EFiled: Nov 03 2014 04:19PM EST
Filing ID 56283111
Case Number 442,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JULIE FRIEDMAN, derivatively on behalf of EXPEDIA, INC., Plaintiff-Appellant, vs. DARA KHOSROWSHAHI, BARRY DILLER, VICTOR A. KAUFMAN, A. GEORGE BATTLE, JONATHAN L. DOLGEN, CRAIG A. JACOBSON, PETER M. KERN, JOHN C. MALONE, JOSÉ A. TAZÓN and WILLIAM R. FITZGERALD, Defendants-Appellees, -and- EXPEDIA, INC., a Delaware Corporation, Nominal Defendant-Appellee.	No. 442, 2014 Case below: Court of Chancery of the State of Delaware C.A. No. 9161-CB

DEFENDANTS BELOW, APPELLEES' ANSWERING BRIEF

RICHARDS, LAYTON & FINGER, PA
Gregory P. Williams (#2168)
Lisa A. Schmidt (#3019)
Susan M. Hannigan (#5342)
One Rodney Square
920 North King Street
Wilmington, Delaware 19801
(302) 651-7700

Attorneys for Defendants-Appellees Dara Khosrowshahi, Barry Diller, Victor A. Kaufman, A. George Battle, Jonathan L. Dolgen, Craig A. Jacobson, Peter M. Kern, John C. Malone, José A. Tazón and William R. Fitzgerald and Nominal Defendant-Appellee Expedia, Inc.

OF COUNSEL:

WACHTELL, LIPTON, ROSEN & KATZ
Warren R. Stern
C. Lee Wilson
51 West 52nd Street
New York, New York 10019
(212) 403-1000

Dated: November 3, 2014

TABLE OF CONTENTS

TABLE OF CITATIONS

Cases Page(s)

Statutes

Other Authorities

NATURE OF THE CASE AND STAGE OF PROCEEDINGS

Plaintiff-appellant Julie Friedman, a purported shareholder of Expedia, Inc. ("Expedia"), appeals from a judgment of the Court of Chancery dismissing her putative derivative action with prejudice.[1] Friedman's derivative action challenged a decision by the independent Compensation Committee of the Expedia Board of Directors (the "Committee") to waive a business goal in a restricted stock unit award (the "RSU Award") made to Expedia's CEO, Dara Khosrowshahi, in 2005. Friedman's two-count complaint asserted that the waiver was a breach of defendants' duty of loyalty and that Mr. Khosrowshahi was unjustly enriched. The RSU Award was authorized by Expedia's 2005 Stock and Annual Incentive Plan (the "Plan"), which was approved by Expedia's shareholders in May 2007. The RSU Award provided that the RSUs would vest if Expedia achieved: (i) one of two performance goals tied to Expedia's stock price or EBITA (the "Performance Goals"), and (ii) a separate business goal tied to the company's OIBA (operating income before amortization) (the "OIBA Target"). In 2013, the Committee approved the vesting of the RSUs, after certifying that a Performance Goal had

---

[1] Citations to Appellant's Corrected Opening Brief appear as "OB __." The trial court's opinion is Exhibit 1 to Appellant's Corrected Opening Brief, and thus citations to it appear as "OB Ex. 1 at __." Citations to the Corrected Appendix of Appellant's Opening Brief appear as "A__." Citations to the Appendix of Appellee's Brief, filed herewith, appear as "B__."

been met and after waiving the separate OIBA Target. The Plan specifically authorized the Committee to modify any award so long as the amendment did not affect tax deductibility or materially impair the rights of the recipient.

Friedman concedes that a Performance Goal was met, does not question the Compensation Committee's business rationale for waiving the OIBA Target, and does not allege that any Expedia director other than Mr. Khosrowshahi personally benefited from the waiver. She claims, rather, that the waiver of the OIBA Target represented an "*intentional*" breach of the directors' fiduciary duties because it violated what she characterizes as "clear and unambiguous" provisions of the Plan — in particular, the provision prohibiting modifications that would affect the tax deductibility of an award. But Friedman does not allege that Expedia did not claim a tax deduction for the RSU Award or that the Internal Revenue Service ever challenged or disallowed such a deduction.

Friedman did not make a pre-litigation demand on Expedia's Board, and so has the burden of alleging demand futility with particularity. On January 31, 2014, defendants moved to dismiss the complaint for failure to make a demand or to plead facts excusing such a demand, and for failure to state a claim upon which relief may be granted. On July 16, 2014, the trial court (Bouchard, C.) granted defendants' motion, holding that Friedman had failed to plead demand futility, and dismissed the complaint with prejudice. On appeal, Friedman argues that her

complaint sufficiently pleads demand futility because she alleges that Expedia's "Board intentionally violated a clear and unambiguous provision(s) of Expedia's stockholder approved Plan," and thereby raised a reasonable doubt that the waiver of the OIBA Target was the product of business judgment. OB 14-15.

