Facts

1. The 2007 Stock Incentive Plan

In 2007, Healthways adopted, and the Company's shareholders approved, a Stock Incentive Plan (the "Plan").[2] Under the Plan, the Company's officers, directors, employees, and consultants are eligible to receive various equity awards, including stock options, stock appreciation rights, restricted stock awards, and performance awards. A committee consisting of all the Company's non-employee directors is responsible for administering the Plan. Although the Compensation Committee is authorized to execute the Plan, the full committee of non-employee directors retains final authority with respect

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[2] The Plan was amended and approved by the Company's shareholders in 2010. It does not appear, however, that any of those amendments are relevant to Pfeiffer's action.

to how the Plan is administered. Among other things, the Plan administrator is responsible for determining the type and number of awards to be granted to the Plan's participants.

Section 4 of the Plan is entitled "Eligibility." Under Section 4, "no Participant may receive (i) Options or Stock Appreciation Rights under the Plan in any calendar year that, taken together, relate to more than 150,000 shares of Stock."[3] The Plan defines an "Option" as "any option to purchase shares of Stock (including Restricted Stock, if the Committee so determines) granted pursuant to Section 5 or Section 9"[4] of the Plan.

Section 8.2 of the Plan outlines the criteria for "Performance Awards." This section states that:

> The Committee shall have sole and complete authority to determine the Participants who shall receive a Performance Award, which shall consist of a right that is (i) denominated in cash or shares, (ii) valued, as determined by the Committee, in accordance with the achievement of such performance goals during such performance periods as the Committee shall establish, and (iii) payable at such time and in such form as the Committee shall determine.[5]

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3 Compl. ¶ 23.

4 Leedle's Opening Br. Ex. E § 1(ee). A copy of the Plan is publicly available in filings with the Securities and Exchange Commission ("SEC"). Accordingly, I may consider it in deciding this motion to dismiss. *See Off v. Ross*, 2008 WL 5053448, at *4 n.5 (Del. Ch. Nov. 26, 2008) ("Delaware courts may take judicial notice of facts publicly available in filings with the [SEC] where those facts are not in dispute.").

5 *Id*. § 8.2.

In addition, "[t]he Committee may grant Performance Awards to Covered Officers based solely upon the attainment of performance targets related to one or more performance goals selected by the Committee from among the goals specified [in Section 8.2(a) of the Plan]."[6] One of the enumerated means to measure performance goals is "stock price or total shareholder return."[7] The Committee's ability to grant performance awards is restricted by Section 8.2(b), which provides in relevant part:

> With respect to any Covered Officer, the aggregate maximum number of shares of Stock in respect of which all Performance Awards and Stock Options may be granted under Sections 5 and 8.2 of the Plan in each year of the performance period is 450,000 . . . in each year of the performance period.[8]

2. The 2011 stock option grants to Leedle

On February 28, 2011, Leedle was granted 84,436 Stock Options pursuant to the Plan. Less than nine months later, on November 3, 2011, the Compensation Committee granted Leedle an additional 500,000 stock options. These options were described in the Company's 2012 Proxy Statement as a "discretionary" grant, designed to "align Mr. Leedle's long-term interests with those of stockholders and to enhance retention incentives."[9] Of the 500,000 options, 365,000 were issued on November 3, 2011, and the remaining 135,000 options were to be issued in February 2012. The 365,000 stock

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6 *Id*. § 8.2(a).

7 *Id*. § 8.2(a)(ix).

8 *Id*. § 8.2(b).

9 Compl. ¶ 26.

options granted under the Plan on November 3 had an exercise price of $9.96 per share, and were scheduled to vest 30 percent on November 3, 2013, 30 percent on November 3, 2015, and 40 percent on November 3, 2017.[10] In 2011, therefore, Leedle received a total of 449,436 stock options in Healthways pursuant to the Plan.

3. The 2012 stock option grants to Leedle

On February 21, 2012, Leedle was issued the remaining 135,000 stock options that the Compensation Committee had granted Leedle in November 2011. These stock options were also granted at an exercise price of $9.96 per share, and were scheduled to vest 30 percent on February 21, 2014, 30 percent on February 21, 2016, and 40 percent on February 21, 2018. That same day, Leedle also was granted an additional 150,000 Stock Options pursuant to Section 5 of the Plan, with an exercise price of $7.47 per share, which were scheduled to vest 25% per year, beginning on February 21, 2013. In 2012, Leedle received a total of 285,000 stock options in Healthways pursuant to the Plan.

