



**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

JULIE FRIEDMAN, derivatively on )  
behalf of EXPEDIA, INC., )  
)  
Plaintiff below, )  
Appellant, )  
)  
vs. )  
)  
DARA KHOSROVSHAHI, BARRY )  
DILLER, VICTOR A. KAUFMAN, A. )  
GEORGE BATTLE, JONATHAN L. )  
DOLGEN, CRAIG A. JACOBSON, )  
PETER M. KERN, JOHN C. )  
MALONE, JOSE A. TAZON and )  
WILLIAM R. FITZGERALD, )  
)  
Defendants below, )  
Appellees, )  
)  
-and- )  
)  
EXPEDIA, INC., a Delaware )  
Corporation, )  
)  
Nominal Defendant. )

No. 442, 2014

Court below:  
Court of Chancery

C. A. No. 9161-CB

**CORRECTED APPELLANT'S OPENING BRIEF**

October 15, 2014

SMITH, KATZENSTEIN & JENKINS LLP  
David A. Jenkins (No. 932)  
Neal C. Belgam (No. 2721)  
800 Delaware Avenue, Suite 1000  
P.O. Box 410  
Wilmington, DE 19899  
(302) 652-8400  
(302) 652-8405 (facsimile)

**OF COUNSEL:**

LEVI & KORSINSKY LLP  
Eduard Korsinsky  
Steven J. Purcell  
30 Broad Street, 24<sup>th</sup> Floor  
New York, NY 10004  
(212) 363-7500  
(866) 367-6510 (facsimile)

## TABLE OF CONTENTS

	<u>Page</u>
NATURE AND STAGE OF THE PROCEEDINGS.....	1
SUMMARY OF ARGUMENT.....	2
STATEMENT OF FACTS.....	4
A. Parties.....	4
B. Expedia’s 2005 Stock and Annual Incentive Plan.....	4
C. The RSU Award.....	8
D. The accelerated vesting and payment to Khosrowshahi.....	10
E. The 2013 Plan amendments .....	11
F. The decision of the Court of Chancery .....	12
ARGUMENT .....	14
I. The Court of Chancery Erred in Finding that Plaintiff Failed to Allege a Plan Violation.....	14
A. Question presented.....	14
B. Scope of review.....	14
C. Plaintiff adequately alleged demand futility .....	14
1. The OIBA Goal was a performance goal .....	17
a. The RSU Award was structured to comport with Section 162(m)	18
b. Defendants were prohibited from waiving the OIBA Goal.....	19
2. The OIBA Goal was a condition placed on the RSU Award that the Committee could not waive under the Plan.....	26

3. The OIBA Goal was a material term that could not be waived under  
Section 162(m) and its regulations ..... 30

CONCLUSION ..... 32

***Exhibits***

Exhibit 1

*Julie Friedman v. Dara Khosrowshahi, et al.*,  
Del. Ch, C.A. No. 9161-CV, Bouchard, C. (July 16, 2014)  
(Memorandum Opinion) (ID 55738148)

## TABLE OF AUTHORITIES

Page

### Cases

<i>Aronson v. Lewis</i> , 473 A.2d 805 (Del. 1984) .....	<i>passim</i>
<i>California Pub. Emps' Ret. Sys. v. Coulter</i> , 2002 WL 31888343 (Del. Ch. Dec. 18, 2002).....	15
<i>Central Mortg. Co. v. Morgan Stanley Mrtg. Capital Holdings LLC</i> , 27 A.3d 531 (Del. 2011) .....	21
<i>Gatz v. Ponsoldt</i> , 925 A.2d 1265 (Del. 2007) .....	14
<i>Green v. Weiner</i> , 766 A.2d 492 (Del. 2001) .....	31
<i>In re Citigroup Inc. S'holder Derivative Litig.</i> , 964 A.2d 106 (Del. Ch. 2009) .....	16
<i>In re Gardner Denver, Inc. S'holder Litig.</i> , 2014 WL 715705 (Del. Ch. Feb. 21, 2014).....	21
<i>Krasner v. Moffett</i> , 826 A.2d 277 (Del. 2003) .....	14
<i>Lynch v. Rawls</i> , 429 Fed. Appx. 641 (9th Cir. 2011).....	30
<i>Sanders v. Wang</i> , 1999 WL 1044880 (Del. Ch. Nov. 8, 1999) .....	15
<i>Seminaris v. Landa</i> , 662 A.2d 1350 (Del. Ch. 1995) .....	15

*Udoff v. Zipf*,  
375 N.E.2d 392 (N.Y. 1978)..... 30

*Weiss v. Swanson*,  
948 A.2d 433 (Del. Ch. 2008) ..... 15, 16, 25

**Rules**

Del. Ct. Ch. R. 12(b)(6)..... 16

Del. Ct. Ch. R. 23.1 ..... 14, 16

**Regulations**

26 C.F.R. § 1.162-27 ..... 10, 18, 30

**Statutes**

26 U.S.C. § 162(m)..... *passim*

## NATURE AND STAGE OF THE PROCEEDINGS

This appeal challenges an order of the Court of Chancery dismissing with prejudice the Complaint of Plaintiff Julie Friedman (“Plaintiff” or “Appellant”) under Court of Chancery Rule 23.1 for failure to plead demand futility. In December 2013 Plaintiff commenced a derivative action (the “Action”) to recover on Expedia, Inc.’s (“Expedia”) behalf 400,000 shares of common stock paid to Dara Khosrowshahi (“Khosrowshahi”), the Company’s Chief Executive Officer, which Plaintiff alleged was paid in violation of Expedia’s stockholder-approved 2005 Stock and Annual Incentive Plan (the “Plan”). Plaintiff argued that demand was excused under the second prong of *Aronson* because the Compensation Committee (the “Compensation Committee” or “Committee”) of Expedia’s Board of Directors (the “Board”) intentionally violated an express and unambiguous provision of the Plan, thus raising a reasonable doubt that the payment to Khosrowshahi resulted from a valid exercise of business judgment.