The trial court carefully considered Friedman's argument that the waiver violated the Plan. After reviewing the Plan, the court found that the defendants had "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." OB Ex. 1 at 3. The court stated that "[a]t most, plaintiff has identified a potential ambiguity in the RSU Award that the compensation committee was authorized to interpret under the terms of the Plan." *Id.* Based on these findings, the court held that Friedman had not pled 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." OB Ex. 1 at 30.

SUMMARY OF ARGUMENT

Defendants-appellees submit this response to Friedman's summary of argument (OB 2-3) pursuant to Delaware Supreme Court Rule 14(b)(iv):

1. Admitted.

2. Admitted.

3. Denied. The Plan was not violated because the OIBA Target was a separate business goal that could be waived without causing the RSU Award to cease to qualify for a tax deduction under Section 162(m) of the Internal Revenue Code. The Plan did not prohibit the Compensation Committee from paying out the Award because, as permitted by the Plan, the OIBA Target had been waived and therefore was not a condition of the Award when it was paid. In any event, the Plan authorized the Committee to resolve any ambiguity in the Award, and the existence of any ambiguity would only bolster the conclusion that there was no "clear and unambiguous" provision in the Plan for defendants to violate.

4. Denied. The complaint does not allege facts showing that the Compensation Committee (or the Board) exceeded its authority, intentionally or unintentionally, under an express and unambiguous provision of the Plan. Demand is therefore not excused.

APPELLEES' COUNTERSTATEMENT OF FACTS

A. The parties and putative derivative claims in the action below

The trial court relied on the allegations of the complaint and the publicly available documents on which the complaint purported to rest. OB Ex. 1 at 3-13. Friedman does not contend that any of those facts were erroneous or that the trial court failed to consider any facts that it was obligated to have assumed to be true. Thus, briefly:

1. On December 13, 2013, plaintiff, an Expedia stockholder, commenced her derivative action on behalf of the company against ten individuals who were members of Expedia's Board of Directors in August 2012 when the Compensation Committee, consisting of three independent directors, determined to accelerate the vesting of the RSU Award to Expedia's CEO, defendant Dara Khosrowshahi. OB Ex. 1 at 3-4; A007-A010. Nine of those individuals remained as directors when the suit was filed; one director, a member of the Compensation Committee, had resigned and had been replaced by an independent director who was not sued. OB Ex. 1 at 4; A009; A020.

2. The RSU Award was made pursuant to Expedia's 2005 Stock and Annual Incentive Plan, which conferred "plenary authority" on the Compensation Committee to grant stock-based awards to eligible persons, including the CEO. OB Ex. 1 at 4, 7-8 (citing A057-A058). Exercising that authority, the

Compensation Committee, in 2006, granted RSUs for 800,000 shares to Mr. Khosrowshahi. *Id.* at 7-8 (citing B019-B025). The grant was made under an agreement providing for vesting upon achievement of both (1) one of two defined "Performance Goals" tied to EBITA or stock price, which were designed to preserve the tax deductibility of the Award under Section 162(m) of the Internal Revenue Code, and (2) the OIBA Target, an additional business goal tied to operating income before amortization. *Id.* at 8 (citing B020).[2] The Award was accurately summarized in Expedia's Form 8-K, filed in March 2006. *Id.* at 8-9 (citing A074-A078).

3. Sections 2(a) and 7(b) of the Plan, with one relevant exception, authorized the Compensation Committee to "modify, amend or adjust the terms and conditions of any Award, at any time . . . ." OB Ex. 1 at 4 (citing A058). Acting under this authority, the Committee, in late 2011, agreed to divide the RSU Award with TripAdvisor, Inc., a company that was being spun-off from Expedia, with Mr. Khosrowshahi as a director. *Id.* at 9-10 (citing A014-A015). The amended RSU Award reduced the number of RSUs to 400,000 shares and retained

[2] Section 162(m)(1) provides that publicly held corporations may not deduct compensation in excess of $1 million paid to certain executives in a tax year. 26 U.S.C. § 162. Section 162(m)(4)(C) provides an exception to this limitation if, among other things, "any remuneration [is] payable solely on account of the attainment of one or more performance goals" established by a compensation committee of two or more independent directors. *Id.* § 162(m)(4)(C).

the vesting conditions of the original award. *Id.* (citing A201-A214). The amended RSU Award stated that "[f]or the avoidance of doubt, the Corporation acknowledges that at least one of the Performance Goals has been satisfied." A202-A203.

4. In August 2012, the Compensation Committee, as part of a new employment agreement between Mr. Khosrowshahi and Expedia, again modified the conditions of the RSU Award, accelerating vesting even though the OIBA Target had not been met. OB Ex. 1 at 11-12 (citing A015-A016). As noted, one of the two performance goals specified in the RSU Award had been met. *Id.* (citing A129).

5. Section 12(d) of the Plan limited the Committee's discretion to modify the terms of an Award by providing that "no such amendment shall . . . cause a Qualified Performance-Based Award to cease to qualify for the Section 162(m) exemption." *Id.* at 5 (citing A070); *see also* Section 11(b) of the Plan (A069-A070). An Award would cease to so qualify if a Performance Goal was waived. But as, Expedia explained in its 2013 Proxy Statement, a Performance Goal "designed to satisfy the requirements of Section 162(m)" had been achieved, and the OIBA Target was a separate business goal. *Id.* at 9-11 (citing A129).