4. The 2012 Proxy Statement

Healthways filed its Proxy Statement in connection with its 2012 Annual Meeting on April 20, 2012. According to the Proxy Statement, the November 2011 stock option grant was a "discretionary performance award," which "was granted in two segments due to restrictions on the number of performance awards that can be granted to an individual

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[10] The options expire after ten years on November 3, 2021. Pfeiffer's Answering Br. 6 n.3.

in one year under the 2007 Plan."[11] In the Proxy, the Board certified that the stock options awarded to Leedle complied with the Plan's provisions.

C. Procedural History

On September 4, 2012, Pfeiffer commenced this derivative action on behalf of Healthways. The Complaint seeks, among other relief, a declaration that the stock options granted to Leedle in 2011 and 2012 were *ultra vires* and not authorized by the Plan and rescission of any stock options awarded to Leedle in excess of what was allowed under the Plan. On November 2, 2012, Defendants moved to dismiss the Complaint in its entirety. After full briefing, I heard argument on that motion on April 15, 2013. This Memorandum Opinion constitutes my ruling on Defendants' motion to dismiss.

D. Parties' Contentions

Pfeiffer is pursuing three derivative counts on behalf of the Company against Defendants. Count I asserts that the Individual Defendants breached their fiduciary duties of loyalty and care by granting stock options to Leedle in violation of the Plan. In addition, Pfeiffer claims that the Individual Defendants breached their fiduciary duties by causing the Company to issue a materially misleading and false 2012 Proxy, which, among other things, falsely stated that Leedle's stock options were granted in accordance with the Plan. In Count II, Pfeiffer avers that Leedle breached his fiduciary duties to the Company by accepting stock options that were not granted in accordance with the Plan.

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[11] Compl. ¶ 38.

Finally, in Count III, Pfeiffer alleges that Leedle was unjustly enriched by receiving unauthorized stock options.

Defendants counter that all of Pfeiffer's claims should be dismissed for failure to make demand. According to Defendants, Pfeiffer has failed to allege particularized facts to show that demand should be excused under either of Delaware's tests for demand futility. Defendants argue further that the grant of stock options to Leedle was expressly permitted by the Plan's plain language, and that even if it was not, Pfeiffer has failed to allege with particularity that Defendants knowingly and intentionally breached the Plan's provisions. Finally, Defendants contend that if demand is excused, Pfeiffer has failed to state a claim upon which relief can be granted because he has not alleged that Defendants engaged in any conduct outside the scope of the Company's exculpatory charter provision and because Pfeiffer has not stated a claim for waste, the standard used to evaluate board-authorized compensation decisions.

II. ANALYSIS

Defendants have moved to dismiss the Complaint for failure to make demand under Court of Chancery Rule 23.1 and for failure to state a claim upon which relief can be granted under Rule 12(b)(6). I consider Defendants' arguments in turn.

A. Standard

Delaware law entrusts a corporation's directors, and not its stockholders, with the authority to manage the entity.[12] This authority includes the ability to bring, and otherwise control, litigation brought in the corporation's name.[13] As derivative stockholder lawsuits abrogate the managerial prerogative of corporate directors, derivative plaintiffs are required to make a demand that the corporation's board of directors initiate the lawsuit on the corporation's behalf before the derivative plaintiffs can proceed with their action. The demand requirement is excused, however, when it would be futile for derivative plaintiffs to comply with that requirement. Where, as here, a derivative plaintiff has not made a pre-suit demand on the corporation's board of directors, the plaintiff must allege with particularity the reasons why demand would have been futile.[14]

There are two tests for determining demand futility under Delaware law. When a plaintiff challenges a board of directors' action or "conscious decision to refrain from acting," demand futility is assessed under the two-part analysis established in *Aronson v.*

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12 *See* 8 *Del. C.* § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1291 (Del. 1998) ("One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation.").

13 *In re Am. Int'l Gp., Inc.*, 965 A.2d 763, 808 (Del. Ch. 2009).