The Court of Chancery found that Plaintiff had not alleged with particularity that there had been a clear or intentional violation of the Plan. Accordingly, the Court of Chancery dismissed the Complaint with prejudice under Rule 23.1. Ex. 1.

## SUMMARY OF ARGUMENT

1. Under *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984) and its progeny, demand upon a board of directors is futile where a plaintiff alleges with particularity facts that raise a reasonable doubt that the challenged board action was a valid exercise of business judgment.

2. A willful violation of an express and unambiguous provision of a stockholder-approved compensation plan is not a valid exercise of business judgment.

3. The Complaint sufficiently alleges that the Compensation Committee intentionally violated two express provisions of the Plan. *First*, the challenged award was a performance-based award intended to be tax-deductible pursuant to Section 162(m) of the Internal Revenue Code. As such, the Compensation Committee was prohibited under the Plan's terms from taking any action that would cause the award to "cease to qualify" for such a tax deduction. In violation of the Plan, the Compensation Committee accelerated the vesting of the award despite the fact that the Company had not met a performance goal underlying the award, thereby causing it to cease to qualify as tax-deductible performance-based compensation under the Plan. *Second*, without regard to the tax-deductibility of the challenged award, under another express and unambiguous provision of the Plan, the Compensation Committee was prohibited from paying out the award

unless all conditions were met, which they indisputably were not.

4. Because the Complaint alleges particularized facts indicating that the Board exceeded its authority under express and unambiguous provisions of a stockholder-approved Plan, demand is excused under the second prong of *Aronson*.



## **STATEMENT OF FACTS**

### **A. Parties**

Plaintiff has been a shareholder of Expedia since 2005. A8. Nominal Defendant Expedia is an online travel company that provides travelers with tools and information enabling them to research, plan and book travel. *Id.* Defendant Dara Khosrowshahi (“Khosrowshahi”) is Expedia’s CEO, the recipient of the wrongful payment at issue in this action, and a member of Expedia’s board of directors. A7-8. At the time the payment to Khosrowshahi was authorized, Expedia’s Board consisted of Barry Diller (“Diller”), Victor A. Kaufman (“Kaufman”), A. George Battle (“Battle”), Jonathan L. Dolgen (“Dolgen”), Craig A. Jacobson (“Jacobson”), Peter M. Kern (“Kern”), John C. Malone (“Malone”), Jose A. Tazon (“Tazon”), William R. Fitzgerald (“Fitzgerald”) and Khosrowshahi himself (collectively, “Defendants”), all of whom, except for Fitzgerald, remained on the Board at the time this action was commenced.<sup>1</sup> A8-10. Defendants Dolgen, Kern and Fitzgerald were members of the Board’s Compensation Committee at the time the payment to Khosrowshahi was made. A9.

### **B. Expedia’s 2005 Stock and Annual Incentive Plan**

The Plan is a compensation plan approved by Expedia’s stockholders that authorizes the Board to grant various equity awards, including restricted stock

---

<sup>1</sup> Non-party Pamela L. Coe was the tenth and final member of the Board when the action was filed.

units, to the Company's directors, officers, employees and consultants. A10. The Plan is administered by the Compensation Committee. *Id.* Pursuant to Section 7 of the Plan, restricted stock units are awards denominated in shares of Expedia common stock that will settle in cash or shares upon satisfaction of whatever vesting conditions the Compensation Committee has established. A10, A65-66.

Pursuant to Section 7(b)(i) of the Plan, the Compensation Committee may designate an award of restricted stock units as a "Qualified Performance-Based Award." A10, A65. As defined in the Plan, a "Qualified Performance-Based Award" is an award that the Compensation Committee intended to qualify as tax-deductible performance-based compensation under Section 162(m). A10, A56-57. Generally, according to Section 162(m) and its regulations, the payment to an executive officer of compensation exceeding \$1 million will be tax-deductible if, among other things: (1) payment of the compensation is made contingent on the attainment of one or more performance goals established by a compensation committee based on a list of business criteria pre-approved by stockholders; and (2) the compensation is paid only after the compensation committee certifies in writing that those goals have been achieved. A11.

Section 7(b)(i) of the Plan describes the various vesting conditions that the Compensation Committee may attach to an award of restricted stock units:

- (i) The Committee may, in connection with the grant of Restricted Stock Units, designate them as Qualified Performance-Based Awards,

in which event it shall condition the grant or vesting thereof upon the attainment of Performance Goals. If the Committee does not designate Restricted Stock Units as Qualified Performance-Based Awards, it may also condition the grant or vesting thereof upon the attainment of Performance Goals. Regardless of whether Restricted Stock Units are Qualified Performance-Based Awards, the Committee may also condition the vesting thereof upon the continued service of the Participant. The conditions for grant or vesting and the other provisions of Restricted Stock Awards (including without limitation any applicable Performance Goals) need not be the same with respect to each recipient. Subject to Section 11(b), the Committee may at any time, in its sole discretion, accelerate or waive, in whole or in part, any of the foregoing restrictions. An Award of Restricted Stock Units shall be settled as and when the Restricted Stock Units vest or at a later time specified by the Committee or in accordance with an election of the Participant, if the Committee so permits.