6. The 2013 Proxy Statement also attached an amended Plan adopted by the Expedia Board in February 2013 and requested that shareholders approve the

amended Plan. Among other changes, the amended Plan no longer prohibited the Compensation Committee from amending a Qualified Performance-Based Award if such amendment would result in the loss of a Section 162(m) deduction. OB Ex. 1 at 12 (citing A017-018; A168-169). Friedman claims that the amendment was an attempt by the Board to "hide its misconduct . . . by purging the violated terms from the Plan." *Id*.

7. Friedman does not allege that Expedia "ever lost the ability to take a tax deduction concerning the RSU Award." *Id.*

B. The trial court's opinion dismissing the complaint with prejudice

On July 16, 2014, after reviewing the complaint, the Plan, the RSU Award and Section 162(m), the trial court found that the Compensation Committee could have reasonably interpreted the OIBA Target in the RSU Award to be waivable under the Plan, and issued a judgment dismissing Friedman's action with prejudice.

The trial court approached the question of demand futility by "first consider[ing] the competing interpretations of the RSU Award." OB Ex. 1 at 13. It found that "defendants have articulated a reasonable construction of the plain terms of the RSU Award whereby the compensation committee was entitled to waive [the OIBA Target] in accordance with their authority under the Plan," and that "[a]t most, plaintiff has identified a potential ambiguity in the RSU Award that

the compensation committee was authorized to interpret under the terms of the Plan." *Id.* at 3.

In reaching these conclusions, the court first observed that only one "performance goal" needed to be specified for the Section 162(m) deduction and that Friedman conceded that the Compensation Committee "could have imposed other vesting goals or conditions on the RSU Award," including those that would fit the criteria of a Section 162(m) performance goal "without intending such goals or conditions to be used to satisfy Section 162(m)." *Id.* at 16. The trial court then stated that 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 Section162(m)(4) or whether the Compensation Committee intended the OIBA Target to be a separate vesting condition of the Award." *Id.* at 15.

The court below considered this question to be "critical" because it found that Sections 11(b) and 12(d) of the Plan would have prohibited the Committee from amending the RSU Award in any manner that would cause Expedia to lose the Section 162(m) exemption, whereas Sections 2(a) and 12(d) of the Plan permitted the Committee to modify or amend any other term or condition of the

award. *Id.* at 15-16.[3] Thus, if the OIBA Target was not intended by the Committee to be a Section 162(m)(4) performance goal, then the Committee had the authority to waive that condition under the Plan. The RSU Award, the trial court then explained, could reasonably be so construed. *Id.* at 16-18.

The trial court reached this conclusion after observing that the RSU Award "separately-defined . . . 'Performance Goals'" and the "'OIBA Target'" and that the construction was consistent with the explanation for the waiver in Expedia's 2013 Proxy Statement. *Id.* at 19-20.[4] The court conceded for purposes of its

---

[3] Section 2(a) of the Plan states: "[T]he Committee shall have the authority . . . subject to Section 12, to modify, amend or adjust the terms and conditions of any Award, at any time or from time to time . . . ." A057-A058.

Section 11(b) of the Plan states: "Each Qualified Performance-Based Award . . . 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, and 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 . . . ." A069-A070.

Section 12(d) allows the Committee to "unilaterally amend the terms of any Award . . . granted [pursuant to the Plan] . . . but no such amendment shall (i) cause a Qualified Performance-Based Award to case to qualify for the Section 162(m) Exemption . . . ." A070-071.

[4] The RSU Award states in Section 1(b) that "the Restricted Stock Units shall vest and no longer be subject to any restriction . . . in the event both (i) one of the

(Continued . . .)

opinion that Friedman's argument that the OIBA Target could have been made a Section 162(m) performance goal,[5] and addressed Friedman's arguments that Expedia's 2010 Proxy Statement defined the EBITA/stock price goals and the OIBA Target "collectively, as the "'RSU Performance Goals,'" and that the 2013 Proxy Statement discussion occurred after the violation (allegedly as part of an effort to conceal the violation). *Id.* at 18-20. But the court concluded that the 2010 Proxy Statement's description was a "simple mischaracterization of the plain terms of the original RSU Award," and that the distinction was correctly reiterated in the 2011 amendment to the Award. *Id.* at 19-20. At most, the court stated, Friedman's construction of the Award raised an "ambiguity" that the Committee was authorized to resolve under Section 2(a)(vii) of the Plan in the manner set forth in the 2013 Proxy Statement. *Id.* at 20-21.

(. . . continued)

two performance goals approved by the committee (the 'Performance Goals') and relating to EBITA or the Corporation's stock price is achieved and (ii) the Expedia OIBA Target . . . is achieved (collectively, the 'Combined Goals') . . ." A202-203.

[5] The trial court "assume[d]" that the Compensation Committee could have used the OIBA Target as a performance goal for the Section 162(m) deduction had it wished to do so because it is based on "operating income," a criterion specified under the Plan in the list of metrics that could be selected to satisfy Section 162(m). OB Ex. 1 at 15. Defendants do not take issue with that assumption on appeal.