14 Ct. Ch. R. 23.1(a).

Lewis.[15] Under *Aronson*, demand is excused when the plaintiff alleges particularized facts that create a reasonable doubt that: (1) the directors are disinterested and independent; or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[16] The standard for demand futility differs, however, when the action that the derivative suit is challenging is not a business decision made by the board of directors or is a business decision of a different board of directors than the board that has to consider demand. In these situations, *Rales v. Blasband*[17] provides the appropriate analytical framework. Demand is excused under *Rales* only if the plaintiff's particularized factual allegations "create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[18]

When considering a motion to dismiss under Rule 23.1, this Court must accept as true the complaint's well-pled factual allegations.[19] Pleadings under Rule 23.1, however, are held to a higher standard than those under Rule 8(a)'s permissive pleading regime.[20] A plaintiff can satisfy Rule 23.1 only by setting forth "particularized factual statements

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15 473 A.2d 805 (Del. 1984).

16 *Id.* at 814.

17 634 A.2d 927 (Del. 1993).

18 *Id.* at 934.

19 *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009).

20 *Id.*

that are essential to the claim."[21] "A prolix complaint larded with conclusory language . . . does not comply with these fundamental pleading mandates."[22]

B. Demand Excusal will be Evaluated Under *Aronson*

The parties disagree as to whether *Aronson* or *Rales* is the appropriate test to determine if Pfeiffer's failure to make demand on the Company's Board was excused. Pfeiffer claims that the Board, and not just the Compensation Committee, made the decision to award options to Leedle. In addition, Pfeiffer avers that, even if the Compensation Committee was solely responsible for granting the awards to Leedle, *Aronson* still applies because the Board made a "conscious decision to refrain from acting" when it failed to seek any remedial measures when the terms of the award grant were made public. Defendants argue that, because the Compensation Committee, whose four members comprise less than half of the board, made the award, *Rales* is the appropriate demand futility test. Defendants also contend that Pfeiffer has failed to plead particularized facts that the rest of the Board consciously decided to refrain from taking any action with respect to the options awarded to Leedle.

Notwithstanding the dispute over this issue, Defendants agreed in briefing[23] and at oral argument to assume the applicability of *Aronson* for purposes of resolving this

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21 *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

22 *Id.*

23 Leedle's Reply Br. 5–6.

motion to dismiss. Based on Defendants' concession, I focus my analysis on whether demand was excused in this case under the two-part *Aronson* test.

C. The Business Judgment Rule and the Second Prong of *Aronson*

Pfeiffer's primary argument in this matter is that demand should be excused under the second part of the *Aronson* test. Under *Aronson*'s second prong, demand will be excused if the plaintiff creates a reasonable doubt that the challenged transaction was a product of the Board's valid exercise of its business judgment. In other words, the plaintiff must rebut the business judgment rule. A plaintiff can rebut the business judgment rule by pleading particularized facts that raise a doubt that the Board's action was taken on an informed basis or that the action was taken honestly and in good faith.[24] Having all but conceded that Defendants were disinterested and independent with respect to Leedle's stock option grant, Pfeiffer must carry a "heavy burden" to show that demand should be excused under the second prong of *Aronson.*[25]

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[24] *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003).

[25] *White v. Panic*, 783 A.2d 543, 551 (Del. 2001). *See also In re Tyson Foods, Inc.*, 919 A.2d 563, 592 (Del. Ch. 2007) ("[W]here a director is independent and disinterested, there can be no liability for corporate loss, unless the facts are such that no person could possibly authorize such a transaction if he or she were attempting in *good faith* to meet their duty.") (quoting *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1052–1053 (Del. Ch. 1996)). The *Tyson* court described this standard as a "severe test." *Id.*

The business judgment rule is a fundamental principal of Delaware corporate law,[26] which states that courts will not disturb the business decision of a corporate board when that decision is made on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the corporation.[27] Conspicuously absent from the business judgment rule's requirements is the need for corporate directors actually to make the "correct" decision.[28] So long as corporate fiduciaries act in the *procedurally* responsible manner outlined by the business judgment rule, the *substance* of their decisions is relevant only in exceptionally rare circumstances.[29] "Therefore, the

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[26] *See In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 43 (Del. Ch. 2013) ("Delaware's default standard of review is the business judgment rule.").

