

2015

**James Robert Rawcliffe, Plaintiff and Appellant, v. Robert
Anciaux. Et Al., Defendants and Appelles**

Utah Court of Appeals

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No. 20150852-CA

**IN THE
UTAH COURT OF APPEALS**

JAMES ROBERT RAWCLIFFE,

Plaintiff and Appellant,

v.

ROBERT ANCIAUX, *et al.*,

Defendants and Appellees.

OPENING BRIEF OF APPELLANT

**On appeal from the Third Judicial District Court, Honorable
Heather Brereton, District Court No. 140905252**

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LIST OF PARTIES

Plaintiff-Appellant	James Robert Rawcliffe
Defendants-Appellees	Robert Anciaux a/k/a Robert Auciaux Jerry G. McClain Ronald S. Poelman James H. Bramble Jim Brown Gilbert Fuller Kevin G. Guest Daniel A. Macuga David A. Wentz Deborah Woo
Nominal Defendant-Appellee	USANA Health Sciences, Inc.

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JURISDICTIONAL STATEMENT

This is an appeal from the Amended Memorandum Decision and Final Judgment of Dismissal and the Final Judgment of the district court dismissing a stockholder derivative complaint for failure to state a claim upon which relief could be granted. This Court has jurisdiction in this matter pursuant to Sections 78A-3-102(3)(j) and 78A-4-103(2)(j) of the Utah Code.

STATEMENT OF ISSUES

Issue: Did the district court err in granting the motion to dismiss of defendants-appellees Directors and Officers (as defined herein) for failure to state a claim under Rule 12(b)(6) of the Utah Rules of Civil Procedure where the complaint alleged that the Directors and Officers of a Utah corporation engaged in self-interested misconduct, breached their fiduciary duties and committed other violations of law by manipulating the price of equity awards for their own personal benefit at the expense of the corporation and its stockholders?

Standard of Review: The propriety of a district court's dismissal under Utah Rule of Civil Procedure 12(b)(6) for failure to state a claim is a question of law, and therefore is entitled to "no deference" and is "review[ed] under a correctness standard." *Helf v. Chevron U.S.A., Inc.*, 2009 UT 11, ¶ 14, 203 P.3d 962 (citations and internal quotations omitted); *Osguthorpe v. Wolf Mtn. Resorts, L.C.*, 2010 UT 29, ¶ 10, 232 P.3d 999.

Preservation: This issue was preserved in plaintiff-appellant James Robert Rawcliffe's Opposition to Defendants' Motion to Dismiss the Complaint

(R. 435-69), his Notice of Supplemental Authority (R. 509-62), and at the January 23, 2015 hearing on the Directors and Officers' motion to dismiss (R. 755-824).

DETERMINATIVE PROVISIONS

Not applicable.

STATEMENT OF THE CASE

I. NATURE OF THE CASE

This is a stockholder derivative action brought by plaintiff-appellant James Robert Rawcliffe ("Rawcliffe") on behalf of nominal defendant-appellee USANA Health Sciences, Inc. ("USANA" or the "Company"). Rawcliffe alleges that the members of the Compensation Committee (the "Compensation Committee") of USANA's Board of Directors (the "Board") breached their fiduciary duty of loyalty owed to USANA and wasted corporate assets by deliberately granting themselves and other directors and officers of the Company equity awards that were "spring-loaded," *i.e.*, granted just prior to the release of material information that was reasonably expected to drive the market price of the Company's stock higher, thereby artificially increasing the value of the equity awards by establishing an artificially low exercise price. Rawcliffe also alleges that the Directors' and Officers' receipt of such spring-loaded equity awards constituted a further breach of fiduciary duty and unjust enrichment of the recipients.

II. COURSE OF PROCEEDINGS

Rawcliffe filed his Verified Stockholder Derivative Complaint (the “Complaint”) on August 4, 2014. (R. 1-70). Defendants-appellees Robert Anciaux a/k/a Robert Auciaux (“Anciaux”), Jerry G. McClain (“McClain”), Ronald S. Poelman (“Poelman”), James H. Bramble, Jim Brown, Gilbert Fuller (“Fuller”), Kevin G. Guest, Daniel A. Macuga, David A. Wentz (“D. Wentz”), and Deborah Woo (collectively, the “Directors and Officers”) moved to dismiss the Complaint on October 2, 2014. (R. 230-427). Rawcliffe filed his opposition brief on November 13, 2014, (R. 435-69), and the Directors and Officers filed their reply brief on December 11, 2014, (R. 470-86). On January 9, 2015, Rawcliffe filed a notice of supplemental authority attaching a case involving similar facts that had recently been decided in the Delaware Court of Chancery in which the court denied the defendants’ motion to dismiss. (R. 509-62). On January 23, 2015, the district court held a hearing on the Directors and Officers’ motion to dismiss. (R. 755-824).

III. DISPOSITION AT DISTRICT COURT

On March 18, 2015, the district court entered a Memorandum Decision and Order Granting Defendants’ Motion to Dismiss (the “Original Memorandum”). (R. 567-79). On April 3, 2015, the district court entered an Amended Memorandum and Decision and Final Judgment of Dismissal (the “Amended Memorandum”), which superseded the Original Memorandum. (R. 604-20).¹

¹ A copy of the Amended Memorandum is attached at Addendum A.

On September 22, 2015, the district court² entered an appealable Final Judgment.³ Rawcliffe timely filed a Notice of Appeal on October 6, 2015. (R. 721-25).

The district court concluded that the Complaint failed to state a claim upon which relief could be granted under Utah Rule of Civil Procedure 12(b)(6) on the grounds that the spring-loading of equity awards does not constitute breach of fiduciary duty, waste, or unjust enrichment under Utah law. In so doing, the court held, *inter alia*, that the conduct complained of did not violate the Company's equity incentive award plan and was protected by the business judgment rule.

² The Amended Memorandum was entered by the Honorable Keith A. Kelly. The case was subsequently reassigned and the Final Judgment was entered by the Honorable Heather Brereton. (R. 716-720).

³ Rawcliffe filed his original Notice of Appeal on April 10, 2015 (Case No. 20150365). (R. 621-26). On July 1, 2015, the Supreme Court entered an Order electing to retain the appeal on its docket. A copy of the Order is attached at Addendum B. On July 22, 2015, the Supreme Court issued an order notifying the parties that it was considering sua sponte dismissal of the appeal on the grounds that it lacked appellate jurisdiction under *CUWCD v. King*, 2013 UT 13, 297 P.3d 619, because the Amended Memorandum entered by the district court did not state that no further order was necessary and therefore was not a final, appealable order under Rule 7(f)(2) of the Utah Rules of Civil Procedure. (See R. 704). On August 5, 2015, Rawcliffe requested that the Supreme Court dismiss the appeal without prejudice so that he could obtain a final, appealable order from the district court. A copy of Appellant's Memorandum Addressing Supreme Court's Jurisdiction is attached at Addendum C. The Supreme Court granted Rawcliffe's request on September 2, 2015. (R. 702-04). On September 22, 2015, Rawcliffe, on behalf of all parties to the action, submitted a Joint Request for Entry of Final Judgment and a proposed Final Judgment to the district court, which was entered the same day. (R. 705-20).

STATEMENT OF FACTS

I. BACKGROUND

USANA is a Utah corporation that, according to its public filings, develops and manufactures “high-quality, science-based nutritional and personal care products.” (R. 4). In 2006, USANA’s Board adopted, and its stockholders approved, the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (the “Plan”). (R. 10, 31-56). The stated purpose of the Plan was, among other things, to align the interests of the directors and officers of the Company with its stockholders “by reinforcing the relationship between participants’ rewards and shareholder gains.” (R. 10, 31). The Compensation Committee, consisting of Anciaux, McClain and Poelman, administers the Plan. (R. 10-11). Under the terms of the Plan, the Compensation Committee is authorized to grant directors, officers, or employees of the Company various types of equity awards, including stock-settled stock appreciation rights (“SSARs”), which are rights to receive a bonus equal to the difference between the exercise price of the right and the trading price of USANA’s stock on the date the right is exercised. (R. 11, 31-56). The Plan requires that the exercise price of SSARs “shall not be less than 100% of Fair Market Value on the date of grant,” which the Plan defines as the then-current trading price of USANA common stock. (R. 11, 40).

II. THE GRANTING OF THE SPRING-LOADED SSARS

After the market closed on February 4, 2014, USANA issued a press release reporting net sales for the fourth quarter of \$186.3 million, an increase of 10.5%

over the same period in 2012, and net sales for the year of \$718.2 million, a 10.7% increase over 2012. (R. 12). USANA’s net sales and earnings per share figures for fiscal year 2013 significantly exceeded analysts’ estimates, as did the Company’s guidance for fiscal year 2014. (*Id.*). Indeed, USANA’s Chief Executive Officer, defendant-appellee D. Wentz, touted fiscal year 2013 as “an exceptional year.” (R. 13).

On February 6, 2014, each of the Directors and Officers identified in the chart below filed with the Securities and Exchange Commission (“SEC”) a Form 4 disclosing that on February 3, 2014—just ***one day before*** the Company’s 2013 results and 2014 guidance were publicly announced—the Compensation Committee members had granted each of the Directors and Officers, ***including the Compensation Committee members themselves***, SSARs with an exercise price of \$57.62 per share, which was the closing price of USANA’s stock on February 3rd:

Name	Title	Number of SSARs Awarded
Robert Anciaux	Director and Compensation Committee member	12,000
James H. Bramble	Chief Legal Officer and Secretary	37,000
Jim Brown	Chief Production Officer	32,500
Gilbert Fuller	Director	12,000
Kevin G. Guest	President of North America	58,500
Daniel A. Macuga	Chief Communications Officer	34,500
Jerry G. McClain	Director and Compensation	12,000

	Committee member	
Ronald S. Poelman	Director and Compensation Committee Chair	12,000
David A. Wentz	Chief Executive Officer	40,983
Deborah Woo	President of Asia Pacific	58,000
Total		309,483

(R. 13-14).

At the time Compensation Committee granted over 300,000 SSARs—presently worth approximately \$19.5 million⁴—to themselves and other insiders, the Compensation Committee was aware of the Company’s successful financial results, knew the Company would release the results the next day, and expected that the Company’s stock price would increase substantially upon the release of the results. (R. 14). Indeed, upon the release of these results, the trading price of shares of USANA’s common stock jumped to \$68.46 per share on February 5th, an 18.8% increase over the trading price when the SSARs were granted on February 3rd. (*Id.*). Thus, the Compensation Committee members deliberately granted the SSARs to themselves and the other Directors and Officers immediately before the earnings release in order use this inside information to take advantage of the market price of USANA’s stock on February 3rd before the earnings news caused the market price to rise. (*Id.*). The Compensation Committee members’ deliberate granting of the SSARs prior to the earnings release ensured that the SSARs carried an artificially low exercise price, which

⁴ Based on USANA’s trading price of \$120.62 on March 21, 2016. *Yahoo! Finance* <http://finance.yahoo.com/q/hp?s=USNA&a=02&b=21&c=2016&d=02&e=21&f=2016&g=d>.

made the SSARs more valuable to the Directors and Officers by reducing the price USANA stock would have to exceed for the SSARs to be “in the money.”

This practice, the granting of equity awards just prior to the release of material information that is reasonably expected to drive the market price of a company’s stock higher, thereby artificially increasing the value of the equity awards by establishing an artificially low exercise price, is known as “spring-loading.” It is well-established under Delaware law that spring-loading is improper and constitutes a breach of fiduciary duty by the grantors and recipients of such equity awards. The Delaware Court of Chancery has succinctly described the misconduct of spring-loading: “[w]hen you engage in behavior that, based on the allegation of the complaint, appears self-interested such that you give yourself assets for less than their fair value, that’s classic breach of the duty of loyalty stuff.” *In re CytRx Corp. S’holder Derivative Litig.*, C.A. No. 9864-VCL, Oral Argument, Defendants’ Motions to Stay or Dismiss and the Court’s Rulings (TRANSCRIPT) at 41:13-18 (Del. Ch. Jan. 8, 2015).⁵ To be sure, spring-loading is “eyebrow-raising self-interested conduct.” *Id.* at 38:13.

III. THE DIRECTORS AND OFFICERS’ HISTORY OF SIMILAR MISCONDUCT

The members of the Compensation Committee, as well as USANA’s Chairman of the Board and controlling stockholder Myron Wentz (“M. Wentz”), have a history of engaging in improper activities relating to USANA equity

⁵ A copy of the *CytRx* transcript, which contains the court’s oral opinion, is attached at Addendum D.

awards to benefit themselves and other USANA directors and officers. (R. 15). Indeed, a review of past equity awards granted by the Compensation Committee demonstrates that the Compensation Committee has been manipulating the granting of equity awards since 2006—as long as the Plan has been in existence. (*Id.*).