The trial court also addressed Friedman's alternative arguments to the effect that Section 162(m)(4)(C)(iii) of the Internal Revenue Code and Section11(b) of the Plan prohibited the waiver because, respectively, the OBIA Target was a "material term" or "other condition" of the RSU Award, which had to be satisfied before the Award became payable. *Id.* at 21. These restrictions, the court found, did not apply when the Award became payable because the OIBA Target had already been waived was no longer a condition or material term of the Award. *Id*.

Having concluded that the Compensation Committee could have reasonably construed the RSU Award to permit waiver of the OIBA Target and, in any event, was authorized to resolve any ambiguity, the trial court held that demand could not be excused under the second prong of *Aronson* because Friedman had failed to allege "a clear or intentional violation of a compensation plan" and therefore had "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." *Id.* at 30. The cases relied on by Friedman, the court

explained, involved allegations showing "clear or intentional" violations of express and unambiguous plan provisions. *Id.* at 28-29 and 29 n.80.[6]

[6] The trial court also held that Friedman had failed to allege facts excusing demand under the first prong of *Aronson* because the allegations did not show that a majority of the Expedia Board of Directors was either interested or lacked independence. OB Ex. 1 at 23-28. Friedman does not appeal from this holding. OB 15.

ARGUMENT

I. THE JUDGMENT SHOULD BE AFFIRMED BECAUSE THE COURT OF CHANCERY CORRECTLY FOUND THAT FRIEDMAN FAILED TO PLEAD A KNOWING AND INTENTIONAL VIOLATION OF THE PLAN.

A. Question Presented

Has Friedman pleaded with particularity that Expedia's Board "intentionally violated a clear and unambiguous provision(s)" of Expedia's executive compensation Plan? OB 14 (citing A231-A261).

B. Scope of Review

The question involves competing interpretations of a legal instrument. Review is *de novo*. *Schoon* v. *Smith*, 953 A.2d 196, 200 (Del. 2008).

C. Merits of Argument

1. Friedman failed to plead that the waiver of the OIBA Target violated the Plan, let alone that defendants knowingly and "intentionally" violated a "clear and unambiguous provision" of the Plan.

A shareholder initiating a derivative action must plead "with particularity" either that demand was made on the corporation to initiate suit on its own, or that such demand "would have been futile." Rule 23.1; *Wood* v. *Baum*, 953 A.2d 136, 140 (Del. 2008). This requirement reinforces the "cardinal precept . . . that directors, rather than shareholders, manage the business and affairs of the corporation," *Aronson* v. *Lewis*, 473 A.2d 805, 811 (Del. 1984), and that, absent a reason to doubt their ability to do so, the company's directors — not a self-

appointed shareholder — have the power to determine whether litigation is in the best interests of the corporation. *Brehm* v. *Eisner*, 746 A.2d 244, 257 (Del. 2000).

Aronson establishes that demand is excused only if the plaintiff pleads facts sufficient to cast a reasonable doubt upon (i) the directors' disinterestedness and independence or (ii) the presumption that the transaction at issue was the product of a "valid exercise of business judgment." 473 A.2d at 814; OB 14-15. Otherwise a court must presume "that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." 473 A.2d at 812 (citations omitted). "[C]onclusory statements or mere notice pleading" will not suffice: plaintiff must provide "particularized factual statements that are essential to the claim." *Brehm*, 746 A.2d at 254.

On appeal, Friedman relies solely on the second prong of *Aronson* as a basis for excusing demand. OB 14. She argues that her complaint sufficiently pled that the waiver of the OIBA Target was not a "valid exercise of business judgment" because the Committee intentionally violated the Plan in waiving the OIBA Target. OB 16, 17-31. These arguments should be rejected because Friedman has not demonstrated that the waiver of the OIBA Target violated the Plan, and, in any event, she has not pleaded facts showing that any such violation was intentional as required to excuse demand.

The Plan confers broad discretion on the Compensation Committee. Section 7(b)(i) of the Plan states: "Subject to Section 11(b), the Committee may at any time, in its sole discretion, accelerate or waive, in whole or in part" any conditions in an award of restricted stock made under the Plan. A065-066. Thus, unless Section 11(b) barred the Committee from waving a restriction on an RSU, it had the authority to do so. Section 11(b), however, only prohibits the Committee from amending or exercising any discretionary authority in a manner that would cause a "Qualified Performance-Based Award," like the RSU Award, "to cease to qualify for the Section 162(m) Exception." A069-A070. This is the only limit in the Plan on the Committee's broad discretion.

Section 162(m) provides an exception to the general rule that a company cannot deduct compensation paid to certain employees, including the company's CEO, exceeding $1 million. It states that if compensation exceeding $1 million is payable to a specified executive only upon the attainment of one or more performance goals established by a compensation committee, then such compensation is deductible. 26 U.S.C. § 162(m)(4)(C). However, nothing in Section 162(m) prohibits a compensation committee from adding an *additional* vesting condition (such as the OIBA Target) to one or more Section 162(m) "performance goals." At oral argument in the court below, Friedman conceded that companies are entitled to do so. B127-B128 (31:21-32:8).