[27] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

[28] In briefing, Pfeiffer argued that Defendants "cannot claim protection of the business judgment rule by relying on an incorrect interpretation of a shareholder-approved plan." Leedle's Reply Br. 21. To the extent that Pfeiffer argues that only correct decisions are protected by the business judgment rule, he is wrong. Reasonable decisions made by a board that is informed and acting in good faith will be entitled to the business judgment presumption even if those decisions are ultimately incorrect.

[29] *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993), *modified on reargument in part*, 636 A.2d 956 (Del. 1994) ("The rule posits a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be 'attributed to any rational business purpose.'" (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971))).

judgment of a properly functioning board will not be second-guessed and [a]bsent an abuse of discretion, that judgment will be respected by the courts."[30]

The business judgment rule will not be rebutted, and thus demand will not be excused, when a plaintiff alleges only that a board of directors failed to follow the terms of a stock incentive plan.[31] Such allegations pertain to the substance of the board's decision and fail to address the critical question of how the board reached the result that it did.[32] Eliminating the protection of the business judgment rule and finding demand futile in these instances effectively would nullify the business judgment rule and eviscerate the demand requirement. The business judgment standard is not appropriate, and demand will be excused, however, when a plaintiff pleads particularized facts that indicate that the board knowingly or deliberately failed to adhere to the terms of a stock incentive

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30 *Orman v. Cullman*, 794 A.2d 5, 20 (Del. Ch. 2002) (citation and internal quotation omitted).

31 *See Freedman v. Redstone*, 2013 WL 3753426, at *9 (D. Del. July 16, 2013) (holding for demand to be excused under the second prong of *Aronson* when a plaintiff alleges that a board violated the company's stock incentive plan that "the allegations must support an inference that said violation was made knowingly and intentionally."). *See also Weiss v. Swanson*, 948 A.2d 433, 447 (Del. Ch. 2008) ("[T]he allegations support an inference that the Director Defendants did not disclose the practices challenged in this case, and therefore the complaint must be read as giving rise to a reasonable inference that the directors *intended* to circumvent the restrictions of the plans.") (emphasis added).

32 *See Wood v. Baum*, 953 A.2d 136, 142 (Del. 2008) ("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.").

plan.[33] One way that a plaintiff can allege sufficiently a knowing and deliberate failure on the part of a board is by demonstrating that the alleged action was a clear and unambiguous violation of the company's stock incentive plan. The case of *Sanders v. Wang*[34] provides a relevant example.

In *Sanders*, a corporation had a shareholder approved stock incentive plan that authorized the board's compensation committee to grant up to 6 million shares of the corporation's common stock. The issuance of 4 million of these shares was contingent on the corporation's common stock reaching and maintaining certain price targets on the New York Stock Exchange. The compensation committee was entitled under the plan to account for stock splits in determining whether the price targets had been met. The stock plan, however, did not contain a provision authorizing the compensation committee to adjust the maximum number of shares it could grant to account for stock splits or other recapitalization transactions. In total, the compensation committee in *Sanders* granted 20.25 million shares under the stock plan, which was equivalent to 6 million shares adjusted for three separate stock splits that had occurred after the stock plan had been enacted.

Finding that demand was excused under the second prong of *Aronson*, then-Vice Chancellor Steele noted that the plaintiffs had alleged that the board had breached an

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[33] *See Ryan v. Gifford*, 918 A.2d 341, 354 (Del. Ch. 2007) ("A board's knowing and intentional decision to exceed the shareholders' grant of express (but limited) authority raises doubt regarding whether such decision is a valid exercise of business judgment and is sufficient to excuse a failure to make demand.").

[34] 1999 WL 1044880 (Del. Ch. Nov. 8, 1999).

express and unambiguous provision of the corporation's stock plan. Although the director defendants asserted that they reasonably interpreted the plan to allow their actions, the court rejected that argument because it found that the plan's terms were not "susceptible to varying interpretations under any reasonable analysis that could lead to the conclusion that the board had the authority to award excess shares over the [6 million share] limitation."[35] Because "the Plan's language [was] straightforward enough that only the plaintiffs' reading can be plausible, and the defendants' reading, at best, distorts the Plan's plain language,"[36] the court determined that the directors' decision to exceed the 6 million share limit was not a valid exercise of business judgment and that demand should be excused.