A10, A65-66. Under Section 7(b)(i), the Compensation Committee may condition the vesting of restricted stock units “upon the attainment of Performance Goals.” *Id.* However, if an award of restricted stock units has been designated a Qualified Performance-Based Award, the Compensation Committee *must* condition the vesting of the award “upon the attainment of Performance Goals.” A65-66. “Performance Goals” is defined in Section 1(dd) of the Plan. A56. With respect to awards in general, the Compensation Committee can establish whatever Performance Goals it wants. In the case of Qualified Performance-Based Awards, however, the Performance Goals must be based on the list of twenty-four business criteria set forth in Section 1(dd), which includes such measures as EBITA, gross profit, sales, asset quality, operating income, marketing-spending efficiency, cost

saving levels and stock price. *Id.*<sup>2</sup> Section 7(b)(i) further provides that “subject to Section 11(b), the Committee may at any time, in its sole discretion, accelerate or waive, in whole or in part, any of the foregoing restrictions.” A11, A65.

Section 11(b) has two main clauses.<sup>3</sup> The first clause provides that:

[e]ach Qualified Performance-Based Award (other than an Option or Stock Appreciation Right) shall be earned, *vested* and payable (as applicable) *only* upon the achievement of one or more Performance Goals, *together with the satisfaction of any other conditions*, such as continued employment, as the Committee may determine to be appropriate. . . .

A11-12, A69-70 (emphasis added). Thus, once a restricted stock unit award has been designated a Qualified Performance-Based Award, the discretion otherwise available to the Compensation Committee to accelerate or waive vesting conditions under Section 7(b)(i) no longer exists. Instead, the award can only vest upon the achievement of the Performance Goals and satisfaction of whatever other conditions the Compensation Committee had previously established for the award.

*Id.*

---

<sup>2</sup> Section 1(dd) provides that “‘Performance Goals’ means the performance goals established by the Committee in connection with the grant of Restricted Stock, Restricted Stock Units or Bonus Awards or other stock-based awards. In the case of Qualified-Performance Based Awards that are intended to qualify under Section 162(m)(4), (i) such goals shall be based on the attainment of one or any combination of the following [identifying twenty-four specific items].” *Id.*

<sup>3</sup> Section 11(b) also contains an additional section pertaining to the effect of a change in control or death or disability of the recipient, neither of which are relevant.

The second clause of Section 11(b) provides that:

no Qualified Performance-Based Award may be amended, nor may the Committee exercise any discretionary authority it may otherwise have under this Plan with respect to a Qualified Performance-Based Award under this Plan, in any manner that would cause the Qualified Performance-Based Award to cease to qualify for the Section 162(m) Exemption.

A12, A70. Similarly, Section 12(d) of the Plan provides the Compensation Committee with the authority to amend the terms of any award granted under the Plan, prospectively or retroactively, subject to the same proviso that “no such amendment shall (i) cause a Qualified Performance-Based Award to cease to qualify” as tax-deductible performance-based compensation under Section 162(m). *Id.* Thus, read in conjunction with Section 7(b)(i), which requires that a Qualified Performance-Based Award be conditioned on the attainment of Performance Goals, the second clause of Section 11(b) and Section 12(d) in turn prohibit the Compensation Committee from paying compensation underlying a Qualified Performance-Based Award unless and until those specific Performance Goals have been achieved because doing so would cause the compensation to cease to qualify as tax-deductible performance-based compensation under Section 162(m). A12.

### **C. The RSU Award**

On March 7, 2006, pursuant to Section 7 of the Plan, the Compensation Committee granted to Khosrowshahi an award of restricted stock units covering 800,000 shares of Expedia common stock (the “RSU Award”). A13. The

Compensation Committee conditioned the vesting of the RSU Award (and thereby the payment of the 800,000 shares of stock underlying the award) on the attainment of certain performance goals. *Id.* Specifically, pursuant to its terms, the RSU Award would vest only in the event that two conditions were met: (1) Expedia achieved a certain EBITA target or a certain target increase in its stock price (the “EBITA/Stock Price Goal”); and (2) Expedia achieved \$1 billion in operating income before amortization (“OIBA”) during any fiscal year (the “OIBA Goal”). *Id.* Once both goals were achieved, 75% of the Restricted Stock Units would initially vest, with the remaining 25% vesting if Khosrowshahi had not voluntarily terminated his employment with Expedia and had not been terminated for cause on or before the first anniversary of the initial vesting date. *Id.*

The Compensation Committee intended the RSU Award to qualify as tax-deductible performance-based compensation under Section 162(m). As stated in the Schedule 14A Proxy Statement Expedia filed with the U.S. Securities and Exchange Commission (“SEC”) on April 30, 2007 (“2007 Proxy”), the RSU Award was “designed to meet the requirements for deductible compensation” under Section 162(m). A13-14. Accordingly, the RSU Award constituted a Qualified Performance-Based Award under the Plan. A14. Section 162(m) and its regulations require, among other things, that in order for compensation paid thereunder to be tax-deductible, a compensation committee must certify prior to

payment that the “performance goals and any other material terms [of the award] were in fact satisfied.” A239 (citing 26 U.S.C. § 162(m)(4)(c)(iii) and 26 C.F.R. § 1.162-27(e)(5)).

After Expedia completed the spin-off of its TripAdvisor Media Group into a separate public company, TripAdvisor, Inc. (“TripAdvisor”), on December 21, 2011, the RSU Award was reduced to 400,000 shares as a result of an agreement among Khosrowshahi, Expedia and TripAdvisor to divide the RSU Award between the two companies. A14-15. In connection with the spin-off, Khosrowshahi became a director of TripAdvisor while also maintaining his position as CEO and director of Expedia. A14. At the time of the spin-off, the vesting conditions for the RSU Award had not been met because, although the EBITA/Stock Price Goal had been met, Expedia had not satisfied the OIBA Goal during any fiscal year since the RSU Award was granted. *Id.* On December 20, 2011, Khosrowshahi and Expedia entered into an agreement amending the terms of the RSU Award to, among other things, reduce the shares covered by the RSU Award from 800,000 shares to 400,000 shares and reduce the OIBA Goal from \$1 billion to \$714.4 million. A15, A202-03.