The Compensation Committee established an additional vesting condition in the RSU Award here. The RSU Award states:

> The Restricted Stock Units shall vest and no longer be subject to any restriction . . . in the event both (i) one of two performance goals approved by the Committee (the "Performance Goals") and relating to EBITA or the Corporation's stock price is achieved and (ii) the Expedia OIBA Target (as defined [below]) is achieved (collectively, the "Combined Goals").

A202. Thus, the RSU Award included distinct goals — the "Performance Goals" for Section 162(m) purposes and the separate OIBA Target.

While Section 11(b) of the Plan prohibited the Compensation Committee from waiving achievement of the "performance goals" prior to vesting of the RSU Award because that would risk losing the Section 162(m) exception, nothing in Section 11(b) prohibited the waiver of the separate OIBA Target. In light of these facts, all drawn from documents integral to Friedman's complaint that she does not dispute that this Court may consider, it is clear that the Compensation Committee's determination that it had the authority under the Plan to waive the OIBA Target comports with the Plan and the RSU Award.

Indeed, the reasonable inference is that the Compensation Committee, by specifying alternative performance goals, sought to assure that the award of the RSUs would be tax-deductible, and, by specifying an additional target, sought to create a business incentive *beyond* the minimum requirements needed to satisfy Section 162(m). It would be unreasonable to conclude that the Committee created

the additional hurdle in order to make it more difficult for Expedia to achieve the tax benefit or that the shareholders so read the Plan when they approved it. Thus, Friedman failed to plead a violation of the Plan at all.

Even if she has pleaded a violation of the Plan, however, Friedman concedes that to excuse demand she must also plead that the violation was knowing and intentional. OB 14. Delaware courts have made clear that a plaintiff's "bald assertion of non-conformance with the [compensation] plan" is insufficient to excuse demand. *Seinfeld* v. *Slager*, 2012 WL 2501105, at *16 (Del. Ch. June 29, 2012). "[T]he 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." *Pfeiffer* v. *Leedle*, 2013 WL 5988416, at *5 (Del. Ch. Nov. 8, 2013). Instead, a plaintiff must plead "particularized facts that indicate that the board *knowingly* or *deliberately* failed to adhere to the terms of a stock incentive plan." *Id.* (emphasis added).[7]

[7] *See also In re Ebix, Inc. Stockholder Litig.*, 2014 WL 3696655, at *21-22 (Del. Ch. July 24, 2014) (quoting *Pfeiffer* and the trial court's decision in the present case); *Abrams* v. *Wainscott*, 2012 WL 3614638, at *3 (D. Del. Aug. 21, 2012) (rejecting plaintiff's "blanket proposition" "that a shareholder need only allege violation of a compensation agreement to excuse demand, without additional allegations of knowledge and intent"); *Freedman* v. *Redstone*, 2013 WL 3753426, at *9 (D. Del. July 16, 2013) (same), *aff'd*, 753 F.3d 416 (3d Cir. 2014); *Freedman* v. *Mulva*, 2014 WL 975308, at *4 (D. Del. Mar. 12, 2014) (same).

Friedman does not allege any facts to show what the directors on the Compensation Committee were told or discussed in connection with their decision to waive the OIBA Target.[8] Instead, her knowledge-and-intent allegation rests on the premise that the Compensation Committee's waiver of the OIBA Target violated such "clear and unambiguous" provisions of the Plan that this Court can reasonably infer that Expedia's directors must have known they were violating the Plan. However, even if this Court were to assume that the waiver violated the Plan, there is no basis to find that the violation was clear and unambiguous. As discussed above, interpreting the Plan requires (at least) a review of multiple Plan terms, the terms of the RSU Award itself, and Section 162(m) of the Internal Revenue Code. Unlike the cases cited by Friedman (OB 15), there is no provision in the Plan here that was so clear that it *must* have put the Compensation Committee on notice that it was violating the Plan. *See* OB Ex. 1 at 29 & n.80 (rejecting Friedman's reliance on *Sanders* v. *Wang*, 1999 WL 1044880, at *1, *4-5 (Del. Ch. Nov. 8, 1999) and *Cal. Pub. Emps.' Ret. Sys.* v. *Coulter*, 2002 WL 31888343, at *11 (Del. Ch. Dec. 18, 2002) for this reason).

[8] While Friedman alleges the Compensation Committee was informed about the terms of the Plan and the RSU Award (A016 (Compl. ¶ 48)), and does not contest that the Compensation Committee was advised by counsel (A238; *see also* A126-A127), she makes no allegation as to whether the Compensation Committee sought advice from counsel as to its decision to waive the OIBA Target, the advice it received, or whether it acted consistently with that advice.

Further undermining Friedman's inference that the Compensation Committee must have known it was violating the Plan is the conclusion of the trial court that the Compensation Committee was *authorized* to waive the OIBA Target under the terms of the Plan. Whether or not the trial court's legal conclusion is correct, given that legal conclusion, it is preposterous to contend that the Plan so *clearly and unambiguously* prohibited the waiver that the Compensation Committee must have known that the waiver was improper.