Sanders does not stand for the proposition that demand will be excused whenever a plaintiff alleges that a board violated the terms of a stock plan.[37] Rather, *Sanders* teaches that when a plaintiff presents particularized factual allegations that indicate that the board clearly violated an unambiguous provision of a stock plan, it is proper to infer

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35 *Id.* at *7.

36 *Id.* at *9.

37 *See Abrams v. Wainscott*, 2012 WL 3614638, at *3 (D. Del. Aug. 21, 2012) ("Plaintiff's cited cases [including *Sanders*] do not convince the Court of the blanket proposition that a shareholder need only allege violation of a compensation agreement to excuse demand, without additional allegations of knowledge and intent.").

that such violation was committed knowingly or intentionally and, therefore, that demand should be excused.[38]

The Complaint in this case is devoid of particularized factual allegations that address the Board's process, knowledge, or intent when it granted stock options to Leedle as a Performance Award. Accordingly, demand will be excused under *Aronson's* second prong in this case only if Pfeiffer's allegations fit within the *Sanders* framework.[39] For

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[38] *See Freedman v. Redstone*, 2013 WL 3753426, at *9 (D. Del. July 16, 2013) ("Although the *Sanders* court did not mention whether or not the plaintiffs alleged a knowing or intentional violation, it appears that the challenged transaction was such a clear and undisputed violation, that violation, alone, created a reasonable doubt that the board acted without knowledge."); *Landy v. D'Alessandro*, 316 F. Supp. 2d 49, 65–66 (D. Mass. 2004) ("The [*Sanders*] court made no mention of whether the board *knew* the transaction would violate the plan, or whether the plaintiff alleged a *knowing* violation. But the court . . . concluded that the violation was so clear that the board could not contend good faith or honest belief within the meaning of the business judgment rule."). This Court has drawn a similar inference when a plaintiff alleged sufficiently that the board had committed an *ultra vires* act. *See Cal. Pub. Emps.' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *11 (Del. Ch. Dec. 18, 2002) ("It appears undisputed that the repricings were conducted under the options plan without additional shareholder approval. Quite naturally, the parties disagree whether the repricings constituted a 'change' to the exercise price. One plausible answer is that they did. Thus, plaintiff alleges with particularity that repricing of directors' options in 1997 and 1999 was *ultra vires.* Any action of the board that falls outside the rather broad scope of its authority is not entitled to the protection of the business judgment rule and demand is excused.") (footnote omitted).

[39] Pfeiffer argues that Defendants have provided no evidence in support of their claimed "good faith basis" for believing that the stock options awarded to Leedle complied with the Plan's terms. In this respect, Pfeiffer fundamentally misstates the respective burdens of the parties at this stage of the litigation. It is settled Delaware law that "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." *Beam v. Stewart*, 845 A.2d 1040, 1048–49 (Del. 2004).

the following reasons, I conclude that Pfeiffer has alleged that the Board clearly violated an unambiguous provision of the Plan and that demand should be excused.

D. The Plan Does Not Prohibit the Issuance of Stock Options as Performance Awards

Section 8.2 of the Plan states that Performance Awards "shall consist of a right that is (i) denominated in cash or shares of Stock." In addition, Performance Awards are payable "in such form as the Committee shall determine." Pfeiffer avers that this language completely bars the use of stock options as Performance Awards. Defendants argue that Pfeiffer's interpretation is inconsistent with the plain meaning of the language of Section 8.2. I agree with Defendants' position on this issue.

There is no language in Section 8.2 that prohibits the issuance of stock options as Performance Awards. Pfeiffer's assertion that only shares of stock, and not stock options, can be granted as Performance Awards is not supported by the Plan's terms. A stock option is a right (to purchase shares of stock), and it is denominated in shares of stock. Pfeiffer has failed to provide any reasonable argument as to how construing a Performance Award to include a stock option is inconsistent with the plain terms of Section 8.2. The section expressly permits Performance Awards, and such awards may include rights denominated in shares of stock. Although the Company can issue shares as Performance Awards under the Plan, that fact does not undermine the Company's ability to grant Performance Awards in a different form that is consistent with Section 8.2's requirements. Indeed, the language of Section 8.2 expressly entrusts the Plan's administrators with the right to determine the form of Performance Awards.