USANA typically announces its quarterly and year-end earnings on a Tuesday after the close of the stock market. (R. 15). In 2008, 2010, and 2014, the Compensation Committee awarded SSARs to various directors and officers immediately **before** the release of quarterly earnings, and each time, the trading price of the Company's stock **increased** following the earnings release:

Date of SSAR Grant	Exercise Price	Total SSARs Granted	Date of Earnings Release	Stock Price After Earnings Release ⁶	Percent Increase
July 21, 2008	\$26.06	1,370,000	July 22, 2008	\$28.14	8.0%
April 27, 2010	\$35.47	412,500	April 27, 2010	\$38.17	7.6%
February 3, 2014	\$57.62	309,483	February 4, 2014	\$68.46	18.8%

(R. 15-16).

In contrast, in 2006, 2007, and 2011, the Compensation Committee chose to wait to award SSARs or stock options until immediately **after** the release of quarterly earnings, and each time, the trading price of the Company's stock **decreased** following the earnings release:

⁶ Closing price the day after earnings were announced, *i.e.*, July 23, 2008, April 28, 2010, and February 5, 2014, respectively. (R. 16).

Date (Type) of Equity Grant	Exercise Price	Total Equity Awards Granted	Date of Earnings Release	Stock Price Prior to Earnings Release ⁷	Percent Decrease
April 26, 2006 (stock options and SSARs)	\$37.60	2,956 options 164,956 SSARs	April 18, 2006	\$41.79	10.0%
April 19, 2007 (stock options)	\$40.59	4,587 options	April 17, 2007	\$42.82	5.2%
July 27, 2011 (SSARs)	\$28.16	78,000 SSARs	July 26, 2011	\$31.76	11.3%

(R. 16).

The timing of these equity awards is hardly a coincidence. (R. 16). Rather, each time the Compensation Committee granted equity awards, its members manipulated the timing to ensure that the equity awards had the lowest possible exercise price, and thus the highest possible value to the recipients. (*Id.*). In 2008 and 2010, as in 2014, the Compensation Committee granted SSARs that were spring-loaded, while in 2006, 2007, and 2011, the Compensation Committee purposely delayed the grant of equity awards until after negative news was released, which caused the stock price, and thus the exercise price of the equity awards, to go down, a practice referred to as “bullet-dodging.” (R. 16-17).⁸

⁷ Closing price the day earnings were announced, *i.e.*, April 18, 2006, April 17, 2007, and July 26, 2011, respectively. (*Id.*).

⁸ Bullet-dodging is the corollary to spring-loading and likewise constitutes a breach of fiduciary duty. *See, e.g., In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 576 n.16, 593 (Del. Ch. 2007). Bullet-dodging provides the recipients of the equity awards with a lower exercise price than they would have received if the grant of the equity awards had not been delayed. As a result, the

In addition, between December 10, 2012 and December 12, 2012, McClain, Poelman and M. Wentz collectively sold over \$20.3 million worth of Company stock. (R. 17). Shortly after their selling spree, USANA announced a “reorganization of its management team,” including the resignation of several executive officers, which sent the Company’s shares tumbling. (R. 17-18). The timing and amount of these stock sales strongly indicate that McClain, Poelman, and M. Wentz sold their USANA stock on the basis of and because of their knowledge of material nonpublic information concerning the impending departures of the Company’s executive officers. (R. 18). Notably, for Poelman and McClain, the amounts sold constituted their entire holdings in USANA common stock at the time. (*Id.*).

Hence, the February 2014 spring-loading of which Rawcliffe complains in this action is not an isolated incident. Rather, it is part of a consistent pattern of misconduct in connection with equity awards granted by the Compensation Committee and of corporate insiders taking advantage of inside information for their own personal benefit.⁹

recipients of bullet-dodged equity awards are able to reap a gain when the stock price recovers from the negative news that precipitated the drop.

⁹ Utah law requires that a stockholder seeking to enforce derivative claims on behalf of a corporation must have been a stockholder of the corporation at the time of the wrongdoing complained of. *See* Utah Code § 16-10a-740(2)(a). Here, Rawcliffe has been a stockholder of USANA since October 23, 2013, and therefore could not bring claims on behalf of the Company for the spring-loading, bullet-dodging and insider sales that took place prior to such date.

IV. RAWCLIFFE MADE A PROPER PRE-SUIT DEMAND, WHICH WAS WRONGFULLY REFUSED

Utah Code § 16-10a-740(3) requires that before filing a derivative action to challenge misconduct by officers and directors of a Utah corporation, a stockholder must first make a written demand on the board of directors to take action to address the wrongdoing. The purpose of this statutory scheme is to allow the board of directors the first opportunity to take appropriate action, including conducting a good faith investigation of the alleged wrongdoing. Thus, in accordance with Utah law, on March 18, 2014, Rawcliffe made a demand (the “Demand”) on the Board to commence an action against the Directors and Officers in connection with the spring-loaded SSARs granted in February 2014. (R. 19, 58-60). Specifically, Rawcliffe demanded that the Board take action to recover damages that USANA has sustained, rescind the grants of the SSARs to the Directors and Officers, and correct the deficiencies in the Company’s internal controls that allowed the misconduct to occur. (*Id.*).

On May 28, 2014, USANA’s counsel sent a letter rejecting the Demand (the “Rejection Letter”). (R. 19-20, 62-66). Such a response was not surprising, as the Board—comprised almost entirely of the same individuals who granted and/or received the improperly granted SSARs¹⁰—did not appoint independent individuals to investigate Rawcliffe’s claims as contemplated by Utah’s statutory

¹⁰ Specifically, the Board consists of defendant-appellees Anciaux, Fuller, McClain and Poelman, all of whom received the spring-loaded SSARs, and Board Chairman M. Wentz, whose son, D. Wentz, also received the spring-loaded SSARs. (R. 4-7, 14).

scheme, nor did it prepare a written report in connection with the purported investigation. (R. 20, 70). Rather, the so-called investigation simply rubber-stamped the Directors' and Officers' misconduct, "conclud[ing] that the February 2014 SSARs grants were in conformity with governing law and consistent with USANA's 2006 Equity Incentive Award Plan [and] the [Compensation] Committee's action was proper and undertaken in good faith." (R. 19-20, 62).

The Rejection Letter provided absolutely no facts regarding what the purported investigation entailed, *e.g.*, the extent to which documents were reviewed or witnesses were interviewed, if at all. (R. 20, 62-66). Instead, the Rejection Letter attempted to provide a legitimate explanation for how the Compensation Committee members, year after year, granted themselves and their fellow Directors and Officers equity awards at consistently low prices. (*Id.*). However, this explanation was simply not credible, as it was based upon numerous factual misrepresentations and clearly demonstrated that the Board failed to perform a good-faith, reasonable investigation as required by Utah law. (R. 21-24).

For example, the Rejection Letter contended that the timing of all grants of equity awards was dictated solely by the schedule of Compensation Committee meetings, which were typically held on Mondays, one day before corresponding Board meetings held on Tuesdays. (R. 21, 64). A review of the Company's SEC filings clearly demonstrates this statement is false. Indeed, while USANA typically announces its earnings on Tuesdays after the close of the stock market,

the Compensation Committee has only granted equity awards on Mondays twice, and on both occasions the trading price of USANA's stock increased following the Tuesday earnings release. (R. 22). In contrast, when disappointing results were released, the Compensation Committee delayed the grant of awards until after such results were made public, *i.e.*, until Wednesday or Thursday, after the news had caused the stock price to decrease. (*Id.*). Thus, the timing of the Compensation Committee's grants of Plan-based awards to themselves and their fellow directors has never been "solely attributable to[] USANA's standard scheduling for board and board committee meetings" as the Rejection Letter contends. (R. 21-22). Rather, the Compensation Committee has varied the timing of equity awards, including the days of the week on which they are granted, yet has consistently granted awards with exercise prices most favorable to the recipients, including themselves. (R. 22).

In addition, the Rejection Letter asserts that the Compensation Committee could not have predicted that the Company's stock price would rise following the February 4, 2014 earnings release because "USANA's share price has historically defied that kind of prediction." (R. 23, 64). The Rejection Letter provides a single example, when the Company's stock dropped from \$40.21 on February 8, 2011 to \$35.00 on February 9, 2011 despite the purported announcement of "positive news" on February 8, 2011. (R. 23, 64-65). In actuality, the news announced on February 8, 2011 was anything but positive, as USANA announced earnings per share and guidance for the year that were substantially lower than

analysts' estimates and stated that the Company's outlook was "cautious" because investments required to integrate a newly acquired business would be higher than originally estimated. (R. 23-24). In sum, the Rejection Letter and the so-called investigation into the Directors' and Officers' own wrongdoing is just another example of the Board members' complete abdication of their fiduciary duties as directors of a Utah corporation.

V. PROCEDURAL HISTORY OF THE ACTION

Rawcliffe filed his Complaint on August 4, 2014. (R. 1-70). The Complaint asserts four counts against the Directors and Officers: Counts I and II assert claims for breach of fiduciary duty and waste of corporate assets, respectively, against the Compensation Committee members for granting the spring-loaded SSARs. (R. 24-25). Counts III and IV assert claims for breach of fiduciary duty and unjust enrichment against the Directors and Officers in connection with their receipt of the spring-loaded SSARs. (R. 25-26).

The Directors and Officers moved to dismiss the Complaint on October 2, 2014. (R. 230-427). Rawcliffe filed his opposition brief on November 13, 2014, (R. 435-69), and the Directors and Officers filed their reply brief on December 11, 2014, (R. 470-86). On January 9, 2015, Rawcliffe filed a notice of supplemental authority attaching the transcript opinion in *CytRx*, in which the Delaware Court of Chancery denied the defendants' motion to dismiss substantially similar claims. (R. 509-62). On January 23, 2015, the district court held a hearing on the Directors' and Officers' motion to dismiss. (R. 755-824).

On March 18, 2015, the district court entered the Original Memorandum granting the Directors' and Officers' motion to dismiss. (R. 567-79). On April 3, 2015, the district court entered the Amended Memorandum, which superseded the Original Memorandum. (R. 604-20). The district court concluded that the Complaint failed to state a claim upon which relief could be granted on the grounds that the spring-loading of equity awards does not constitute breach of fiduciary duty, waste, or unjust enrichment under Utah law. Specifically, the district court held that the Compensation Committee members complied with the strict letter of the Plan, (R. 611-613, 615), and therefore it did not matter that the Compensation Committee members had material inside information that they knew would cause USANA's stock price to increase. The district court also held that because they complied with the strict letter of the Plan, the Compensation Committee's conduct was protected by the business judgment rule. (R. 612-14).

SUMMARY OF THE ARGUMENT

The district court erred in holding that the spring-loading of equity awards does not constitute breach of fiduciary duty, unjust enrichment, or corporate waste. The duty of loyalty is well-established in the State of Utah. *See, e.g., Nicholson v. Evans*, 642 P.2d 727, 730 (Utah 1982) ("Directors and officers have a fiduciary duty of loyalty to their corporation and its stockholders."). And Utah courts have long held that directors who engage in self-dealing are liable to the corporation and its stockholders for breaching their fiduciary duty of loyalty. *Id.* at 732 (holding that directors breached their fiduciary duty of loyalty by usurping

corporate opportunity); *Fausett v. Am. Res. Mgmt. Corp.*, 542 F. Supp. 1234, 1241 (D. Utah 1982) (recognizing that a claim for breach of fiduciary duty exists when a corporate officer engages in insider trading). The question of whether the spring-loading of equity awards is one of the various types of conduct that constitutes a breach of fiduciary duty is an issue of first impression in Utah. But this issue has been litigated in other jurisdictions, including Delaware and at least one federal district court, which have consistently held that spring-loading equity awards constitutes a breach of the fiduciary duty of loyalty. *See, e.g., CytRx*, Tr. at 39:13-40:2 (denying motion to dismiss claim for breach of fiduciary duty by approving spring-loaded stock option grants); *Weiss v. Swanson*, 948 A.2d 433, 448 (Del. Ch. 2008) (same); *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 593 (Del. Ch. 2007) (same); *Ausikaitis v. Kiani*, 962 F. Supp. 2d 661, 679 (D. Del. 2013) (same).