#### **D. The accelerated vesting and payment to Khosrowshahi**

On August 2, 2012, Expedia entered into a new employment agreement with Khosrowshahi (the “Employment Agreement”). A15. As described in the

Schedule 14A Proxy Statement Expedia filed with the SEC on April 30, 2013 (the “2013 Proxy”), Expedia had still not achieved the OIBA Goal as of August 2, 2012. *Id.* The 2013 Proxy also disclosed that, in connection with Khosrowshahi’s new Employment Agreement, “management recommended, and the Compensation Committee approved, accelerated vesting of . . . [the RSU Award] that had been subject to the achievement of a business goal tied to the operating income before amortization (‘OIBA’) of the Company, which had not at that time been achieved.” A15-16, A129. That same day, Khosrowshahi was paid all 400,000 shares of Expedia common stock covered by the RSU Award. A16.

#### **E. The 2013 Plan amendments**

On February 28, 2013, less than seven months after the RSU Award was accelerated, the Board<sup>4</sup> adopted, and asked stockholders to approve, various amendments to the Plan, including a six-million-share increase in the amount of stock the Board was authorized to issue and an extension of the Plan’s expiration date. A17. In amending the Plan, the Board also deleted certain language from the Plan, which changes were not explained or described to stockholders aside from being labeled “administrative” in nature. Specifically, the Board: (i) removed the language in Sections 11(b) and 12(d) of the Plan that prohibited the Compensation Committee from amending a Qualified Performance-Based Award in a manner that

---

<sup>4</sup> Excluding Defendant Fitzgerald, who had by that time resigned.



would cause the award to cease to qualify as tax-deductible performance-based compensation under Section 162(m); (ii) removed the language in Section 7(b)(i) that made the Compensation Committee's discretion to accelerate or waive the restrictions of a Restricted Stock Unit award subject to the provisions of Section 11(b); and (iii) removed the word "only" from the phrase "shall be earned, vested and payable only upon the attainment of one or more Performance Goals" (collectively, the "'Administrative' Amendments"). A17-18, A165-66, A169.

#### **F. The decision of the Court of Chancery**

Plaintiff brought suit in the Court of Chancery of the State of Delaware on December 13, 2013, alleging that: (i) the Defendants breached their fiduciary duties by approving, recommending, permitting and/or accepting the accelerated vesting of the RSU Award in violation of the terms of the Plan; and (ii) by receiving the RSU Award, Defendant Khosrowshahi was unjustly enriched at the expense and to the detriment of the Company. A6-A26. In an opinion issued on July 16, 2014, the Court of Chancery granted Defendants' Motion to Dismiss the Action. Ex. 1 at 1. Specifically, the Court of Chancery held that Plaintiff had not sufficiently alleged that the OIBA Goal was a "performance goal" for Section 162(m) purposes, and that Plaintiff had therefore not alleged that payment of the RSU Award, despite the failure of the Company to achieve the OIBA Goal, violated the Plan by causing the RSU Award to no longer be tax-deductible under

Section 162(m). *Id.* at 19-21.

The Court of Chancery also rejected Plaintiff's arguments in the alternative that the OIBA Goal was a "material term" of the RSU Award for purposes of Section 162(m) and, in any event, an "other condition" under Section 11(b) of the Plan. In so doing, the Court of Chancery concluded that by the time the award was accelerated, the OIBA Goal had been "waived" by the Committee and was thus "neither a 'material term' nor an 'other condition' of the RSU Award when it became payable." *Id.* at 21. Based on these findings, the Court of Chancery held that Plaintiff had failed to establish that demand upon the Board would have been futile. *Id.* at 30-31.

## ARGUMENT

### **I. The Court of Chancery Erred in Finding that Plaintiff Failed to Allege a Plan Violation**

#### **A. Question presented**

Whether Plaintiff sufficiently pled that the Board intentionally violated a clear and unambiguous provision(s) of Expedia's stockholder-approved Plan, thereby rendering demand futile under Del. Ct. Ch. R. 23.1. The question presented was preserved by Appellant in the Court of Chancery on April 2, 2014 in her answering brief on a motion to dismiss. (A231-261).

#### **B. Scope of review**

The Court of Chancery held that Plaintiff's Complaint had failed as a matter of law to allege with particularity that the Defendants had violated provisions of the Plan. Review of dismissal of a derivative suit under Rule 23.1 is *de novo* and plenary. *Gatz v. Ponsoldt*, 925 A.2d 1265, 1274 (Del. 2007); *Krasner v. Moffett*, 826 A.2d 277, 283 (Del. 2003).

#### **C. Plaintiff adequately alleged demand futility**

A plaintiff challenging the decision of a board of directors need not make a demand upon that board prior to commencing a derivative action if the plaintiff alleges facts sufficient to raise a reasonable doubt that either: (1) a majority of the board was disinterested and independent; or (2) the challenged transaction was a product of a valid exercise of business judgment. *Aronson*, 473 A.2d at 814;

*Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995) (“If a derivative plaintiff can demonstrate a reasonable doubt as to the first or second prong of the *Aronson* test, then she has demonstrated that demand would have been futile.” (citation omitted)). In the instant matter, Plaintiff argued in opposition to Defendants’ motion to dismiss that she had adequately pled demand futility under both prongs of *Aronson*, though she only appeals from the Court of Chancery’s ruling with respect to the second prong.