In addition, Pfeiffer is unable to point to any language in another provision of the Plan that would prevent the Company from granting stock options as Performance Awards. The Plan does not require that stock options be granted solely under Section 5 or Section 9, nor does the language of either section foreclose definitively the possibility that options could be granted under another part of the Plan. In sum, granting stock options as Performance Awards appears to be consistent with the language of Section 8.2 and is not prohibited by any other part of the Plan. Accordingly, I reject Pfeiffer's argument that granting stock options to Leedle as a Performance Award was a clear violation of the Plan.

E. The Board Violated an Unambiguous Provision of the Plan

Pfeiffer claims next that, even if the Board was allowed to issue stock options as a Performance Award, Defendants' characterization of Leedle's grant as a Performance Award is an improper attempt to circumvent the Plan's restrictions on Stock Options. Defendants argue that the stock options granted to Leedle comply with the various requirements for a Performance Award under the Plan and that granting Leedle a Performance Award in the form of non-Plan defined stock options, as opposed to Plan defined Stock Options, was a valid exercise of their authority under the Plan.

In its Form 10-Q filed with the SEC for the quarter ended March 31, 2012, the Company attached a series of exhibits that contained the "forms" of awards the Company

can issue under the Plan.[40] Exhibit 10.2 is the form for a "Non-Qualified Stock Option Agreement"; Exhibit 10.3 is the form for a "Restricted Stock Unit Award Agreement"; and Exhibit 10.4 is the form for a "Performance Cash Award Agreement." There is no dispute that Leedle's stock options were granted in accordance with the form in Exhibit 10.2,[41] and there is no allegation or other indication in the Complaint or elsewhere that the contents of Leedle's award differed materially from the language in Exhibit 10.2.

Section 2 of Exhibit 10.2, titled "Option Plan," states in relevant part that, "[t]his Option is granted as a non-qualified stock option under the Plan,[42] and is not intended to qualify as an incentive stock option."[43] The Plan defines a "Non-Qualified Stock Option" as "any Stock Option that is not an Incentive Stock Option."[44] Finally, "Stock Option" is

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40 The parties do not dispute the contents of the Company's publicly filed Form 10-Q. Therefore, I may consider that document on a motion to dismiss. *See Solomon v. Armstrong*, 747 A.2d 1098, 1121 n.72 (Del. Ch. 1999) ("[I]t is well settled that where certain facts are not specifically alleged (or in dispute) a Court may take judicial notice of facts publicly available in filings with the SEC.").

41 Letter from William M. Lafferty, Esq., to the Court responding to Plaintiff's Nov. 5, 2013 letter (Nov. 6, 2013).

42 Exhibit 10.2 defines "the Plan" as "Healthways 2007 Stock Incentive Plan, as amended."

43 Although "non-qualified stock option" is in lower case, when read in the context of Exhibit 10.2, it is clear that the term is intended to be equivalent to the Plan's defined term "Non-Qualified Stock Option." First, the words "under the Plan" immediately follow "non-qualified stock option" in Exhibit 10.2. Second, even without that additional language, Section 2 of Exhibit 10.2 also states that "[t]erms not otherwise defined herein shall have the same meanings given them in the Plan."

44 Leedle's Opening Br. Ex. E § 1(r).

defined as "any option to purchase shares of Stock . . . granted pursuant to Section 5 or Section 9 below."[45] Because Leedle was granted Non-Qualified Stock Options, he necessarily was granted Stock Options, as defined in the Plan. In that regard, I find Defendants' argument that Leedle was issued "stock options" in a non-Plan defined sense to be unpersuasive and unreasonable in light of the clear language of Exhibit 10.2 and the Plan.

Furthermore, Section 4 of the Plan prohibits unambiguously an individual from receiving more than 150,000 Stock Options under the Plan in any calendar year. Because Leedle was awarded 449,436 and 285,000 Stock Options in 2011 and 2012, respectively, Pfeiffer has pled facts sufficient to support a reasonable inference that the Board clearly violated the unambiguous Stock Option limitations prescribed in Section 4 in each of those years.[46] Therefore, based on the logic of *Sanders*, demand is excused under the second prong of the *Aronson* test.[47]

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45 *Id.* § 1(ee).