In granting the Directors and Officers' motion to dismiss, the district court first misinterpreted these cases, (R. 613-15), as discussed below, and then chose not to follow them in any event, (R. 615). Rawcliffe respectfully submits that this was error. The courts of Utah often look to the courts of Delaware for guidance on matters of corporate law, particularly where there is "no Utah authority squarely on point." *See, e.g., Zagg, Inc. v. Harmer*, 2015 UT App 52, ¶¶8, 11-13, 345 P.3d 1273 (relying on Delaware law in reversing district court's denial of an injunction to prevent the sale of stock). Here, there is no Utah law squarely on point, and the facts alleged in this action are **identical** to those in *CytRx*, *Weiss*

and *Tyson*, in which the courts held that the plaintiffs adequately stated claims for: (1) breach of fiduciary duty against the directors who awarded the spring-loaded equity awards, *see CytRx*, Tr. at 39:13-40:2; *Weiss*, 948 A.2d. at 448; *Tyson*, 919 A.2d at 593; (2) breach of fiduciary duty against the directors and officers who knowingly received the spring-loaded awards, *see CytRx*, Tr. at 41:11-18; *Weiss*, 948 A.2d at 449; (3) unjust enrichment against the recipients of the awards, *see CytRx*, Tr. at 41:19-42:10; *Weiss*, 948 A.2d. at 449-50; *Tyson*, 919 A.2d at 602-03; and (4) waste of corporate assets against the directors who granted the awards, *see CytRx*, Tr. at 40:3-41:10; *Weiss*, 948 A.2d. at 450. Accordingly, Rawcliffe's Complaint clearly states claims against the Directors and Officers in connection with the spring-loaded SSARs.

The district court erroneously distinguished the instant case from *Tyson* and *Weiss* on the grounds that here, the Plan required the Compensation Committee to use the trading price of USANA's stock on the date the SSARs were granted as the exercise price. (R. 615). In fact, this is precisely what the plans in *Tyson* and *Weiss* required, but the courts in those cases held that the equity award grants, which were made with the benefit of material non-public information that the defendants knew would cause the stock price to increase, "undermine[d] the very objectives" of the plans' requirements that the exercise price be equal to fair market value. *See Tyson*, 919 A.2d at 592-93. Furthermore, this conduct is not protected by the business judgment rule because the Directors and Officers "possessed material non-public information that would affect the

company's share price" and issued the SSARs "with an intent to circumvent otherwise valid stockholder-approved restrictions" on the exercise price of the SSARs, *i.e.*, the fair market value requirement. *Weiss*, 948 A.2d at 442 n.21 (citing *Tyson*, 919 A.2d at 593 & n.75). In sum, the instant case is factually and legally indistinguishable from *Tyson* and *Weiss*. Accordingly, the district court's dismissal of the Complaint should be reversed. To hold otherwise would be to encourage fiduciaries of Utah corporations to manipulate the timing of equity awards to line their own pockets at the expense of the corporations and stockholders they serve.

ARGUMENT

I. THE COMPLAINT STATES A CLAIM AGAINST THE COMPENSATION COMMITTEE MEMBERS FOR BREACH OF THE FIDUCIARY DUTY OF LOYALTY FOR GRANTING THE SPRING-LOADED SSARS

A. Utah Law Prohibits Self-Dealing By Corporate Fiduciaries, and the Spring-Loading of Equity Awards Is a Type of Self-Dealing

The district court erred in holding that spring-loading does not constitute a breach of fiduciary duty in Utah. The duty of loyalty is well-established in the State of Utah. *See, e.g., Nicholson*, 642 P.2d at 730 ("Directors and officers have a fiduciary duty of loyalty to their corporation and its stockholders."); *Elggren v. Woolley*, 64 Utah 183, 192, 228 P. 906 (Utah 1924) ("Directors of a corporation occupy a position of trust and confidence and are considered in the law as standing in a fiduciary relation toward the stockholders"). Utah courts have long held that directors who engage in self-dealing are liable to the corporation and its

stockholders for breaching their fiduciary duty of loyalty. *See, e.g., Nicholson*, 642 P.2d at 732 (holding that directors breached fiduciary duty of loyalty by usurping corporate opportunity); *Elggren*, 64 Utah at 192 (“The directors of a corporation are not permitted to use their position of trust and confidence to further their private interests. . . .” (citations and quotations omitted))).

Indeed, as early as 1924, the Utah Supreme Court recognized that “courts have adopted and are strictly and rigidly enforcing a policy which minimizes the temptation of officers of corporations to prefer their own interests rather than those of the corporation and the stockholders.” *Id.* at 194. The Utah Supreme Court has further recognized that:

As agents intrusted with the management of the corporation for the benefit of the stockholders and creditors, [directors] occupy a fiduciary relation, and are held liable to the corporation as trustees. . . . “Directors and other officers must exercise the utmost good faith in all transactions touching their duties to the corporation and its property. . . . All their acts must be for the benefit of the corporation and not for their own benefit. . . . They are not permitted to profit as individuals by virtue of their position.”

Glen Allen Mining Co. v. Park Galena Mining Co., 77 Utah 362, 384-85, 296 P. 231 (Utah 1931) (quoting 4 Fletcher, Cyc. Corp. § 2272); *see also Nicholson*, 642 P.2d at 730 (“Directors and officers have a fiduciary duty of loyalty to their corporation and its stockholders. . . . They are obligated to use their ingenuity, influence, and energy, and to employ all the resources of the corporation, to preserve and enhance the property and earning power of the corporation, even if the interests of the corporation are in conflict with their own personal

interests.”); *Bingham Consol. Co. v. Groesbeck*, 2004 UT App 434, ¶ 22, 105 P.3d 365 (same).

There are many different ways in which a director or officer can breach his or her fiduciary duties owed to a corporation. *See, e.g., C&Y Corp. v. Gen. Biometrics, Inc.*, 896 P.2d 47, 54 (Utah Ct. App. 1995) (providing several examples of conduct that constitutes a breach of fiduciary duty, including: usurpation of corporate opportunity; using “confidential information to the corporation’s detriment”; and “urg[ing] the corporation to sell an asset to the detriment of the corporation and its stockholders”); *Fausett*, 542 F. Supp. at 1241 (recognizing that a claim for breach of fiduciary duty exists when a corporate officer engages in insider trading).

The instant action is the first Utah case in which corporate directors are alleged to have breached their fiduciary duty of loyalty by spring-loading equity awards. In such circumstances, Utah courts often look to the courts of Delaware for guidance on matters of corporate law, particularly where, as here, there is “no Utah authority squarely on point.” *See, e.g., Zagg, Inc. v. Harmer*, 2015 UT App 52, ¶¶8, 11-13, 345 P.3d 1273 (relying on Delaware law in reversing district court’s denial of an injunction to prevent the sale of stock); *Torian v. Craig*, 2012 UT 63, ¶¶24-26, 289 P.3d 479 (relying on and adopting *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006) regarding the distinction between derivative and direct claims); *Oakridge Energy, Inc. v. Clifton*, 937 P.2d 130, 132-35 (Utah 1997) (relying on *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980) in determining fair value of

stock in appraisal proceeding brought pursuant to Utah statute); *Nicholson*, 642 P.2d at 730 (citing *Guth v. Loft*, 5 A.2d 503 (Del. Ch. 1939) in discussing the fiduciary duty of loyalty owed by corporate directors).

Delaware courts have consistently held that spring-loading allegations identical to those here are sufficient to state a claim for breach of the fiduciary duty of loyalty. See, e.g., *CytRx*, Tr. at 39:13-40:2; *Weiss*, 948 A.2d at 448; *Tyson*, 919 A.2d at 593. As explained by Delaware's then-Chancellor Chandler:

The relevant issue is whether a director acts in bad faith by authorizing options with a market-value strike price, as he is required to do by a shareholder-approved incentive option plan, at a time when he **knows** those shares are actually worth more than the exercise price. A director who intentionally uses inside knowledge not available to shareholders in order to enrich employees while avoiding shareholder-imposed requirements cannot, in my opinion, be said to be acting loyally and in good faith as a fiduciary.

Tyson, 919 A.2d at 592-93 (emphasis in original).¹¹ At least one federal court faced with substantially identical allegations is in agreement. *Ausikaitis*, 962 F.

¹¹ Courts across the country have routinely found that corporate fiduciaries who engage in another form of manipulating the price of equity awards to take advantage of a low stock price referred to as "backdating" have breached their fiduciary duties. See *Ryan v. Gifford*, 918 A.2d 341, 357-58 (Del. Ch. 2007) (finding that plaintiff stated a claim for breach of fiduciary where the complaint alleged that corporate fiduciaries granted and/or received backdated stock options); *Conrad v. Blank*, 940 A.2d 28, 40 (Del. Ch. 2007) (denying motion to dismiss breach of fiduciary duty claim where complaint alleged that corporate fiduciaries granted and/or received backdated stock options); *In re THQ, Inc. Derivative Litig.*, No. BC 357600, 2007 WL 4990689, at *3-4 (Cal. Super. Ct. Oct. 11, 2007) (same); *Edmonds v. Getty*, 524 F. Supp. 2d 1267, 1276-77 (W.D. Wash. 2007) (same); *Belova v. Sharp*, No. CV 07-299-MO, 2008 WL 700961, at *8 (D. Or. Mar. 13, 2008) (holding that plaintiff stated a claim for breach of fiduciary where the complaint alleged that corporate fiduciaries granted and/or

Supp. 2d at 679.¹² Utah should follow these decisions and hold that the spring-loading of equity awards to directors and officers of a Utah corporation constitutes a breach of fiduciary duty.

B. The Instant Action Is Nearly Identical to *Tyson, Weiss, and CytRx*, All of Which Upheld Claims for Breach of Fiduciary Duty Arising from Allegations of Spring-Loading

The allegations in the present action are nearly identical to the successful pleadings in *Tyson, Weiss, and CytRx*. In *Tyson*, the plaintiffs alleged that on four occasions between 1999 and 2003, “[d]ays before Tyson would issue press releases that were very likely to drive stock prices higher, the Compensation Committee would award options to key employees.” *Tyson*, 919 A.2d at 576. For example, the plaintiffs alleged that on September 19, 2003, the Tyson compensation committee granted stock options to a number of executives and directors at \$13.33 per share. *Id.* On September 23, 2003, Tyson announced that its earnings would exceed Wall Street’s expectations, and its stock price increased to \$14.25. *Id.* The court held that this conduct constituted a “deception” because the compensation committee authorized the stock options with a market-value strike price when they knew those shares were actually worth more than the

received backdated stock options); *In re Atmel Corp. Derivative Litig.*, No. 06-4592-JF (HRL), 2008 WL 2561957, at *12 (N.D. Cal. June 25, 2008) (same); *Alaska Elec. Pension Fund v. Olofson*, No. 08-2344-CM, 2009 WL 1580296, at *10 (D. Kan. June 3, 2009) (same).

¹² Allegations of spring-loading of equity awards, which resulted in false and misleading financial statements because of their effect on the company’s reported compensation expense, have also been held to be sufficient to state claims for violations of federal securities laws. *See Hall v. The Children’s Place Retail Stores, Inc.*, 580 F. Supp. 2d 212 (S.D.N.Y. 2008).

market value. *Id.* at 592-93. Accordingly, the court held that the plaintiffs had adequately stated a claim for breach of the fiduciary duty of loyalty and denied the defendants' motion to dismiss. *Id.* at 593.

Similarly, in *Weiss*, the plaintiff alleged that the directors of Linear Technology Corporation ("Linear") granted spring-loaded stock options to various recipients "just prior to the quarterly earnings release" when the directors knew "the quarterly earnings release contained material information expected to drive up the market price of Linear's shares." *Weiss*, 948 A.2d at 439. Following the reasoning set forth in *Tyson*, the court in *Weiss* held that these allegations stated a claim against the defendants for breach of the fiduciary duty of loyalty. *Id.* at 443.

Finally, in *CytRx*, the plaintiffs alleged that the defendant directors attended a board meeting during which they were informed that an important clinical trial relating to the company's primary drug had received positive and "transformational" results, which was the most important news in the company's history. *Id.* at 29:1-15. The very next day, the compensation committee granted to themselves and their fellow directors options to purchase stock with an exercise price of \$2.39 per share, which was the trading price of the company's stock at the time. *Id.* at 29:16-20. The information regarding the clinical trial was not yet public when the options were granted. *Id.* at 29:20-23. The following day, the company issued a press release touting the positive results of the trials,

which over the course of two days sent the stock price up to a two-year high of \$6.12 per share. *Id.* at 30:2-8. The court summarized the allegations as follows:

So just to review, December 9th, you find out about these great transformational results. December 10th, before the results are disclosed and at a time when you know these results are confidential and that the information is not public, you grant yourself and your senior officers approximately 3 million options at a strike price reflecting the price of the stock without any market knowledge of this information. And then the next day, you release the information, and then, indeed, the stock price spikes.