2. Friedman's arguments on appeal lack merit.

On appeal, Friedman concedes that, to excuse demand, she must allege with particularity that the Board "intentionally granted an award in violation of an express, unambiguous" term of the Plan. OB 15. She maintains that Section 11(b) of the Plan was such a term because the OIBA Target was a non-waivable "performance goal" and, even if it was not, the waiver also violated Section 11(b) because it was a "condition" of the RSU Award. OB 17, 27, 30-31. Her arguments rest on interpretations of the Plan that ignore (1) the terms of the RSU Award, (2) her own concession that the Compensation Committee was authorized to establish goals for the RSU Award that were distinct from tax-motivated performance goals, and (3) that the Plan itself authorized the Committee to resolve any ambiguities with respect to the interpretation of the Award.

a. The OIBA Target was not unambiguously a non-waivable performance goal.

Friedman acknowledges that "[t]he dispute is whether the OIBA Goal constituted a 'performance goal' pursuant to Section 162(m)'s requirements." OB 17. She then argues that the Committee (and the trial court) was required to consider it a performance goal because the OIBA Target was a "pre established, objective performance goal[]" of the type that would meet the requirements for deductibility under Section 162(m). OB 18. She goes on to characterize the RSU Award as providing that "Khosrowshahi would be paid the 400,000 shares only if *both* the EBITA/Stock Price Goal *and* the OIBA Goal were achieved." OB 19. But this characterization ignores the fact that, as discussed, the RSU Award separately defined the "Performance Goals" and the "OIBA Target."

She also maintains that an interpretation of the OIBA Target as a separate, waivable goal would be inconsistent with the requirement of Section 162(m), as expressed in the underlying rules under that Section, of an "objective formula." OB 18-19, 20, 22-24. But the EBITA/Stock Price goals were "objective" and nothing in the Plan, the statute or the regulations prohibits a compensation committee from establishing additional business goals that could be waived once the Section 162(m) performance goals were met. As noted, plaintiff conceded as much at oral argument. B127-B128 (31:21-32:8). Moreover, such a requirement would be inconsistent with the regulations under Section 162(m) that expressly

allow a compensation committee to retain negative "discretion [to] reduce[] or eliminate[] the compensation or other economic benefit that was due upon attainment of the [performance] goal" without sacrificing tax deductibility under Section 162(m). 26 C.F.R. 1.162-27(e)(iii).[9]

Friedman confuses the issue when she asserts that the trial court improperly focused on the "intent" of the Committee rather than what it "did." OB 20. To the contrary, the court below rested its analysis on the RSU Award itself, which by its terms distinguished between the OIBA Target and the "performance goals." OB Ex. 1 at 8-10 (citing A202 and B020). Its references to "intent" were entailed by the *Aronson* test, which focuses on whether directors knowingly and intentionally acted wrongfully. Friedman then asserts that the trial court was obliged by

---

[9] It is common practice among public companies to establish an "umbrella plan" or a "plan within a plan." That is, a company's compensation committee will often set a separate business goal — here, the OIBA Target — to govern the compensation to be awarded once the Section 162(m) Performance Goal — here, the goal based on stock price or EBITA — is met. Pamela Baker, A.L.I., *Current Issues Under Internal Revenue Code Section162(m)* (June 12, 2013), VCU0612 ALI-ABA 79; Executive Compensation for Emerging Growth Companies § 2.82 (3d ed.) (observing that "some employers have adopted what are referred to as a 'plan within a plan' or an 'umbrella plan'"); *see also Committee on Employee Benefits, Joint Committee on Employee Benefits, Internal Revenue Service*, at the ABA May Meeting 2013 (May 10, 2013), Question 17 (stating that a company may "impose additional predetermined conditions on the receipt of qualified performance-based compensation where the additional conditions are not preestablished objective performance goals that have been approved by shareholders").

pleading rules to accept her characterization of the RSU (and other documents referenced in the complaint), but her argument ignores the principle that a court is not obliged on a motion to dismiss to accept a plaintiff's characterization of documents integral to the complaint. *Malpiede* v. *Townson*, 780 A.2d 1075, 1083 (Del. 2001) (a court is not required to accept "every strained interpretation of the allegations proposed by the plaintiff" and "a claim may be dismissed if allegations in the complaint or in the exhibits incorporated into the complaint effectively negate the claim as a matter of law"); *TransDigm Inc.* v. *Alcoa Global Fasteners, Inc.*, 2013 WL 2326881, at *4 (Del. Ch. May 29, 2013) (holding a complaint was subject to dismissal where "despite allegations to the contrary . . . the unambiguous language of documents upon which the claims are based contradict[s] the complaint's allegations.").