46 Other allegations further support a reasonable inference that the Board impermissibly granted Leedle Stock Options and not Performance Awards. In addition to the fact that Exhibit 10.2 is entitled "Non-Qualified Stock Option Agreement," the form contains numerous references to Section 5 of the Plan, but not a single reference to Section 8.2, which deals with Performance Awards. Furthermore, on November 7, 2011, Leedle filed a Form 4 with the SEC stating that the Board had granted him "a special one-time retention grant" of 500,000 options. Pfeiffer's Reply Br. Ex. A. Although Leedle later filed an amendment to his Form 4, the first public disclosure of the stock option grant notably contained no mention of Performance Awards.

47 In *Sanders*, the Court of Chancery held that the plaintiffs were entitled to judgment on the pleadings that the company's directors wrongfully authorized

Even assuming that Defendants were correct that these Stock Options were also Performance Awards, the result remains unchanged. Section 8.2(b) of the Plan authorizes the Board to grant Stock Options and Performance Awards with respect to a maximum of 450,000 shares in any calendar year.[48] Nothing in Section 8.2(b), however, alters the 150,000 limit on Stock Options specified in Section 4. Thus, while an individual may receive a combination of Stock Options and Performance Awards relating to up to 450,000 shares of the Company's stock, only 150,000 can be Stock Options and the remaining 300,000 must be comprised of other forms of rights denominated in shares of stock. Although one of these other forms conceivably could be non-Plan defined "stock options," in the present case, Pfeiffer has pled sufficiently that Leedle was awarded only Plan-defined Stock Options. Accordingly, the Stock Options granted to Leedle clearly appear to have violated the Plan's plain terms, regardless of whether certain of those Stock Options also could be considered Performance Awards.

F. Dismissal is Not Warranted Under Rule 12(b)(6)

Having concluded that demand is excused because Pfeiffer has alleged sufficiently that the Board clearly violated the Plan's unambiguous Stock Option limitation, I turn to

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awards under the stock incentive plan. Pfeiffer has not asked for judgment on the pleadings in this case, nor am I prepared to make any such merits-based ruling at this juncture. I hold only that Pfeiffer has pled particularized facts sufficient to rebut the presumption that the Board's decision to grant Stock Options to Leedle is entitled to the protection of the business judgment rule, and that demand is excused as a result.

[48] Leedle's Opening Br. Ex. E § 8.2(b).

Defendants' argument that Pfeiffer has failed to state a claim upon which relief can be granted. As recently reaffirmed by the Delaware Supreme Court,[49] "the governing pleading standard in Delaware to survive a motion to dismiss is reasonable 'conceivability.'"[50] That is, when considering such a motion, a court must:

> accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof.[51]

This "reasonable conceivability" standard asks whether there is a "possibility" of recovery.[52] If the well-pled factual allegations of the complaint would entitle the plaintiff to relief under a reasonably conceivable set of circumstances, the court must deny the motion to dismiss.[53] The court, however, need not "accept conclusory allegations unsupported by specific facts or . . . draw unreasonable inferences in favor of the non-

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49 *See Winshall v. Viacom Int'l, Inc.*, 2013 WL 5526290, at *4 n.12 (Del. Oct. 7, 2013).

50 *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011) (footnote omitted).

51 *Id.* (citing *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896–97 (Del. 2002)).

52 *Id.* at 537 & n.13.

53 *Id.* at 536.

moving party."[54] Moreover, failure to plead an element of a claim precludes entitlement to relief and, therefore, is grounds to dismiss that claim.[55]

The standard under Rule 12(b)(6) is less stringent than that under Rule 23.1.[56] "Thus, where plaintiff alleges particularized facts sufficient to prove demand futility under the second prong of *Aronson*, that plaintiff *a fortiori* rebuts the business judgment rule for the purpose of surviving a motion to dismiss pursuant to Rule 12(b)(6)."[57] In this case, Pfeiffer has alleged sufficiently that the Board clearly violated an unambiguous provision of the Plan. Under *Sanders*, a *prima facie* showing of such a clear violation supports an inference that the Board either knowingly or deliberately exceeded its authority. Knowing or deliberate violations of a stockholder approved stock plan implicate the duty of loyalty, and breaches of the duty of loyalty cannot be exculpated by a charter provision adopted pursuant to 8 *Del. C.* § 102(b)(7).[58] Therefore, because demand is excused under the second prong of *Aronson* due to conduct that conceivably

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54 *Price v. E.I. duPont de Nemours & Co., Inc.*, 26 A.3d 162, 166 (Del. 2011) (citing *Clinton v. Enter. Rent-A-Car Co.*, 977 A.2d 892, 895 (Del. 2009)).