Id. at 30:9-19. The court observed that “[i]t really would be difficult to design a fact pattern that would more graphically capture what spring-loading is all about. It’s almost like a law school hypothetical. . . .” *Id.* at 39:18-21. Accordingly, the court held that the plaintiff stated a claim for breach of fiduciary duty against the granting directors. *Id.* at 40:2.

The allegations in the Complaint in this case are indistinguishable from those in *Tyson*, *Weiss*, and *CytRx*. First, the Complaint alleges that the SSARs were granted pursuant to the Plan, which was approved by USANA’s stockholders and contained express restrictions on the exercise price of equity awards granted thereunder. (R. 10-11); *Tyson*, 919 A.2d at 593; *Weiss*, 948 A.2d at 442. Second, the Complaint alleges that the Compensation Committee members (Anciaux, McClain and Poelman) knew USANA was about to announce quarterly and year-end earnings that would cause the Company’s stock price to increase. Indeed, on the day of the SSAR grants they attended a meeting of the Audit Committee at which they reviewed the Company’s financial statements. (R. 14, 22-23); *Tyson*,

919 A.2d at 593; *Weiss*, 948 A.2d at 442-43; *CytRx*, Tr. at 29:9-15. Third, the Complaint alleges that the Compensation Committee members approved the spring-loaded SSARs with the intent to circumvent the stockholder-approved restriction that the exercise price of the SSARs be equal to the fair market value of USANA stock as of the date of the grant. (R. 14-17); *Tyson*, 919 A.2d at 593; *Weiss*, 948 A.2d at 443; *CytRx*, Tr. at 29:16-30:19. As the Delaware Court of Chancery held in *Tyson*, “[s]uch allegations would satisfy a plaintiff’s requirement to show adequately at the pleading stage that a director acted disloyally and in bad faith.” *Tyson*, 919 A.2d at 593; *see also Weiss*, 948 A.2d at 443 (“These particularized allegations support an inference that the Director Defendants granted spring-loaded . . . options.”); *Ausikaitis*, 962 F. Supp. 2d at 679 (“[P]laintiff has pled particularized facts that give rise to an inference that the directors intentionally violated the Compensation Plans, which would be a breach of the fiduciary duty of loyalty.”).¹³

¹³ The district court did not separately address Rawcliffe’s breach of duty claims against the recipients of the spring-loaded SSARs. Such claims have also been consistently upheld by the Delaware courts. In *Weiss*, the court held:

Weiss has also stated a claim [for breach of fiduciary duty] against the Officer Defendants and Maier for receiving the challenged grants. Here, the complaint alleges that these individuals knew or, absent recklessness, should have known that the grants violated the stockholder-approved option plans. Under the liberal pleading standards of this court, this knowledge may be averred generally. Such allegations, taken as true, support an inference that the Officer Defendants and Maier, ***via their receipt of the options, breached their fiduciary duties.***

Id. at 449 (emphasis added). *See also CytRx*, Tr. at 41:13-18 (“When you engage in behavior that, based on the allegation of the complaint, appears self-interested

C. The Terms of the Plan Do Not Permit Spring-Loading

The district court's dismissal of the Complaint was based in large part on its conclusion that the Compensation Committee complied with the literal terms of the Plan. *See* R. 611 ("All of the February 2014 SSARs grants complied with the terms of the Plan"); R. 612 ("It is undisputed that the Members of the Compensation Committee complied with the terms of the Plan when they issued the February 2014 SSARs"); R. 613 ("The facts alleged in the Complaint confirm that the Compensation Committee followed the Plan when it granted the February 2014 SSARs"); R. 615 ("In it [sic] undisputed that the SSARs were issued at the then-current trading price . . . as expressly permitted in the Plan"); *id.* ("the SSARs were issued consistent with the Plan, at their publicly traded share price"). Specifically, the Plan required that the exercise price of stock appreciation rights "shall not be less than 100% of Fair Market Value on the date of grant," which the Plan defines as the then-current trading price of USANA common stock. (R. 11). The district court held that because the exercise price of the SSARs granted on February 3, 2014 was equal to the trading price of the Company's stock on that date, the Compensation Committee members complied

such that you give yourself assets for less than their fair value, that's classic breach of the duty of loyalty stuff. So Count III [against the recipients of the spring-loaded equity awards] certainly states a claim.") Here, as in *Weiss* and *CytRx*, Rawcliffe alleges that the Directors and Officers knew the SSARs were improperly spring-loaded because they too were aware of the Company's positive financial results that would undoubtedly cause the trading price to rise once public. (R. 15, 25-26). Thus, Rawcliffe states a claim for breach of fiduciary duty against the Directors and Officers as recipients of the SSARs. *Weiss*, 948 A.2d at 449; *CytRx*, Tr. at 41:17-18.

with the Plan and therefore cannot be held accountable for breach of their fiduciary duties despite knowing that USANA's stock price would likely increase significantly the next day once they disclosed the inside information they possessed at the time they made the grants.

The district court's holding misses entirely the problem with spring-loading, which is a way for corporate fiduciaries to circumvent a plan's requirement that equity awards be granted at fair market value by using non-public, inside information to manipulate "fair market value" to benefit themselves. As explained in *CytRx*:

Basically, what the allegation is, is that the directors found a way to give themselves dollars for 25 cents. In other words, ***the stock at the time, because of the transformational news that they knew and the market didn't, had a fair market value far greater than the \$2.39 strike price.*** Indeed, it ultimately went up to 7-ish bucks a share. But because they used the market price where the market did not know about this information, they were able to price the options for approximately 25 percent or a third of that. So they got dollars for 25 cents or 33 cents.

CytRx, Tr. at 40:11-22 (emphasis added). If the market had the same information the Directors and Officers had on the day the SSARs were awarded, the market price would have been significantly higher, as evidenced by the fact that once the market received the positive information, USANA's stock price jumped to \$68.46. (R. 13). Accordingly, the true "fair market value" of USANA stock on the day the SSARs were awarded was "far greater" than the \$57.62 exercise price, which was based on the price of USANA stock as determined by

the market without the benefit of the inside information the Directors and Officers knew. *See CytRx*, Tr. at 40:13-16. Indeed, as the Court held in *CytRx*, once the insiders were in possession of potentially market-moving news, they were obligated to postpone granting any equity awards until after the market absorbed the relevant information and the stock price was reflective of the actual market value. *Id.* at 38:2-11, 38:18-39:3.

In reaching its conclusion, the district court incorrectly distinguished the instant action from *Tyson* and *Weiss* on the grounds that USANA's Plan required equity awards to be granted at the then-current trading price. (R. 615). In fact, in *Tyson* and *Weiss*, each of the companies had stockholder-approved equity incentive plans with provisions requiring the granting of incentive options at the market value—just like USANA. *See Tyson*, 919 A.2d at 575 n.15 (under the terms of Tyson's stock incentive plan, "[t]he exercise price of an incentive stock option may not be less than the fair market value of the Class A Common Stock on the date of the grant"); *Weiss*, 948 A.2d at 439 (under the terms of Linear's stockholder-approved option plan, "the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of the grant" with "'Fair Market Value' [] defined as the closing bid price for Linear's stock . . . on the date the options are granted"). Even though the options at issue in those cases were granted with an exercise price equal to the trading price of the respective company's common stock on the dates of the grants, the courts held

that the grants violated the spirit and intent of the plans' requirement that the exercise price be equal to fair market value. As explained in *Tyson*:

Granting spring-loaded options, without explicit authorization from shareholders, clearly involves an indirect deception. A director's duty of loyalty includes the duty to deal fairly and honestly with the shareholders for whom he is a fiduciary. It is inconsistent with such a duty for a board of directors to ask for shareholder approval of an incentive stock option plan and then later to distribute shares to managers in such a way as to undermine the very objectives approved by shareholders. ***This remains true even if the board complies with the strict letter of a shareholder-approved plan as it relates to strike prices or issue dates.***

Tyson, 919 A.2d at 592-93 (emphasis added). Accordingly, the district court improperly distinguished *Weiss* and *Tyson* on this basis. In the instant action, just like in *Tyson* and *Weiss*, although the Compensation Committee complied with the "strict letter" of the Plan by granting the SSARs at the February 3 trading price, because the Compensation Committee was in possession of material nonpublic information that it knew would cause USANA's stock price to rise, the Compensation Committee "undermine[d] the very objectives" of the Plan. *Id.*

D. The Practice of Spring-Loading Is Not Protected by the Business Judgment Rule

The district court also held that spring-loading is protected by the business judgment rule. (R. 612-14). Delaware courts have expressly rejected this conclusion. Specifically, in *Weiss*, the court stated:

Although the defendants are correct that compensation decisions are typically protected by the business judgment rule, the rule applies to the directors' grant of

options pursuant to a stockholder-approved plan ***only when the terms of the plan at issue are adhered to***. Thus, as the court held in [*Tyson*], allegations in a complaint rebut the business judgment rule where they support an inference that the directors intended to violate the terms of stockholder-approved option plans.

Weiss, 948 A.2d at 441-42 (emphasis added). Specifically, “a claim of spring-loading” successfully “rebut[s] the business judgment rule” if:

(1) the plaintiff establishes that the challenged grants were given pursuant to an options plan, and (2) the plaintiff establishes that directors who approved the grants (a) possessed material non-public information soon to be released that would affect the company’s share price, and (b) issued options with an intent to circumvent otherwise valid stockholder-approved restrictions upon the exercise price of the options.

Id. at 441 n.21 (citing *Tyson*, 919 A.2d at 593 & n.75). In both *Tyson* and *Weiss*, the courts found that facts identical to those alleged here met the above test, and accordingly the defendants’ conduct was not protected by the business judgment rule. *See Weiss*, 948 A.2d at 444; *Tyson*, 919 A.2d at 593 (“Such allegations . . . satisfy a plaintiff’s requirement to show adequately at the pleading stage that a director acted disloyally and in bad faith and is therefore unable to claim the protection of the business judgment rule.”).

The Compensation Committee members’ intent to circumvent the exercise price restrictions is demonstrated by their historical manipulation of the timing of equity award grants, by consistently granting equity awards before the release of information expected to increase the trading price of USANA’s stock, and after the release of information expected to decrease the trading price. (R. 15-16).

Thus, the Compensation Committee's granting of the spring-loaded SSARs is not protected by the business judgment rule.

The district court relied on *DeSimone v. Barrows*, 924 A.2d 908 (Del. Ch. 2007), to support its holding that the Directors and Officers' conduct was protected by the business judgment rule. (R. 613). However, *DeSimone* is distinguishable from the instant case on several grounds. First, in *DeSimone* the Delaware Court of Chancery expressly recognized the existence of a "claim of disloyalty under the theory articulated in *Tyson*, which is that directors breach their fiduciary duties if they approve spring-loaded or bullet-dodging options in a bad faith effort to circumvent stockholder-approved restrictions on the exercise price of options," *id.* at 944, but dismissed the complaint because in *DeSimone* (unlike in *Tyson*, *Weiss*, *CytRx*, *Ausikaitis*, and the present action), "below-market options were ***expressly permitted*** by the Incentive Plan. Therefore, there were no rigid exercise price restrictions to circumvent." *Id.* (emphasis added).¹⁴ The plaintiff in *DeSimone* also failed to allege that any of the directors who approved the awards were aware of the forthcoming positive information, and no such inference could be drawn because the information was released weeks later and the stock price went down before it went up. *Id.* at 945. The court in *DeSimone* further noted that the challenged options were granted by disinterested directors, *id.* at 946, unlike here, where Anciaux, McClain, and

¹⁴ The Delaware Court of Chancery specifically rejected *DeSimone* as "clearly distinguishable" from the facts at issue in *CytRx*, which are identical to the facts in this action. *CytRx*, Tr. at 39:15-17.