When a plaintiff challenges compensation paid out under the terms of a stockholder-approved plan, the board is afforded the protection of the business judgment rule “only when the terms of the plan at issue are adhered to.” *Weiss v. Swanson*, 948 A.2d 433, 441 (Del. Ch. 2008). If a plaintiff adequately alleges that a board intentionally granted an award in violation of an express, unambiguous term of such a plan, that plaintiff has established demand futility under the second prong of *Aronson*, as the allegations necessarily raise a reasonable doubt that the grant of the award was the product of a good faith business judgment. *Sanders v. Wang*, 1999 WL 1044880, at \*1, \*4-5 (Del. Ch. Nov. 8, 1999); *see also California Pub. Emps’ Ret. Sys. v. Coulter*, 2002 WL 31888343, at \*11 (Del. Ch. Dec. 18, 2002) (excusing demand where the plaintiff alleged that board repriced stock options in violation of incentive plan).

The Court of Chancery found that demand was not excused under the second prong of *Aronson* because Plaintiff did not “allege[] with particularity a clear or intentional violation of a compensation plan in this case.” Ex. 1 at 30. As demonstrated below, the Complaint sufficiently pled that the RSU violated two discrete provisions of the Plan.<sup>5</sup> In essence, Expedia’s stockholders, through their approval of the Plan, required that the Board’s Compensation Committee take no action that would impair the tax treatment of an award intended to be tax-deductible. The Compensation Committee, in so acting and intentionally disregarding this prohibition, abrogated the will of the Company’s stockholders. Thus the practical effect of the Court of Chancery’s ruling was to bless an outright contravention of corporate democracy. It should be reversed accordingly.

---

<sup>5</sup> The Court of Chancery iterated its finding that Plaintiff had not pled demand futility with respect to Plaintiff’s unjust enrichment claim, which was “derivative of the fiduciary claim discussed above.” Ex. 1 at 31. As demonstrated above, however, Plaintiff did plead with particularity that the RSU Award was paid to Khosrowshahi in violation of the Plan. Accordingly, demand was excused under the second prong of *Aronson*. Because Plaintiff adequately pleaded her breach of fiduciary duty claim under Del. Ct. Ch. R. 23.1, she necessarily pled a claim under the lesser pleading standard of Del. Ct. Ch. R. 12(b)(6). *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 139 (Del. Ch. 2009) (stating that generally a “complaint that survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss, assuming that it otherwise contains sufficient facts to state a cognizable claim”); *Weiss*, 948 A.2d at 448 (“[W]here [the] 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 purposes of surviving a motion to dismiss pursuant to Rule 12(b)(6).”) (citation omitted).

### **1. The OIBA Goal was a performance goal**

The Plan is clear. Once an award was designated as a Qualified Performance-Based Award, as was the case with the RSU Award, the Compensation Committee was prohibited under Sections 11(b) and 12(d) of the Plan from taking any action that would cause the award to cease to qualify as tax-deductible compensation under Section 162(m). Defendants do not dispute this.

Section 162(m) and its implementing regulations provide that compensation will cease to qualify as tax deductible if the “performance goals” are not achieved. Defendants concede that the OIBA Goal was not achieved. The dispute is whether the OIBA Goal constituted a “performance goal” pursuant to Section 162(m)’s requirements; if it did, then the 400,000 shares paid to Khosrowshahi would no longer qualify as tax-deductible performance-based compensation under Section 162(m), thereby violating the Plan’s express terms.

In considering the motion to dismiss, the Court of Chancery recognized that, because it was based on the criteria set forth in Plan Section 1(dd), “the Compensation Committee could have used the OIBA [Goal] to satisfy the performance goal requirement of Section 162(m)(4) if it wished to do so.” Ex. 1 at 15. The Court of Chancery went on to find, however, that the Compensation Committee did not intend that the OIBA Goal be a performance goal, but rather “a separate vesting condition of the [RSU] Award,” which “the Compensation

Committee thus had the authority to waive.” *Id* at 15, 17.

**a. The RSU Award was structured to comport with Section 162(m)**

In her Complaint, Plaintiff alleged particularized facts, which the Court of Chancery should have accepted as true, demonstrating that the OIBA Goal was a “performance goal.” Section 162(m) prescribes certain rules for establishing “performance goals,” including that the compensation committee: (1) select certain “business criteria” from a list preapproved by stockholders; (2) establish “one or more preestablished, objective performance goals” that are based on the business criteria selected; and (3) establish an “objective formula” for “computing the amount of compensation payable to the employee” if the performance goals are achieved. A11-A12; 26 C.F.R. § 1.162-27(e)(2); 26 C.F.R. § 1.162-27(e)(4); 26 U.S.C. § 162(m)(4)(C). Compensation will not be tax-deductible if the preestablished, objective performance goals are not met. In order for an award to qualify for the tax deduction, the compensation committee “must certify in writing prior to payment of the compensation that the performance goals and any other material terms were in fact satisfied.” A11-A12; 26 C.F.R. § 1.162-27(e)(5); 26 U.S.C. § 162(m)(4)(C).

In accordance with these regulations, the Compensation Committee selected three business criteria from the stockholder-approved list itemized in Section 1(dd) of the Plan—EBITA, stock price and operating income—and established the

EBITA/Stock Price Goal and the OIBA Goal based on those criteria. A13. As required by Section 162(m), the Compensation Committee then established an objective formula that governed the payment of the 400,000 shares to Khosrowshahi. A13-14. As stated in the RSU Award Agreement, Khosrowshahi would be paid the 400,000 shares only if *both* the EBITA/Stock Price Goal *and* the OIBA Goal were achieved. A202. This was the *only* objective formula in the RSU Award Agreement. *Id.* Thus, taking Plaintiff's well-pled facts as true, Plaintiff sufficiently alleged that both the EBITA/Stock Price and the OIBA Goal had to be achieved for Khosrowshahi's award to qualify as tax-deductible performance-based compensation. A13-14. Because the OIBA Goal was indisputably not achieved, Plaintiff also sufficiently alleged that the Defendants violated the Plan when they paid Khosrowshahi the 400,000 shares. A15-16, A37.