Friedman also takes the trial court to task for pointing out that its interpretation of the RSU Award was consistent with the 2013 Proxy Statement because that "document was filed after the alleged Plan violation had occurred." OB 22. But it was Friedman who relied on that document in support of her "cover-up" theory in her opposition to defendants' motion to dismiss (and it was Friedman who invoked Expedia's 2010 Proxy Statement to support her interpretation of the RSU Award). *See* A017-A019; A248; B040. Friedman thus improperly argues that a court could consider such statements only when they support her

interpretation of the RSU Award but not otherwise. In any event, Expedia's 2007 Proxy Statement, indisputably pre-waiver, is likewise consistent with defendants' interpretation of the Plan (B069), as is the language of the RSU Award itself.

Friedman also faults the trial court for viewing her argument as, at most, raising an ambiguity that the Plan permitted the Committee to resolve. She asserts the "administrative authority to 'interpret' the terms of an award is irrelevant" and that "the real issue is whether waiver of the OIBA Goal would negate the tax-deductibility of the RSU Award under Section 162(m)." OB 24. But, as Friedman elsewhere concedes, the "real issue" is whether the "Board intentionally violated a clear and unambiguous provision(s) of Expedia's stockholder-approved Plan . . . ." OB 14. Even if the RSU Award was "ambiguous" with respect to the waivability of the OIBA Target, Friedman could not show such an intentional violation and therefore could not plead demand futility — as the trial court held. OB Ex. 1 at 30. Friedman's premise, moreover, is entirely conclusory — there is no allegation that Expedia did not claim a tax deduction for the RSU Award or that the IRS ever denied or challenged any such deduction. *Id*. at 12; *Brehm*, 746 A.2d at 254 ("[C]onclusory statements or mere notice pleading" will not suffice: plaintiff must provide "particularized factual statements that are essential to the claim.").

Friedman tries to bolster her claim by pointing to the 2013 Plan amendments permitting the Committee to waive performance goals and forego the Section

162(m) deduction. *Id.* at 30-31. But these amendments do not logically imply that the OIBA Target was a Section 162(m) performance goal. *In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 660 (Del. Ch. 2013) (Strine, C.) (holding that a court is "only required to accept those reasonable inferences that flow 'logically' from the non-conclusory facts pled in the Complaint, and [it is] not required to accept 'every strained interpretation of the allegations proposed by the plaintiff'") (quoting *Malpiede*, 780 A.2d at 1083). And while Friedman claims that the 2013 Proxy was intended to "conceal" the violation, the 2013 Proxy very clearly explained that the Compensation Committee accelerated the vesting of Mr. Khosrowshahi's RSUs notwithstanding the fact that the OIBA Target "had not at that time been achieved" (A129) and disclosed the full text of Expedia's amended Plan to shareholders (A156-A171), who also had ready access to the Plan as adopted in 2005 (A054-A073).

b. *Friedman's "condition" and "material term" arguments do not show a violation of the Plan, much less a knowing and intentional violation of a clear and unambiguous provision.*

Friedman argues that even if the OIBA Target was not a "performance goal" it was nevertheless a "condition" of the RSU Award that could not be waived under Section 11(b) of the Plan and a "material term" that could not be waived under the regulations promulgated pursuant to Section 162(m). OB 28-31. Friedman faults "as circular" the trial court's reasoning that these limits did not

apply because the OIBA Target had been waived when the Award was paid. *Id.* To the contrary, this holding was entirely logical, and it is Friedman whose arguments are illogical because they assume that "material term" or "condition" must be read to mean any additional business goal included in an award intended to be deductible under Section 162(m).

Nothing in Section 11(b) or Section 162(m) alters the general discretion that the Compensation Committee had under the Plan to amend or waive any condition, unless such an amendment would result in the Award not qualifying for the Section 162(m) deduction. The Compensation Committee exercised this authority and waived the OIBA Target; thus, there was no OIBA Target condition or term to be met at the time Mr. Khosrowshahi's RSUs vested.

This interpretation is consistent with the regulations under Section 162(m), which permit a company to specify business goals in addition to the threshold performance goals for deductibility, and companies commonly do specify such goals.[10] It would be illogical (and inconsistent with Friedman's concession, *see supra* page 16) to read Section 11(b) of the Plan or Section 162(m) of the Code as precluding waiver of such additional goals because they happen to be included in a Qualified Performance-Based Award, and it would unduly constrain compensation

[10] *See supra* page 22 note 9.

committees' broad flexibility to regulate executive compensation as warranted by evolving business circumstances and their business judgment. *Cf. Freedman* v. *Adams*, 58 A.3d 414, 417 (Del. 2013) (finding that "retain[ing] flexibility in compensation decisions is a classic exercise of business judgment").

Moreover, even if this Court were to disagree, a contrary finding would not suggest that the Compensation Committee had violated a "clear and unambiguous" provision of the Plan. The meaning of "condition" in the context of Section 11(b) of the Plan and "material term" in the context of 26 C.F.R. § 1.162-27 are far from "clear and unambiguous," and Friedman's claim that the Delaware Court of Chancery also misconstrued the provisions only proves the point.