Poelman granted the spring-loaded SSARs to **themselves** as well as other recipients, and thus are anything but disinterested. (R. 2, 13-14).¹⁵ Indeed, even if the grants had not been spring-loaded, the Compensation Committee members' grants of SSARs to themselves would not be protected by the business judgment rule because they are not disinterested in their own grants. See *Telxon Corp. v. Meyerson*, 802 A.2d 257, 265 (Del. 2002) ("Like any other interested transaction, directoral self-compensation decisions lie outside the business judgment rule's presumptive protection"); see also, *Calma v. Templeton*, 114 A.3d 563, 578 (Del. Ch. 2015) (holding that a compensation committee's approval of equity awards to themselves and other directors "were conflicted decisions because all three members of the Compensation Committee received some of the RSU Awards" and thus was not protected by the business judgment rule); *Valeant Pharm. Int'l v. Jerney*, 921 A.2d 732, 745 (Del. Ch. 2007) ("Where the self-compensation involves directors or officers paying themselves bonuses, the court is particularly cognizant to the need for careful scrutiny" and therefore "[s]elf-interested compensation decisions made without independent protections" are subject to higher scrutiny under the entire fairness standard as opposed to the deferential business judgment rule).

¹⁵ *In re 3COM Corp. S'holders Litig.*, No. C.A. 16721, 1999 WL 1009210 (Del. Ch. Oct. 25, 1999), on which the district court also relied, (R. 613), did not even involve allegations of spring-loading, bullet-dodging or similar manipulation of the timing of equity grants. Rather, the plaintiffs there simply alleged that the amounts of the equity grants awarded to the defendant directors were excessive. Accordingly, *3COM* is not applicable to the instant case.

E. The Fact that the SSARs Had Not Yet Vested Is Irrelevant

The district court also held that the Complaint failed to state a claim because the SSARs would not vest until January 2016 for the directors and August 2016 to August 2017 for the officers. Specifically, the district court stated that “even in light of allegations that the stock price jumped just after the February 3, 2014 SSARs were issued, this should not form the basis for a breach of fiduciary duty or malfeasance claim when the value of the SSARs will be based on stock values at the dates of potential exercise at least 23 to 42 months later.” (R. 614). This position has also been rejected by Delaware law, which squarely holds that, “if there is a wrong, ***it occurs at the moment the stock option is granted.***” *Ryan v. Gifford*, 935 A.2d 258, 267 (Del. Ch. 2007) (emphasis added).

The defendants in *Weiss* attempted to argue that the long vesting schedule of the spring-loaded options was a basis for dismissal, and the court, relying on a similar holding in *Tyson*, rejected that argument:

the *Tyson* court already rejected the defendants’ argument regarding vesting as a basis for granting the defendants’ motion for judgment on the pleadings. As that court noted, “recipients of options are generally unable to benefit financially from [options] until a vesting period has elapsed, and thus an option’s value to an executive employee is of less immediate value than an equivalent grant of cash.” . . . Nonetheless, the *Tyson* court held that such grants may represent a breach of fiduciary duty. . . .

Weiss, 948 A.2d at 447 (citing *Tyson*, 919 A.2d at 592 n.75). This holding makes sense because the value of an option or SSAR is in the difference between the

exercise price of the instrument and the market price of the stock when the instrument is exercised, and a lower exercise price reduces the amount of price appreciation necessary for the instrument to be “in the money” regardless of the vesting schedule. In this case, as a result of their artificially low exercise price, upon vesting the SSARs could be “in the money” even if USANA’s stock price is **lower** than it was on February 5, 2014, which would completely defeat the purpose of stock **appreciation** rights.

Likewise, the fact that the SSARs have not yet been exercised is of no consequence. As the Delaware Court of Chancery held in *Weiss*, “the defendants retain something of value—the challenged options—at the expense of the corporation. Nothing suggests that the defendants are prevented from exercising their options once they fully vest.” *Id.* at 450 (denying motion to dismiss because “one can imagine a situation where [the defendants] exercise[] the options and benefit[] from the low exercise price.” (quoting *Ryan*, 918 A.2d at 361)). Indeed, the SSARs, even if not vested, have a monetary value. The Directors and Officers have the ability to pledge or sell their SSARs even before they vest, and economists and compensation experts have developed methods for valuing unvested and unexercised options, such as the Black-Scholes method, which USANA and other corporations routinely use to value equity awards when reporting them in the Company’s SEC filings. As the *CytRx* Court explained, the fact that the defendants had not yet exercised the improperly granted equity awards was irrelevant to determining whether they had breached their fiduciary

duties: “Like even guys who rob a bank know how to lay low for a while and not to go out and spend a bunch of money that would call attention to themselves. I mean, it’s sort of like shooting up a flare if you do that, isn’t it?” *CytRx*, Tr. 19:16-20.

II. THE COMPLAINT STATES CLAIMS AGAINST THE DIRECTORS AND OFFICERS FOR CORPORATE WASTE AND UNJUST ENRICHMENT

The district court further erred in holding that Rawcliffe’s “claims for corporate waste and unjust enrichment are conclusory” and “without supporting factual allegations.” (R. 616).

To state a claim for unjust enrichment, a plaintiff must allege that (1) a benefit has been conferred on one person by another; (2) the recipient appreciated or had knowledge of the benefit; and (3) the recipient accepted or retained the benefit under such circumstances as to make it inequitable for the recipient to retain the benefit without payment of its value. *See, e.g., Desert Miriah, Inc. v. B&L Auto, Inc.*, 2000 UT 83, ¶¶13-16, 12 P.3d 580. The Complaint easily satisfies these elements. It alleges that the Compensation Committee caused the Company to confer a benefit—the improperly spring-loaded SSARs—on the Directors and Officers. (R. 2, 13-15, 26). The Complaint further alleges that the Directors and Officers had knowledge of this benefit. (R. 12-15, 23, 26). Additionally, the Complaint alleges that it would be inequitable to allow the Directors and Officers to retain the spring-loaded SSARs. (R. 26). Multiple courts have refused to dismiss unjust enrichment claims against the

recipients of spring-loaded equity awards based on identical allegations. *See CytRx*, Tr. at 41:19-42:4; *Weiss*, 948 A.2d at 449-50; *Tyson*, 919 A.2d at 602-03; *Ausikaitis*, 962 F. Supp. 2d at 680; *see also, Ryan*, 918 A.2d at 361 (refusing to dismiss unjust enrichment claims against the recipients of backdated stock options). As discussed above at page 28, the *CytRx* court explained that the defendants used the market price of the company's stock—when the market did not have the “transformational news” that the defendants had—to price the options for approximately 25-33% of what they would have been priced at had the market known of the news. *CytRx*, Tr. at 40:10-22. With respect to the plaintiff's unjust enrichment claim against the recipients of the stock options, the *CytRx* court stated “[w]hen you get dollars for whatever it works out to be, 25 cents, 33 cents, because you priced at the market when you hadn't told the market about this transformational information, you're unjustly enriching yourself. So Count IV states a claim.” *Id.* at 41:24-42:4. Likewise, here, the Directors and Officers received options that should have had an exercise price of \$68.46 but actually had an exercise price of \$57.62. Accordingly, the Directors and Officers were unjustly enriched.

The district court further held that “the Complaint nowhere suggests that any of the Defendants who received the SSARs did little or no work for USANA or were otherwise not deserving of compensation for their services” and that the Directors and Officers were indeed entitled to compensation for their services. (R. 616). This holding mischaracterizes Rawcliffe's allegations. Rawcliffe does

not allege that the Directors and Officers were not entitled to receive compensation for their roles at USANA, nor does he allege that the Directors and Officers were not entitled to receive SSARs at all. To the contrary, the Complaint acknowledges that the Plan expressly permits the Compensation Committee to grant **properly priced** SSARs and other types of equity awards to eligible participants. (R. 11). What Rawcliffe alleges, however, is that the Directors and Officers were not entitled to receive **spring-loaded** SSARs and that the Directors and Officers were unjustly enriched by the **additional** value they received as a result of the spring-loading, *i.e.*, the \$10.84 difference between the exercise price and the trading price after the market had reacted to the news. *See, e.g., Weiss*, 948 A.2d at 449 (explaining that spring-loading “ensures that the exercise price of a grantee’s option is lower than it otherwise would be. Thus, upon exercise of the option, the grantee receives more value, and the company less, than he should.”). The Compensation Committee members should have waited to grant the SSARs until after the positive news was released, or “tried to make a determination about what the fair market value was on that date, assuming full knowledge by a willing buyer and seller of all material information. . . .” *CytRx* Tr. at 38:2-11, 38:18-39:3.

Finally, the Complaint alleges that Anciaux, McClain and Poelman, as members of the Compensation Committee, wasted the assets of USANA by granting the spring-loaded SSARs. (R. 25). As the Court explained in *CytRx*:

Would an ordinary person swap dollars for 25 cents?
No. An ordinary person, if you go up to them and say,
“I’ve got \$5. How about you give me \$1,” they’re not
going to do that deal.

For fiduciaries to say, “Yes, we will do that deal” raises
an inference of waste. That is the type of transaction
that no reasonable person would agree to.

CytRx, Tr. at 40:23-41:6. Rawcliffe does not allege that **all** grants of SSARs to the Directors and Officers would necessarily constitute waste, but only that the grant of **spring-loaded** SSARs constitutes waste because such grants are “approved without any valid corporate purpose.” *Weiss*, 948 A.2d at 450. Thus, under *CytRx* and *Weiss*, Rawcliffe has adequately stated a claim for waste against the Compensation Committee members.

III. AFFIRMING THE DISTRICT COURT’S DECISION WOULD BE CONTRARY TO PUBLIC POLICY

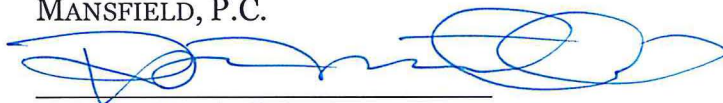
As stated above, the directors and officers of a Utah corporation ““must exercise the utmost good faith in all transactions touching their duties to the corporation and its property”” and must act in the best interests of the corporation and not for their own personal benefit. *Glen Allen Mining*, 77 Utah at 384-85 (quoting 4 Fletcher, Cyc. Corp. § 2272). Such directors and officers ““are not permitted to profit as individuals by virtue of their position.”” *Id.* If this Court affirms the district court’s holding, the directors and officers of Utah corporations will have no disincentive to engage in self-dealing through the manipulation of the timing of equity awards. Accordingly, the district court’s decision should be reversed in the interests of public policy.

CONCLUSION

For all of the foregoing reasons, Rawcliffe respectfully requests that the Court reverse the Amended Memorandum and the Final Judgment and remand this case to the district court for further proceedings.

DATED this 24th day of March 2016.

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CERTIFICATE OF COMPLIANCE WITH RULE 24(f)(1)

I hereby certify that:

1. This brief complies with the type-volume limitation of Utah R. App. P. 24(f)(1) because this brief contains 10,436 words, excluding the parts of the brief exempted by Utah R. App. P. 24(f)(1)(B).

2. This brief also complies with the typeface requirements of Utah R. App. P. 27(b) because it has been prepared in a proportionally spaced typeface using Microsoft Word in 13-point Georgia.

DATED this 24th day of March 2016.

A handwritten signature in blue ink is written over a horizontal line. The signature is stylized and appears to be a first name followed by a last name.


CERTIFICATE OF SERVICE

I hereby certify that on the 23rd day of March 2016, I caused two true and correct copies of the foregoing Opening Brief of Appellant and a CD containing a courtesy electronic copy of the foregoing Opening Brief of Appellant to be served via U.S. mail, first-class postage prepaid, upon the following:

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Addendum A

The Order of Court is stated below:

Dated: April 03, 2015
05:33:06 PM

/s/ Keith Kelly
District Court Judge



**IN THE THIRD JUDICIAL DISTRICT COURT
SALT LAKE COUNTY, STATE OF UTAH**

JAMES ROBERT RAWCLIFFE,
derivatively on behalf of nominal defendant
USANA HEALTH SCIENCES, INC.,

Plaintiff,

v.

ROBERT ANCIAUX a/k/a ROBERT
AUCIUX, JERRY G. MCCLAIN,
RONALD S. POELMAN, JAMES H.
BRAMBLE, JIM BROWN, GILBERT
FULLER, KEVIN G. GUEST, DANIEL A.
MACUGA, DAVID A. WENTZ, and
DEBORAH WOO,

Defendants,

and

USANA HEALTH SCIENCES, INC.,

Nominal Defendant.

**AMENDED MEMORANDUM
DECISION AND FINAL JUDGMENT
OF DISMISSAL**

Case No. 140905252

Judge Keith A. Kelly

Before the Court is Defendants' October 2, 2014 Motion to Dismiss the Plaintiff's Verified Shareholder Derivative Complaint ("Complaint"). Plaintiff opposed the Motion on November 13, 2014, and Defendants submitted their reply on December 11, 2014. Plaintiff submitted supplemental authority on January 9, 2015. The Court heard oral argument on January

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23, 2015, and the Court took this matter under advisement.