**b. Defendants were prohibited from waiving the OIBA Goal**

The Court of Chancery erred in determining that Plaintiff had not sufficiently alleged that the OIBA Goal constituted a performance goal for purposes of Section 162(m). *First*, the Court of Chancery did not take into account Plaintiff's allegations concerning Section 162(m)'s rules for establishing "performance goals." To the contrary, the Court of Chancery found that the only "critical" fact in determining whether a term constituted a "performance goal" was the Compensation Committee's intent. Ex. 1 at 15 ("The critical question is



whether the Compensation Committee, when it granted the RSU Award, intended to use the OIBA Target as a performance goal to satisfy the performance goal requirement of Section 162(m)(4) or whether the Compensation Committee intended the OIBA Target to be a separate vesting condition of the Award.”).

Nothing in Section 162(m) or its regulations, however, states that the *intent* of the Compensation Committee is dispositive in determining whether a specific provision in an award constitutes a performance goal. Instead, Section 162(m)’s regulations require that a compensation committee establish an objective formula comprising the performance goals that need to be achieved before the compensation can be paid. If the objective formula is not satisfied, the compensation will not be tax-deductible, as required by the Plan. Here, the only objective formula in the RSU Award agreement unambiguously provided that Khosrowshahi would be paid the 400,000 shares of Expedia stock only if *both* the EBITA/Stock Price Goal *and* the OIBA Goal were achieved. A202. The Court of Chancery’s finding that the *intent* of the Compensation Committee was the critical question incorrectly focused on what the Compensation Committee intended, as opposed to what it did when it “established” the objective formula (*i.e.*, the performance goals) pursuant to Section 1(dd) of the Plan.

*Second*, even assuming *arguendo* that the intent of the Compensation Committee were relevant for Section 162(m) purposes, the Court of Chancery

erred by failing to take Plaintiff's well-pled factual allegations as true and draw reasonable inferences in Plaintiff's favor. *See, e.g. Central Mortg. Co. v. Morgan Stanley Mrtg. Capital Holdings LLC*, 27 A.3d 531, 538 (Del. 2011) (reversing dismissal of complaint and stating that “[a]t the motion to dismiss stage [] it matters not which party’s assertions are actually true. [The Court] must draw all reasonable inferences in favor of [plaintiff]” and determine only “whether [plaintiff’s] well-pleaded [c]omplaint stated a claim that is provable under any reasonably conceivable set of circumstances[.]”); *In re Gardner Denver, Inc. S’holder Litig.*, 2014 WL 715705, at \*6-7 (Del. Ch. Feb. 21, 2014) (on a motion to dismiss a court must accept allegations in complaint as true, draw all reasonable inferences in plaintiff’s favor, and decline to resolve disputed questions of fact or conflicting inferences concerning such questions (citing omitted)). Instead, the Court of Chancery impermissibly accepted Defendants’ *post hoc* characterization of events and drew inferences in Defendants’ favor.

In their motion to dismiss, Defendants introduced their own version of facts to argue that the Compensation Committee did not intend the OIBA Goal to constitute a performance goal under Section 162(m). Specifically, the Defendants argued that the Compensation Committee intended the OIBA Goal to be a “business goal,” and not a performance goal. In support of that contention, Defendants pointed to: (1) the 2013 Proxy, which called the OIBA Goal a

“business goal”; and (2) the RSU Award agreement, which distinguished between the EBITA/Stock Price Goal and the OIBA Goal by calling the former “Performance Goals” and the latter the “OIBA Target.” A36-37.

As Plaintiff pointed out, however, the description of the OIBA Goal in the 2013 Proxy should not have been considered because that document was filed after the alleged Plan violation had occurred, and indeed as Plaintiff had specifically alleged, Defendants were attempting to use the very same proxy to conceal the violation. A251 n.12. At the same time, Plaintiff noted that the 2010 Proxy, which was filed before the Plan violation, described both the EBITA/Stock Price Goal and the OIBA Goal collectively as the “RSU Performance Goals.” A237.

Moreover, there is no distinction between a “performance goal” and a “business goal” under Section 162(m). A236-37. Indeed, as the Court of Chancery recognized, “to qualify as a performance goal under Section 162(m), the goal must be selected from a list of pre-established, objective, stockholder-approved business criteria.” Ex. 1 at 14. Finally, Plaintiff pointed out that the RSU Award agreement’s characterization of the EBITA/Stock Price Goal as the “Performance Goals” and the OIBA Goal as the “OIBA Target” was in no way dispositive (or for that matter, indicative of the Compensation Committee’s intent) because Section 162(m) requires that an award be conditioned upon satisfaction of a written, objective formula, which once established cannot be waived pursuant to

Sections 7(b), 11(b) and 12(d) of the Plan. A65-66, A69-70, A237. Because the achievement of both the EBITA/Stock Price Goal *and* the OIBA Goal constituted the only “objective formula” in the RSU Award agreement, these facts indicate that both goals constituted “performance goals” for purposes of Section 162(m) and thus the Plan. A237.

Rather than taking Plaintiff’s well-pled allegations as true and drawing all reasonable inferences in Plaintiff’s favor, the Court of Chancery did just the opposite. It began its analysis by “first consider[ing] the competing interpretations of the RSU Award that have been presented.” Ex. 1 at 13. The Court of Chancery then found the use of “separately-defined terms in the RSU Award [agreement] differentiating between the ‘Performance Goals’ and the ‘OIBA Target’” conclusive in part because this was “consistent” with the disclosures contained in the 2013 Proxy. *Id.* at 17-19.