55 *Crescent/Mach I P'rs, L.P. v. Turner*, 846 A.2d 963, 972 (Del. Ch. 2000) (Steele, V.C., by designation).

56 *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001).

57 *Ryan v. Gifford*, 918 A.2d 341, 357 (Del. Ch. 2007).

58 *See* 8 *Del C.* § 102(b)(7) (providing that such an exculpatory provision "shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; [or] (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law").

cannot be exculpated, Pfeiffer has stated a viable claim that the Board breached its fiduciary duties in approving an excessive Stock Option grant to Leedle.

Pfeiffer also has stated a claim with respect to the Board's alleged dissemination of a misleading Proxy Statement. Pfeiffer has pled particularized facts that the Board clearly violated the Plan. At this stage of the proceedings, those alleged facts support an inference that the Board knowingly or intentionally violated the Plan. Drawing all reasonable inferences in favor of Pfeiffer, as the nonmoving party, therefore, I conclude that it is reasonably conceivable that the Board knowingly or intentionally caused the Company to issue a Proxy Statement containing misleading statements that Leedle's Stock Option grants were Performance Awards that were consistent with the Plan's requirements. Accordingly, I decline to dismiss Pfeiffer's claim that the Board breached its fiduciary duties by causing the Company to issue a materially misleading Proxy Statement.

Finally, Pfeiffer has stated claims against Leedle for breach of fiduciary duty and for unjust enrichment. As to the breach of fiduciary duty claim, the Complaint supports a reasonable inference that Leedle knew or should have known that his receipt of more than 150,000 Stock Options in a year violated the Plan.[59] "Such allegations, taken as true,

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[59] At a minimum, Leedle received, and was charged with knowledge of, the Plan's contents when he was awarded his Stock Options. *See* Exhibit 10.2 Section 2 ("The Colleague hereby acknowledges receipt of a copy of the Plan and agrees to be bound by all the terms and provisions thereof, which are incorporated herein by reference and made a part hereof.").

support an inference that [Leedle] . . . via [his] receipt of the options, breached [his] fiduciary duties."[60]

In terms of unjust enrichment, Defendants argue that "Mr. Leedle cannot have violated his fiduciary duties or become unjustly enriched merely by accepting compensation to which he is entitled." Defendants further aver that a claim for unjust enrichment fails where a contract, such as the Plan, governs the parties' relationship. As discussed, Pfeiffer has raised a reasonable doubt that the Board's Stock Option awards to Leedle were a valid exercise of business judgment. It is therefore reasonably conceivable that Leedle received an impermissible number of Stock Options and that he is not, in fact, entitled to the Stock Options that he was granted. Defendants correctly note that "[w]hen the complaint alleges an express, enforceable contract that controls the parties' relationship . . . a claim for unjust enrichment will be dismissed."[61] At this early stage of the proceedings, however, "I cannot conclude that there is no reasonably conceivable set of circumstances under which [Leedle] might be unjustly enriched."[62] The Complaint does not contain a breach of contract claim nor are Leedle's fiduciary duties to the Company contractual in nature. Because it is reasonably conceivable that Pfeiffer can demonstrate that his unjust enrichment claim is governed by fiduciary principles and not an enforceable contract, I decline to dismiss his unjust enrichment claim at this time.

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60 *Weiss v. Swanson*, 948 A.2d 433, 449 (Del. Ch. 2008).

61 *Bakerman v. Sidney Frank Importing Co.*, 2006 WL 3927242, at *18 (Del. Ch. Oct. 10, 2006).

62 *Ryan*, 918 A.2d at 361.

III. CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss is denied in its entirety.

IT IS SO ORDERED.