The cases Friedman cites in support of these arguments are distinguishable. OB 30-31. First, *Lynch* v. *Rawls* is an options backdating case in which plaintiffs alleged a clear provision in a compensation plan that prohibited backdating, and included statistical analysis in their complaint to show that backdating occurred. 429 F. App'x 641, 642-44 (9th Cir. 2011). In that case, unlike here, there was no dispute that the plan was clear — only whether backdating had actually occurred. Second, *Udoff* v. *Ziff* actually supports defendants' position. 44 N.Y.2d 117 (1978). There, the court held that, contrary to plaintiff's allegations, the Board's decision to reduce the option price of certain options previously granted to employees complied with the "express provision" of the stock option plan

approved by shareholders authorizing such reduction and affirmed dismissal of one of plaintiff's claims on this basis. *Id.* at 394. While the court did allow a second claim that the reduction, while legally authorized, breached directors' fiduciary duties, there is no similar claim by Friedman that, even if authorized by the Plan, the Compensation Committee's decision to waive the OIBA Target nonetheless breached their fiduciary duties. *Id.* at 394-95. Third, *Green* v. *Weiner*, 766 A.2d 492 (Del. 2001), a medical malpractice case, has no bearing here. It merely stands for the unremarkable proposition that a court should not grant a motion for summary judgment where there are questions of fact requiring a jury determination — there, whether a doctor had committed malpractice; a question that did not turn on interpretation of documents integral to a complaint.

As the trial court correctly noted (OB Ex. 1 at 30 n.81), the Expedia case more closely resembles decisions from the District of Delaware that dismiss compensation-related claims when a plaintiff's allegations do not support an inference that a company's directors had "made a knowing and intentional decision to violate the terms" of a compensation plan." *See Abrams*, 2012 WL 3614638, at *3; *Redstone*, 2013 WL 3753426, at *9; *Mulva*, 2014 WL 975308, at *4. Friedman does not address these cases.

3. Even if the three-member Compensation Committee knowingly and intentionally violated the Plan, a majority of the full Expedia Board remains capable of considering a demand, and thus demand is not excused.

The decision to waive the OIBA Target in 2012 was made *not* by the full Expedia *Board*, but by the three-member *Compensation Committee* of the Board. A015-A016 (correctly alleging that "the Committee approved" the vesting of the RSUs). By the time Friedman filed her complaint, one of the Compensation Committee members at the time of the waiver had resigned from the Board and had been replaced by a new director who is not a defendant in this action. Thus, even if the waiver violated the Plan, only the two directors on the Compensation Committee who authorized the waiver (plus Mr. Khosrowshahi himself) out of ten Expedia directors total would even arguably be unable to consider a demand regarding the waiver. Given that Friedman has dropped her challenge to the disinterestedness and independence of the Board, there can be no "reasonable doubt regarding the ability of a majority of the Board to exercise properly its business judgment in a decision on a demand had one been made." *Rales* v. *Blasband*, 634 A.2d 927, 937 (Del. 1993). *See Conrad* v. *Blank*, 940 A.2d 28, 36-37 (Del. Ch. 2007) (applying *Rales* to assess demand futility where challenged transactions were approved by compensation committee rather than the full board); *Desimone* v. *Barrows*, 924 A.2d 908, 913-14 (Del. Ch. 2007) (applying *Rales* holding that option backdating-related decisions by compensation committee

consisting of two of six members of the board could not be imputed to the other four members for purposes of establishing demand futility).

CONCLUSION

Friedman's arguments are premised on a legal interpretation of the Plan that would require significant effort by most lawyers (and judges) to reach. It is a legal interpretation that Friedman needed 17 pages in her appellate brief to address (OB 14-31) and to which the trial court devoted nine pages of its opinion (OB Ex. 1 at 13-22). While defendants believe that they have shown that their interpretation of the Plan and the RSU Award is the reasonable interpretation — and the trial court agreed — more fundamentally, Friedman cannot plausibly argue that her interpretation is so "clear and unambiguous" that this Court can infer that the Committee *intentionally* violated the Plan, as required to excuse demand. And even if Friedman could establish an *intentional* violation of an unambiguous provision by the Compensation Committee that benefited Mr. Khosrowshahi, there would still be at least seven of Expedia's ten directors capable of considering a demand.

For all the foregoing reasons, Friedman has not sufficiently pled that demand is futile, and this Court should affirm the trial court's decision dismissing her action with prejudice.

RICHARDS, LAYTON & FINGER, PA

OF COUNSEL:

WACHTELL, LIPTON,
ROSEN & KATZ
Warren R. Stern
C. Lee Wilson
51 West 52nd Street
New York, New York 10019
(212) 403-1000

/s/ Gregory P. Williams
Gregory P. Williams (#2168)
Lisa A. Schmidt (#3019)
Susan M. Hannigan (#5342)
One Rodney Square
920 North King Street
Wilmington, Delaware 19801
(302) 651-7700

Attorneys for Defendants-Appellees Dara Khosrowshahi, Barry Diller, Victor A. Kaufman, A. George Battle, Jonathan L. Dolgen, Craig A. Jacobson, Peter M. Kern, John C. Malone, José A. Tazón and William R. Fitzgerald and Nominal Defendant-Appellee Expedia, Inc.

Dated: November 3, 2014