In reaching this conclusion, the Court of Chancery did not appear to give any consideration to Plaintiff’s allegations that the only objective formula in the RSU Award agreement itself required the achievement of both the EBITA/Stock Price Goal and the OIBA Goal under the Plan. With respect to Plaintiff’s allegation that the Company referred to both the EBITA/Stock Price Goal and the OIBA Goal collectively as the “RSU Performance Goals” in the 2010 Proxy, the Court found that the disclosure “appear[ed] to be a simple mischaracterization of

the plain terms of the original RSU Award.” *Id.* at 19-20. The court concluded that Plaintiff’s allegations “cannot logically be squared” with the defined terms used in the RSU Award agreement and that, at most, Plaintiff’s allegations raised an “ambiguity” as to whether the OIBA Goal was intended to satisfy Section 162(m) when the RSU Award was granted. *Id.* From top to bottom, the Court of Chancery took *Defendants’* version of events as true and drew inferences in *Defendants’* favor, in diametric contradiction of the analysis mandated by applicable law.

After finding that Plaintiff merely raised an “ambiguity,” the Court of Chancery found “salient” that the Compensation Committee had the authority under the Plan to “interpret the terms [of] . . . any Award issued under the Plan,” and thus had the power to resolve the ambiguity the Court of Chancery found to exist. *Id.* at 20. This general administrative authority to “interpret” the terms of an award is irrelevant. That there is “no doubt how the Compensation Committee” would decide to interpret this “ambiguity” in no way impacts whether Plaintiff had adequately alleged a Plan violation. *Id.* at 21. In that regard, the real issue is whether waiver of the OIBA Goal would negate the tax-deductibility of the RSU Award under Section 162(m).

Plaintiff pled with particularity that waiver of the OIBA Goal rendered the RSU Award ineligible for a Section 162(m) tax deduction, and the Plan required

that the RSU Award, as a Qualified Performance-Based Award, be tax-deductible at the time it was disbursed. A14, A16. By failing to accept these well-pled allegations as true and draw reasonable inferences therefrom in Plaintiff's favor, the Court of Chancery erred in determining that Plaintiff had not pled a plan violation under the second prong of *Aronson*. *Weiss*, 948 A.2d at 441.

Moreover, Plaintiff's allegations concerning the "'Administrative' Amendments" demonstrate that the Board knew perfectly well that it had violated the terms of the Plan, and went to considerable lengths to hide their tracks. A17-18. As described in the Complaint, less than seven months after accelerating the vesting of the RSU Award and making the payment to Khosrowshahi, the Board amended the Plan—specifically, Sections 11(b) and 12(d)—to remove the very language the Compensation Committee had violated. *Id.* The effect of these changes was significant. As a result of the "'Administrative' Amendments," the Compensation Committee would have unfettered discretion to modify the terms of a Qualified Performance-Based Award, even if such modifications would cause the award to lose its tax-deductibility status under Section 162(m). *Id.* Notwithstanding the substantial additional powers these new amendments conferred on the Compensation Committee, in seeking stockholder approval the Board did not explain these amendments at all in the 2013 Proxy. To the contrary, the Board perfunctorily referred to them as mere "administrative changes." A19.

The Court of Chancery found that demand was “not excused under the second prong of *Aronson* because Friedman has failed to allege particularized facts to support an inference of bad faith on the part of any of the defendant directors sufficient to raise a reasonable doubt that the decision to waive the OIBA Target was anything other than the product of a valid business judgment.” Ex. 1 at 30. The “‘Administrative’ Amendments,” however, go directly to bad faith. Both the substance of the “‘Administrative’ Amendments” and the manner in which they were included in the 2013 Proxy indicate that the Board knew that the Compensation Committee’s decision to accelerate the vesting of the RSU Award was not allowed by the express terms of the Plan as it existed at the time, and deliberately mischaracterized the revisions to conceal their actions. The Court of Chancery discounted these allegations altogether and concluded that the Board’s misleading description of the “‘Administrative’ Amendments” was not an issue because, since no Plan violation had occurred, the Board did not attempt to conceal any such violation. *Id.* at 31.

**2. The OIBA Goal was a condition placed on the RSU Award that the Committee could not waive under the Plan**

The Court of Chancery dismissed Plaintiff’s Complaint on the grounds that the Defendants “articulated a reasonable construction of the plain terms of the RSU Award whereby the Compensation Committee was entitled to waive the challenged vesting condition in accordance with their authority under the Plan.” Ex. 1 at 3.

The “ambiguity” discussed at length by the Court of Chancery, however, concerned only whether the OIBA Goal was a performance goal for purposes of Section 162(m) compliance. *Id.* at 20. Irrespective of whether the OIBA Goal was a “performance goal,” the Compensation Committee’s decision to accelerate the vesting of the RSU Award still violated the Plan.

Section 11(b) prohibited the accelerated vesting of the RSU Award prior to the achievement of the OIBA Goal independent of Section 162(m) and the effect of the waiver on the award’s tax-deductibility. In concluding that the OIBA Goal was not intended by the Compensation Committee to be a “Performance Goal,” the Court of Chancery acknowledged that the OIBA Goal was a “condition” of the award. Section 1 of that agreement sets forth certain vesting conditions. Specifically, Section 1(b) provides that the RSU Award will vest upon the achievement of both: (1) one of two specifically defined “Performance Goals” relating to the Company’s EBITA or stock price; and (2) an additional goal defined as the “OIBA Target.” These goals are defined collectively as the “Combined Goals.” A202. As the Court of Chancery recognized, “nothing in the Plan prevents the Compensation Committee from making a Qualified Performance-Based Award subject to the achievement of other terms or conditions.” Ex. 1 at 6 (referring to Section 11(b)); *see also id.* at 8 (discussing the “vesting conditions” established in Section 1 of the RSU Award agreement and acknowledging that the



RSU Award would vest “upon the achievement of both” the EBITA Goal and the OIBA Goal).