After hearing oral argument, the Court has analyzed the written arguments, case law, and the transcript of oral argument. Based upon these, the Court is convinced that Defendants' Motion is well taken and issues the following memorandum decision.

The Court issued its original memorandum decision and order on March 18, 2015 in this matter. To clarify the Court's reasons for granting Defendants' Motion, the Court issues this amended memorandum decision, which supersedes the original memorandum decision.

Legal Standard on This Motion to Dismiss

This Motion to Dismiss focuses on the allegations of the Complaint. Defendants' principal arguments are brought under Utah R. Civ. P. 12(b)(6), which provides that the Court "may dismiss an action if the complaint fails to state a claim upon which relief can be granted." *Osguthorpe v. Wolf Mountain Resorts, L.C.*, 2010 UT 29, ¶ 20, 232 P.3d 999 (internal quotations omitted). A motion brought under Rule 12(b)(6) "'admits the facts alleged in the complaint but challenges the plaintiff's right to relief based on those facts.'" *Helf v. Chevron U.S.A., Inc.*, 2009 UT 11, ¶ 14, 203 P.3d 962 (quoting *Oakwood Vill. LLC v. Albertsons, Inc.*, 2004 UT 101, ¶ 8, 104 P.3d 1226).

In considering a Rule 12(b) Motion, this Court accepts the non-conclusory factual allegations of the Complaint as true, but is not bound to accept conclusory statements that are unsupported by underlying factual allegations. Affirming dismissal of conclusory claims of fraud and breach of fiduciary duty, the Utah Court of Appeals recently explained:

The sufficiency of the pleadings within a complaint 'must be determined by the facts pleaded rather than the conclusions stated.' *Franco v. Church of Jesus Christ of Latter-day Saints*, 2001 UT 25, ¶ 26, 21 P.3d 198 (citation and internal quotation marks omitted); *Foster v. Saunders*, 2005 UT App 264, at para. 3, 2005 WL 1356799 (per

curiam). Here, [plaintiff's] complaint asserts that [defendants] breached their fiduciary duties to [plaintiff]. But the complaint does not allege any act [defendant] performed in furtherance of those breaches. [Plaintiff's] complaint claims only that [defendant] 'actively participated' in the breach. This allegation is purely conclusory rather than factual and is therefore insufficient to support a claim for relief. *See Chapman v. Primary Children's Hosp.*, 784 P.2d 1181, 1186 (Utah 1989) ('We have stressed, and continue to hold, that mere conclusory allegations in a pleading, unsupported by a recitation of relevant surrounding facts, are insufficient to preclude dismissal or summary judgment.'). Accordingly, dismissal pursuant to rule 12(b)(6) of the Utah Rules of Civil Procedure was appropriate.

Fidelity National Title Ins. Co. v. Worthington, 2015 UT App 19, ¶ 23, 344 P.3d 156. In light of this authority, the Court examines the factual allegations of the Complaint – rather than conclusory labels – in determining whether Plaintiff has stated a claim.

Plaintiff's allegations of option spring loading are fraud-based claims of "manipulating the granting of equity awards." (*See* Complaint ¶¶ 45, 75-78 & 83-86.) Counsel for Plaintiff expressed this point in oral argument: "This is not a negligence case. We alleged bad faith. We allege intentional misconduct." (Transcript of Oral Argument (1/23/15) at p. 45 ("Argument Transcript").)

Because allegations of option spring-loading sound in fraud, Plaintiff is required to plead his breach of fiduciary duty claims (1st and 3rd claims) with the specificity required by Rule 9(b). *See* Utah R. Civ. P. 9(b) ("In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity."). Rule 9(b) "is not limited to allegations of common law fraud" but instead reaches "all circumstances where the pleader alleges the kind of misrepresentations, omissions, or other deceptions covered by the term 'fraud' in its broadest dimension." *State v. Apotex Corp.*, 2012 UT 36, ¶ 22, 282 P.3d 66 (applying heightened pleading standard of Rule 9(b) to plaintiff's claims under Utah False Claims Act) (internal citations and emphasis omitted).

This heightened pleading standard under Rule 9(b) does not apply to claims for waste of corporate assets and unjust enrichment (2nd and 4th claims) to the extent that those claims are not based upon allegations of fraudulent option spring loading.

At oral argument, both sides agreed that, in addition to considering the allegations of the Complaint, the Court may take judicial notice of public documents such as SEC filings, as well as documents referenced in the Complaint, without converting this Rule 12(b)(6) motion to dismiss into a Rule 56 motion for summary judgment. *See* Argument Transcript at pp. 10 & 27; *BMBT, LLC v. Miller*, 2014 UT App 64, ¶¶ 6-7, 322 P.3d 1172 (court could take judicial notice of document which was public record and also consider it as implicitly referenced in complaint); *Oakwood Vill. LLC v. Albertsons, Inc.*, 2004 UT 101, ¶ 13, 104 P.3d 1226 (same).

Claims Made in the Complaint

Plaintiff filed the shareholder derivative Complaint on behalf of nominal defendant USANA Health Sciences, Inc. (“USANA” or the “Company”) against certain of USANA’s executive officers and members of its Board of Directors (collectively “Individual Defendants”). The Complaint claims that the defendants breached their fiduciary duty, wasted corporate assets and obtained unjust enrichment. The Complaint alleges that, in breach of their fiduciary duties owed to USANA, the members of the Board’s Compensation Committee (the “Compensation Committee”) knowingly and deliberately violated USANA’s stockholder-approved equity plan, the USANA Health Sciences, Inc. 2006 Equity Incentive Award Plan (the “Plan”), a copy of which was attached as Exhibit A to the Complaint. Specifically, the Complaint claims that the Compensation Committee knowingly and deliberately granted to themselves and other directors and officers of USANA a total of 309,483 stock-settled stock appreciation rights (“SSARs”) that

were “spring-loaded,” in other words, granted just prior to the release of material information reasonably expected to drive the market price of the Company’s stock higher, thereby artificially increasing the value of the SSARs by establishing an artificially low exercise price. (Complaint ¶¶ 1-3.)

The Complaint claims that the Compensation Committee granted the spring-loaded SSARs on February 3, 2014, when they knew that USANA was about to announce impressive financial results for the fourth quarter and year ended December 28, 2013. These results were announced in a press release issued the very next day, February 4, 2014, after the market closed. The results had a favorable effect on USANA’s stock price, which increased by 15.8% the next day. Plaintiff claims that the timing of the SSARs on February 3rd was perfectly orchestrated to “spring-load” the grants in order to capitalize on the market’s expected positive reaction to USANA’s news. The Complaint asserts that Compensation Committee’s award of the spring-loaded SSARs to themselves and other recipients constituted a waste of corporate assets and a breach of the fiduciary duty of loyalty owed by the Compensation Committee to USANA and its stockholders, as well as unjust enrichment of and breach of fiduciary duty by the Individual Defendants. (*Id.* ¶¶ 4-6, 23-43, 75-90.)

The Complaint seeks rescission of the SSARs or, alternatively, to recover damages for the benefit of USANA and to compel the Individual Defendants to disgorge to USANA the benefits they have received from their SSARs. (*Id.* ¶¶ 75-90 & A-E.)

The USANA Equity Incentive Award Plan

In analyzing these claims, the Court considers the undisputed factual allegations concerning the issuance of the SSARs. In April 2006, USANA's shareholders adopted USANA's 25-page Equity Incentive Award Plan (the "Plan") to govern the particulars of USANA's use of stock and other equity instruments in compensating and creating incentives for the Company's high-level personnel. (Complaint ¶¶ 27, 28 & Exhibit A.) The Plan contemplates that USANA will use these incentive awards to attract highly desirable candidates as employees by maintaining "competitive compensation levels." (*Id.*, Ex. A (Plan), at A-1.) It further provides that incentive awards will be used to retain talent by providing "an incentive to management and employees to remain in continuing employment with the Company." (*Id.*) The Plan contemplates that incentive awards will be used to "[c]losely associate the interests of management, employees, directors and consultants . . . with the shareholders by reinforcing the relationship between participants' rewards and shareholder gains." (*Id.*) The Plan is thus structured to "[p]rovide an incentive to management and employees . . . to put forth maximum efforts for the success of its business." (*Id.*)

Pursuant to Utah Code Ann. § 16-10a-624 (1992), the Plan grants extensive powers to the Committee to administer the Plan and issue awards pursuant to its terms. (Complaint, Ex. A (Plan) at A-18.) The Committee has "the exclusive power, authority and discretion" to make all key decisions about awards. (*Id.* at A-19.) This discretion covers "the terms and conditions of any Award granted pursuant to the Plan, including, but not limited to, the exercise price, grant price or purchase price, any reload provision, [and] any restrictions or limitations on the Award." (*Id.*) The Plan also allows the Committee to "[d]ecide all other matters that must be determined

in connection with an Award.” (*Id.* at A-20.)

The Plan provides that the exercise price of incentive awards must be no less than the fair market value of the Company’s shares at the time of the grant. (*Id.* at A-10 (requiring that stock appreciation rights be granted at a price “no less than 100% of the Fair Market Value on the date of grant”).) Absent some contrary determination made by the Committee, the fair market value for publicly traded stock “shall be . . . the mean between the highest and lowest selling price of a share of Common Stock on the principal exchange on which shares of Common Stock are then trading, if any, on that date, or if shares were not traded on such date, then on the closest preceding date on which a trade occurred” (*Id.* at A-3 (defining “Fair Market Value”).)

The Plan authorizes the use of various equity-based incentive awards, (Complaint ¶ 30), including stock appreciation rights (“SARs”). Such rights, when exercised, entitle the holder to receive the difference between the selected exercise price, which is based on the Company’s stock price at the time of issuance, and the trading price of the Company’s stock on the exercise date. (*Id.* ¶ 31.) SARs are non-transferable and have no intrinsic monetary value prior to vesting. (*See id.*, Ex. A at A-15, part 10.3.) SARs are distinct from more traditional “stock options” in that they do not require the recipient to pay an exercise price, but instead involve the issuance of stock or cash to the employee reflecting the difference between the SARs’ issuance price and exercise price. When SARs are “in the money,” the share price on the day of exercise exceeds the pre-set exercise price. Thus, the SARs’ payoff is a function of the Company’s stock price. Out-of-the-money SARs return no value to an exercising party.

Issuance of the February 2014 SSARs

The SARs in question are a form of stock appreciation rights known as SSARs. SSARs

are stock appreciation rights that pay the appreciation amount in stock rather than cash. SSARs cannot be exercised until they vest.

On February 3, 2014, the Committee granted SSARs to certain senior executives, each of whom is named as an Individual Defendant in this action. (Complaint ¶ 40.) Under the grants, the six Officer Defendants received between 32,500 and 58,500 SSARs, half of which were set to vest in August 2016, and half of which were set to vest in August 2017. (*See id.*; Malcolm Affidavit to Defendants' Motion to Dismiss, Exs. C – L (February 6, 2014 Form 4s for the Individual Defendants (“Form 4s”))). The Committee also granted 12,000 SSARs each to the four Director Defendants, which were set to vest quarterly beginning in January 2016. (*Id.*) Thus, on their face, the SSARs would vest and provide value about 23 to 42 months after they were issued.

Even though the Complaint references USANA's prior grants of SARs, the allegations in the Complaint that form the basis for the claims in this case are claims related to the February 3, 2014 SSARs. (Complaint ¶¶ 42-43 & 59.)

All of the February 2014 SSARs grants complied with the terms of the Plan. Indeed, Plaintiff's counsel explained at oral argument that “the compensation committee complied with the letter of the plan. They granted the SSARs at the exercised – at the stock price on the day of the grant. So the letter of the plan they met.” (Argument Transcript at p. 32.)

The day after the Committee granted these awards, on February 4, 2014, USANA announced positive results for 2013. (Complaint ¶¶ 34-38.) The Company's stock price rose the day after to a closing price of \$68.46. (*Id.* ¶ 39.) The issued SSARs were not vested, however,

¹ These SEC filings are public documents whose existence and content are undisputed. Thus, the Court takes judicial notice of these undisputed filings without converting this Rule 12(b)(6) motion to dismiss into a Rule 56 motion for summary judgment.

and would not vest for 23 to 42 months. (See Form 4s.) There is no allegation that this short-term stock price increase would guarantee or translate into long-term value for the SSARs. Under the terms of the Plan, those SSARs would only have value if the overall performance of USANA over the vesting period led to a sustained share price increase.

Significantly, USANA filed Form 4s on February 6, 2014, fully disclosing the issuance of the SSARs just three days after they were issued. (*Id.*) There is no allegation that the Defendants hid or otherwise covered up the issuance of the SSARs.