It is undisputed that the Compensation Committee waived the OIBA Goal at a time when it had not been achieved. The Compensation Committee’s discretion to waive conditions attached to an award of restricted stock units was governed by Section 7(b)(i) of the Plan, which stated, “[s]ubject to Section 11(b), the [Compensation] Committee may at any time, in its sole discretion, accelerate or waive, in whole or in part, any of the foregoing restrictions” attached to such an award. A64.

Section 11(b), in turn, provides exceptions to the Compensation Committee’s ability to accelerate or waive conditions. The first clause of Section 11(b) provides that if an award of RSUs has been designated a Qualified Performance-Based Award, it “shall be earned, *vested* and payable (as applicable) *only* upon the achievement of one or more Performance Goals, *together with the satisfaction of any other conditions*, such as continued employment, as the Committee may determine to be appropriate.” A69-70 (emphasis added). The Compensation Committee’s decision to accelerate the vesting of the RSU Award, despite the fact that an “other condition” that the Compensation Committee attached to the RSU Award—*i.e.* the OIBA Goal—was not satisfied, clearly

violated the first clause of Section 11(b) irrespective of the tax impact of that decision.

The Court of Chancery held that the limitation imposed by Section 11(b) was not implicated because the Committee had waived the OIBA Goal at the time the RSU Award became payable. Ex. 1 at 21. Specifically, it stated that Plaintiff “ignore[d] the fact that the Compensation Committee waived the OIBA [Goal],” the elimination of which meant that it “was [not] an ‘other condition’ of the RSU Award when it became payable.” *Id.* This reasoning is circular. It was the “waiv[ing]” of the OIBA Goal (through the accelerated vesting) that was prohibited by Section 11(b). A240. Indeed, the Court of Chancery noted that the OIBA Goal was “one of the original vesting conditions of the RSU Award [which] had not been satisfied,” and that an award of restricted stock units made under the Plan settles “upon satisfaction of whatever vesting conditions the Compensation Committee has established.” Ex. 1 at 2, 7-8. It erred by determining that waiver of the vesting condition negated the Plan’s prohibition on such waiver.

As explained above, Section 11(b)’s delineated exception to the Compensation Committee’s nearly-plenary authority under the Plan to accelerate or waive restrictions on RSU Awards prohibited the Compensation Committee from, among other things, “vest[ing]” an award until all conditions that the Compensation Committee determined appropriate to attach that award,

performance-based or otherwise, were satisfied. Thus, the “waiv[ing] of the OIBA [Goal],” *i.e.*, the accelerated vesting of the RSU Award, was itself the violation of Section 11(b), and not, as the Court of Chancery erroneously determined, the act that made the first clause of Section 11(b) irrelevant.

By holding that the OIBA Goal was not an “other condition” that the Compensation Committee could not waive under Section 11(b), the court below misinterpreted the Plan and erred as a matter of law. *Lynch v. Rawls*, 429 Fed. Appx. 641, 642-43 (9th Cir. 2011) (overturning a trial court under the more rigorous abuse of discretion standard of review where it drew inferences in defendants’ favor in dismissing plaintiff’s particularized allegations of violation of a stock incentive plan); *see also Udoff v. Zipf*, 375 N.E.2d 392, 395 (N.Y. 1978) (reversing entry of summary judgment where there was a factual question whether the board of directors had complied with the terms of a governing stockholder-approved incentive plan and otherwise satisfied their fiduciary duties).

### **3. The OIBA Goal was a material term that could not be waived under Section 162(m) and its regulations**

Just as it erred in determining that the OIBA Goal was not an “other condition” placed on a Qualified Performance-Based Award which the Plan prohibited the Compensation Committee from waiving, the Court of Chancery also erred in reaching the same determination with respect to the OIBA Goal being a “material term” of the RSU Award. 26 C.F.R. § 1.162-27(e)(5), one of the

regulations implementing Section 162(m), mandates that a compensation committee certify that “performance goals *and any other material terms* [of the award are] in fact satisfied” prior to payment of an award. (emphasis added) The materiality of the OIBA Goal is self-evident, however, as the plain terms of the RSU Award agreement make clear that its satisfaction was a condition precedent to vesting of the shares underlying the RSU Award. A202. The Court of Chancery nevertheless once again put the cart before the horse when it determined that the term was not material because it had been waived. Ex. 1 at 21. At worst, this transgression was, as a matter of law, a deliberate violation of the Plan’s requirement that Qualified Performance-Based Awards not be modified in any manner which would impair their compliance with Section 162(m). At best, it presented a triable issue of fact not suitable for adjudication on a motion to dismiss. *Green v. Weiner*, 766 A.2d 492, 496 (Del. 2001) (reversing trial court’s granting of a motion to dismiss where there was a factual issue “present[ing] a jury question”).

## CONCLUSION

For the foregoing reasons, the Court of Chancery erred in finding that Plaintiff had failed to plead a violation of the Company's Plan, and its determination that demand upon the Board was not excused was consequently also in error. The Order of the Court of Chancery should therefore be reversed.

October 15, 2014

SMITH, KATZENSTEIN & JENKINS LLP

**OF COUNSEL:**

LEVI & KORSINSKY LLP  
Eduard Korsinsky  
Steven J. Purcell  
30 Broad Street, 24<sup>th</sup> Floor  
New York, NY 10004  
(212) 363-7500  
(866) 367-6510 (facsimile)

/s/ David A. Jenkins

David A. Jenkins (No. 932)  
Neal C. Belgam (No. 2721)  
800 Delaware Avenue  
Suite 1000  
P.O. Box 410  
Wilmington, DE 19899  
(302) 652-8400  
(302) 652-8405 (facsimile)

Attorneys for Appellant