Plaintiff's Breach of Fiduciary Duty Claims Fail Because
the Compensation Committee Undisputedly Complied with the Terms of the Plan

It is undisputed that the Members of the Compensation Committee complied with the terms of the Plan when they issued the February 2014 SSARs. Thus their actions are protected by the business judgment rule, and they did not breach their fiduciary duties.

The Committee members' conduct regarding the SSARs grants is governed by the business judgment rule. Under the business judgment rule, courts have "provided directors with broad discretion" and "have been reluctant to make hindsight judgments about corporate affairs." *Resolution Trust Corp. v. Hess*, 820 F. Supp. 1359, 1366 (D. Utah 1993); *see also FMA Acceptance Co. v. Leatherby Ins. Co.*, 594 P.2d 1332, 1334 (Utah 1979) (requiring directors to exercise ordinary care, skill, and diligence in administering the affairs of the corporation). In shielding directors from liability absent some basis for concluding that they acted willfully or with gross negligence, the Utah Code protects the actions of directors acting in good faith and with reasonable care. *See* Utah Code Ann. § 16-10a-840(4) (1993); *see also C & Y Corp. v. Gen. Biometrics, Inc.*, 896 P.2d 47, 55 (Utah Ct. App. 1995) (identifying the Utah corporate statute as "codifying [the] business judgment rule").

Courts have held that “director transactions made under a stock option plan approved by the corporate shareholders are entitled to the benefit of the business judgment rule.” *In re 3COM Corp. S’holders Litig.*, 1999 WL 1009210, at *3 (Del. Ch. Oct. 25, 1999) (granting motion to dismiss); *see also Desimone v. Barrows*, 924 A.2d 908, 934 (Del. Ch. 2007) (finding no claim where directors followed “terms of . . . stockholder-approved option plan”).

In this case, it is undisputed that USANA’s shareholders adopted the Plan authorizing the Company to issue equity based incentive awards and to define the terms of such grants. (Complaint ¶ 27.) The facts alleged in the Complaint confirm that the Compensation Committee followed the Plan when it granted the February 2014 SSARs. The Plan specifically directs that SSARs granted under the Plan must have an exercise price that shall “not be less than 100% of Fair Market Value on the date of the grant.” (*Id.* ¶ 32.) This exercise price is to be the “then-current trading price” of USANA’s stock. (*Id.*) The Complaint alleges that the Company granted the SSARs at issue on February 3, 2014. (*Id.* ¶ 40.) On February 3, 2014, the SSARs were issued with an exercise price of \$57.62, the price of USANA’s stock on the day of the grant. (*Id.*) The Committee therefore followed the shareholders’ instructions in exercising the “exclusive power, authority and discretion” that shareholders gave them to set the terms of SSARs grants. (Plan at A-19.) Then, in three days, on February 6, 2014, USANA fully disclosed the issuance of the SSARs. (Form 4s.) Thus Plaintiff’s counsel admitted during oral argument that “the compensation committee complied with the letter of the plan.” (Argument Transcript at p. 32.)

Nothing in the Utah corporate code prohibits a compensation committee from granting incentive compensation before announcing positive financial results. USANA’s shareholders did not impose any such limitation in the Plan; nor is there a provision in USANA’s corporate

charter or bylaws that would prevent such an award. No other shareholder-imposed restriction governs the timing of SSARs awards. In all, there is nothing in Utah law or USANA's corporate documents that would have given the Compensation Committee members any grounds to believe that they could be held personally liable for granting options before announcing earnings. To the contrary, the Plan gives the Compensation Committee broad discretion in issuing SSARs and expressly states: "No member of the Board or [Compensation] Committee shall be liable for any action taken or decision or determination made in good faith with respect to any Option, the Plan, or any award thereunder." (Complaint, Ex. A (Plan) at A-20, part 12.9.)

Further, under their terms, the Officer Defendants' SSARs will not vest until August 2016 and August 2017, while the Director Defendants' SSARs will not vest until January 2016. (*See* Form 4s.) These long vesting periods mean that the short-term jump in share price immediately after issuance of the SSARs will only bring value to the Defendants if the Company's positive performance is sustained for 23 to 42 months. Thus, the Court concludes that, even in light of allegations that the stock price jumped just after the February 3, 2014 SSARs were issued, this should not form the basis for a breach of fiduciary duty or malfeasance claim when the value of the SSARs will be based on stock values at the dates of potential exercise at least 23 to 42 months later.

Plaintiff cites cases in which trial courts have denied motions to dismiss breach of fiduciary duty claims that were based upon alleged spring loading of stock options. *E.g., Weiss v. Swanson*, 948 A.2d 433, 441-48 (Del Ch. 2008) (denying motion to dismiss claim for breach of fiduciary duty by approving spring-loaded stock options); *In re Tyson Foods, Inc. Consol. Shareholder Litigation*, 919 A.2d 563, 592-93 (Del Ch. 2007) (same). The *Tyson* court held that

a claim of spring-loading rebutted the business judgment rule if (1) the plaintiff alleges that the challenged grants were given pursuant to an options plan, and (2) the plaintiff alleges that persons who approved the spring-loaded grants “(a) possessed material non-public information soon to be released that would affect the company’s share price, and (b) issued those options with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options.” 919 A.2d at 592 & n.75; *see also Weiss*, 948 A.2d at 441-42 & n.21.

The test in *Tyson* and *Weiss* should not bar dismissal in this case. The USANA Plan specifically directs that SSARs granted under the Plan must have an exercise price that shall “not be less than 100% of Fair Market Value on the date of the grant,” which is defined to be “the then-current trading price” of USANA’s stock. (Complaint ¶ 32.) It is undisputed that the SSARs were issued at the then-current trading price (*id.* ¶ 40) – as expressly permitted in the Plan. Since the SSARs were undisputedly issued consistent with this express provision, their issuance cannot be viewed as circumventing valid shareholder-approved restrictions upon the exercise price of the SSARs. Thus, Plaintiff does not state a claim under the *Tyson* and *Weiss* test even in light of allegations that the Compensation Committee possessed material non-public information soon to be released that would affect USANA’s share price.

Further, *Tyson*, *Weiss* and the other trial court cases cited by Plaintiff are not binding on this Court. Those cases are not persuasive to the extent that they may be read to allow claims in circumstances such as those in the present case, where the undisputed facts show: (i) the SSARs were issued consistent with the Plan, at their publicly traded share price; (ii) their terms were publicly disclosed three days later in the Form 4s; and (iii) the SSARs could not be exercised for at least 23 to 42 months after they were issued.

As a result, this Court holds that the business judgment rule bars Plaintiff's breach of fiduciary duty claims as a matter of law under the undisputed factual allegations of this case.

The Conclusory Corporate Waste and Unjust Enrichment
Allegations Fail to State a Claim

Plaintiff's claims for corporate waste and unjust enrichment are conclusory. Plaintiff labels the SSARs as "spring loaded" and then alleges – without supporting factual allegations – that those SSARs were provided for inadequate consideration and without valid corporate purpose, and that keeping them would be unjust and unconscionable. (Complaint ¶¶ 80-81 & 88-89.)

As discussed above, the label "spring loaded" does not raise a claim under the undisputed facts of this case. At the same time, the Complaint nowhere suggests that any of the Defendants who received the SSARs did little or no work for USANA or were otherwise not deserving of compensation for their services. To the contrary, the Complaint makes clear that each of the Individual Defendants had substantial responsibilities and duties to perform at USANA, (*id.* ¶¶ 12-21, 23-24), and that, under their watch, USANA had outstanding financial performance, (*id.* ¶¶ 34-38). Without facts (not conclusory allegations) supporting claims of corporate waste and unjust enrichment, and in light of the analysis of the "spring loading" claims discussed above, the Court concludes that Plaintiff fails to state claims for corporate waste and unjust enrichment.²

FINAL JUDGMENT

Based upon the foregoing, IT IS ORDERED AND ADJUDGED that:

1. Final judgment is entered in favor of Defendants Robert Anciaux a/k/a Robert

² In light of the preceding analysis, the Court does not reach other arguments raised by Defendants in support of their Motion to Dismiss.

Auciaux, Jerry G. McClain, Ronald S. Poelman, James H. Bramble, Jim Brown, Gilbert Fuller, Kevin G. Guest, Daniel A. Macuga, David A. Wentz, and Deborah Woo, dismissing all of Plaintiff's causes of action;

2. This action is hereby dismissed in its entirety, without prejudice;

3. Defendants shall submit to the Court and serve upon Plaintiff an appropriate memorandum of costs within fourteen days of entry of this Judgment and consistent with the procedures set forth in Rule 54(d) of the Utah Rules of Civil Procedure.

In accordance with the Utah R. Civ. P. 10(e), this Order does not bear the handwritten signature of the Judge, but instead displays an electronic signature at the upper right-hand corner of the first page of this Order.

Return of Electronic Notification

Recipients

ALAN S MOURITSEN - Notification received on 2015-04-03 17:38:14.073.

**ERIK A
CHRISTIANSEN** - Notification received on 2015-04-03 17:38:13.277.

J RYAN MITCHELL - Notification received on 2015-04-03 17:38:13.217.

***** IMPORTANT NOTICE - READ THIS INFORMATION *****

NOTICE OF ELECTRONIC FILING [NEF]

A filing has been submitted to the court RE: 140905252

Judge:

KEITH KELLY

Official File Stamp:

04-03-2015:17:37:41

Court:

3RD DISTRICT COURT - SALT LAKE

District

Salt Lake

Case Title:

RAWCLIFFE, JAMES ROBERT vs. ANCIAUX,
ROBERT, et al.

Document(s) Submitted:

Judgment - Amended Memorandum Decision and
Final Judgment of Dismissal

Filed by or in behalf of:

KEITH KELLY

Note from the Court:

The Court has entered this Amended
Memorandum Decision and Final Judgment,
superseding and replacing the March 18, 2015
Memorandum Decision.

This notice was automatically generated by the courts auto-notification system.

The following people were served electronically:

ERIK A CHRISTIANSEN for KEVIN G GUEST et
al

J RYAN MITCHELL for JAMES ROBERT
RAWCLIFFE

ALAN S MOURITSEN for KEVIN G GUEST et al

The following people have not been served electronically by the Court. Therefore, if service is required, they must be served by traditional means:

LUCY C MALCOLM for USANA HEALTH
SCIENCES INC

KRISTEN L ROSS for JAMES ROBERT
RAWCLIFFE

DOUGLAS A RAPPAPORT for USANA HEALTH
SCIENCES INC

ERIC L ZAGAR for JAMES ROBERT
RAWCLIFFE

CHRISTOPHER M EGLESON for USANA
HEALTH SCIENCES INC

Addendum B

IN THE SUPREME COURT OF THE STATE OF UTAH

FILED
UTAH APPELLATE COURTS

JUL 1 - 2015

---oo0oo---

JAMES ROBERT RAWCLIFFE,
Appellant,

v.

ROBERT ANCIAUX; JERRY G. MCCLAIN;
RONALD POELMAN; and DEBORAH WOO,
Appellees,

ORDER

Appellate Case No. 20150365-SC

USANA HEALTH SCIENCES, INC.,

Appellee.


---ooOoo---

This Court has elected to retain the above-entitled appeal on its docket. The prior order of transfer to the Court of Appeals is vacated; however, the Court retains its discretion to transfer the appeal at a later time if circumstances warrant. Unless otherwise notified, the parties shall file all future pleadings in the Supreme Court.

FOR THE COURT:

Date

July 1, 2015



Thomas R. Lee
Associate Chief Justice

CERTIFICATE OF SERVICE

I hereby certify that on July 2, 2015, a true and correct copy of the foregoing ORDER was deposited in the United States mail or was sent by electronic mail to be delivered to:

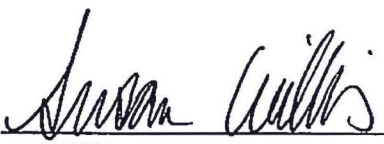
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THIRD DISTRICT, SALT LAKE
ATTN: JULIE RIGBY AND CHERYL AIONO
cheryla@utcourts.gov, julier@utcourts.gov

By 
Susan Willis
Judicial Services Manager

Case No. 20150365
THIRD DISTRICT, SALT LAKE, 140905252

Addendum C

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Counsel for Plaintiff-Appellant

IN THE SUPREME COURT OF UTAH

JAMES ROBERT RAWCLIFFE, Derivatively on Behalf of Nominal Defendant USANA HEALTH SCIENCES, INC.,)	
)	
Plaintiff/Appellant,)	APPELLANT'S MEMORANDUM
)	ADDRESSING SUPREME COURT'S
)	APPELLATE JURISDICTION
v.)	
)	Case No. 20150365—SC
ROBERT ANCIAUX a/k/a ROBERT AUCIAUX, JERRY G. MCCLAIN, RONALD S. POELMAN, JAMES H. BRAMBLE, JIM BROWN, GILBERT FULLER, KEVIN G. GUEST, DANIEL A. MACUGA, DAVID A. WENTZ and DEBORAH WOO,)	Dist. Ct. No. 140905252
)	
Defendants/Appellees,)	
)	
and)	
)	
USANA HEALTH SCIENCES, INC.,)	
)	
Nominal Defendant/ Appellee.)	

Appellant James Robert Rawcliffe (“Appellant”), by and through his undersigned counsel of record, hereby submits the following memorandum addressing the Court’s jurisdiction over this appeal as requested by the Court in its July 22, 2015 Order (the “Order”).

In its Order, the Court informed the parties that it was considering, sua sponte, whether it must dismiss this appeal because it lacks appellate jurisdiction. Specifically, the Court questioned whether the district court’s April 3, 2015 Amended Memorandum Decision and Final Judgment of Dismissal (the “Final Judgment of Dismissal”) was a final, appealable order under Rule 7(f)(2) of the Utah Rules of Civil Procedure, and invited the parties to address this issue and explain why the appeal should or should not be dismissed. Although Appellant believes the language employed by the district court demonstrates clearly that it intended its Final Judgment of Dismissal to be a final, appealable order, Appellant concedes the Final Judgment of Dismissal is technically not final under Rule 7(f)(2) in light of this Court’s decision in Central Utah Water Conservancy District v. King, 2013 UT 13, 297 P.3d 619. In King, the Court held that “a district court that intends its ruling to represent its final, appealable order must explicitly state that no additional order is necessary” otherwise its decision is not final or appealable under Rule 7(f)(2). Id. ¶¶ 24-25.

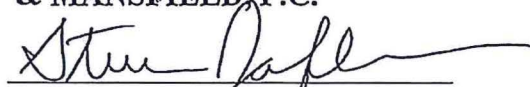
Measured against the King decision’s strict, bright-line standard, the Final Judgment of Dismissal falls short because although the district court designated its

decision as a final judgment and explicitly stated “that final judgment is entered in favor of Defendants . . . dismissing all of Plaintiff’s causes of action,” it did not explicitly state that no additional order was necessary and it did not include any directive for the preparation of a final version of the decision. Because the district court’s Final Judgment of Dismissal fails to include the explicit language required by the King decision, this appeal is not ripe because it was not taken from a final, appealable order.¹ Appellant therefore respectfully requests that its appeal be dismissed without prejudice for lack of appellate jurisdiction and remanded to the district court with directions to enter a final, appealable order in accordance with Rule 7(f)(2) of the Rules of Civil Procedure.

DATED this 5th day of August, 2015.

¹ Appellant is aware that on May 12, 2015, the Supreme Court adopted amendments to Rule 7 of the Utah Rules of Civil Procedure that will do away with the strict, bright-line standard mandated by the current version of rule 7(f)(2) and the Court’s decision in King. Under the amended Rule 7, the district court’s Final Judgment of Dismissal would satisfy the necessary requirements of a final, appealable order removing any question as to the Court’s appellate jurisdiction over this appeal. And while Appellant believes judicial efficiency and economy would best be served by analyzing whether the Final Judgment of Dismissal is a final, appealable order against the requirements of the amended Rule 7, Appellant understands that the amendments do not become effective until November 1, 2015. Accordingly, unless the Court decides to send its King decision into early retirement, the decision remains controlling precedent.

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CERTIFICATE OF SERVICE

I hereby certify that on this 5th day of August, 2015, I caused a true and correct copy of the foregoing APPELLANT'S MEMORANDUM ADDRESSING SUPREME COURT'S APPELLATE JURISDICTION to be served via US Mail, first class postage prepaid, upon the following:

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Attorneys for Defendants/Appellees

A handwritten signature in black ink, appearing to read "Alan S. Mouritsen", is written over a horizontal line.

Addendum D

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE CYTRX CORP. : CONSOLIDATED
STOCKHOLDER DERIVATIVE LITIGATION : C.A. No. 9864-VCL

- - -

Chancery Courtroom No. 12C
New Castle County Courthouse
500 North King Street
Wilmington, Delaware
Thursday, January 8, 2015
11:00 a.m.

- - -

BEFORE: HON. J. TRAVIS LASTER, Vice Chancellor

- - -

ORAL ARGUMENT
DEFENDANTS' MOTIONS TO STAY OR DISMISS
AND THE COURT'S RULINGS

CHANCERY COURT REPORTERS
500 North King Street
Wilmington, Delaware 19801
(302) 255-0521

1 APPEARANCES:

2 P. BRADFORD DELEEUEW, ESQ.
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3 -and-

4 KEVIN H. DAVENPORT, ESQ.
Prickett, Jones & Elliott, P.A.

-and-

5 ROBIN WINCHESTER, ESQ.
of the Pennsylvania Bar
6 Kessler Topaz Meltzer & Check,, LLP

-and-

7 PHILIP T. TAYLOR, ESQ.
of the New York Bar
8 Abraham Fruchter & Twersky LLP
for Plaintiffs

9 EDWARD P. WELCH, ESQ.
10 SARAH R. MARTIN, ESQ.
Skadden, Arps, Slate, Meagher & Flom LLP

11 -and-

12 ALLEN L. LANSTRA, ESQ.
of the California Bar
Skadden, Arps, Slate, Meagher & Flom LLP
13 for Defendants

14 - - -
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1 THE COURT: Welcome, everyone.

2 ALL COUNSEL: Good morning, Your
3 Honor.

4 THE COURT: Mr. Welch, good morning.
5 How are you?

6 MR. WELCH: I'm well, Your Honor.
7 Thank you.

8 If I might, I'd appreciate the
9 opportunity to introduce to the Court my partner and
10 friend Allen Lanstra from our Los Angeles office who
11 will be making the argument to the Court, with the
12 Court's permission.

13 THE COURT: Great. Welcome to the
14 East Coast. I'm sorry we don't have much better
15 weather for you.

16 MR. WELCH: Thank you, Your Honor.

17 MR. DELEEUEW: Good morning,
18 Your Honor. Brad deLeeuw, Rosenthal Monhait &
19 Goddess on behalf of plaintiffs. I'd just like to
20 introduce my co-counsel seated at counsel table.

21 THE COURT: Sure.

22 MR. DELEEUEW: Robin Winchester of
23 Topaz Kessler Meltzer & Check, Philip Taylor of
24 Abraham Fruchter & Twersky, and we also have Kevin

1 Davenport from the Prickett firm.

2 THE COURT: Great. Welcome to all of
3 you.

4 MR. DELEEUW: With Your Honor's
5 permission, Ms. Winchester will handle the argument on
6 the motion to dismiss today, and Mr. Taylor will
7 handle the argument on the motion to stay.

8 THE COURT: That's fine.

9 MR. DELEEUW: Thank you, Your Honor.

10 THE COURT: Please go ahead.

11 MR. LANSTRA: Good morning again, Your
12 Honor. I'd like to start with the motion to stay.

13 There's a factual overlap between the
14 allegations in the securities action in California and
15 the derivative action here. The factual allegations
16 require both cases to call for the determination of
17 questions of fact concerning both spring-loaded stock
18 options and the stock promotions through the
19 DreamTeamGroup. The prosecution of both of those
20 cases simultaneously, we believe, will prejudice the
21 corporation.

22 While the derivative plaintiffs will
23 be seeking answers to questions on behalf of the
24 corporation, the securities plaintiffs will be seeking

1 answers against the corporation. One will be
2 attempting to undermine the credibility of witnesses
3 and the other relying on the veracity of those
4 witnesses.

5 The derivative action here, if it were
6 to go forward simultaneously, could result in an
7 imputation of liability of the officers to the
8 corporation in the securities action.

9 I want to make clear, as everyone
10 reads the briefs and comes back out to argue the
11 cases, I picked up perhaps the suggestion that the
12 plaintiffs believe we are asking the Court to delete
13 this case. We are not asking for the Court to delete
14 this case. We're asking just to hit the pause button
15 and allow the securities action to go forward.

16 We think there's good reasons why the
17 securities action should be the one that goes forward
18 as opposed to the derivative action. The securities
19 action is broader. It is setting forth an allegation
20 of a broad scheme that sweeps into it allegations of
21 not only the spring-loading of the stock option grants
22 but the stock promotion.

23 They're arguing that there's an
24 artificial inflation of the stock, it's related to a

1 secondary offering, and that the directors and the
2 officers are attempting to capitalize on it. The lead
3 plaintiff there has allegedly over a million dollars
4 in losses so he's a real plaintiff, and he's going to
5 be obligated or certainly interested in pushing
6 forward with all might.

7 There's a broader range of dates
8 involved in California as well. Depending on who
9 characterizes the derivative complaint here, we could
10 be talking about a window of three days of events. We
11 could also be arguing from about October all the way
12 until about March. That range is within the range and
13 the allegations of spring-loading and the DreamTeam
14 are all combined or a part of the securities action in
15 California.

16 I think, in short, both cases will
17 call for the determination of substantially the same
18 questions of fact, and we think that that causes not
19 only a conflict that will prejudice the corporation
20 but will also be a waste of resources, I think, in our
21 opinion.

22 I don't know if you have any --

23 THE COURT: Remind me of the status of
24 the federal action.

1 MR. LANSTRA: The defendants have
2 moved to dismiss, Your Honor. That briefing is not
3 complete. I believe the briefing will be complete in
4 February. There are derivative cases as well. And
5 I'm not sure how much it's set forth in the briefs,
6 but there were three cases in Delaware or in
7 California that were filed derivatively.

8 One of them, we were able to convince
9 the plaintiff to withdraw the case and dismiss it
10 based on a forum selection clause because we believe
11 that the derivative cases should be handled here when
12 they're taken care of.

13 And the other two cases, handled by
14 the same counsel, they don't agree with the forum
15 selection clause, so they're fighting it out. That
16 has been fully briefed before Chief Judge King in the
17 Central District. He has indicated he will not take
18 oral argument, so the opinion on that could come any
19 day.

20 To be clear, we believe that this is
21 the place for those cases. We have moved in the
22 alternative for a stay of the California derivative
23 cases for this action as well as a stay for the class.

24 THE COURT: All right. Thank you.

1 Do you want to go ahead and address
2 the other motions or take them one by one?

3 I guess since they're splitting it up,
4 why don't we focus on the stay for now, and I'll have
5 you back.

6 MR. LANSTRA: Certainly. Thank you,
7 Your Honor.

8 MR. TAYLOR: Good morning, Your Honor.
9 Philip Taylor. I think I'll just address first the
10 factual overlap that the defendants speak of. I think
11 this Court addressed in the Molycorp litigation that
12 the factual overlap between a federal and a derivative
13 case shouldn't cause a stay to be put in place here in
14 Delaware.

15 I think Vice Chancellor Noble said
16 that "It's almost foreseeable that directors of
17 Delaware corporations might be called to defend both
18 securities and derivative actions based on the same
19 factual basis."

20 So we really don't believe that this
21 factual overlap should cause a stay. And that is
22 especially true because the claims, we believe, here
23 are quintessentially Delaware claims. The meat of our
24 action is really Delaware, Delaware claims, whereas

1 the federal claims are disclosure-based claims. We're
2 look at the Delaware fiduciaries -- excuse me -- the
3 compensation practices of Delaware fiduciaries. And
4 these have been described as questions of great import
5 to Delaware law.

6 As defendants point out, they have a
7 Delaware forum selection clause which requires all
8 such types of actions, claims, to be brought here in
9 Delaware. They agreed that the claims should be
10 litigated here in Delaware. And, really, the only
11 prejudice that's going to be suffered is by delaying
12 plaintiffs' litigation of these claims.

13 There's no indemnity claims pled in
14 our case, so there's no practical considerations to
15 hold off litigating the claims because of how the
16 federal securities litigation turns out.

17 The other practical considerations
18 with respect to the facts that are going to be
19 developed in this case, a lot of the key facts that
20 they're concerned about, we've already obtained in the
21 220 documents. So I don't think that there's any
22 practical considerations in terms of overlapping
23 discovery.

24 We actually were the first plaintiffs

1 to assert the spring-loading claim, so the
2 spring-loading claims only came up in the federal
3 securities actions after they were asserted here in
4 Delaware.

5 And the DreamTeam and stock promotion
6 claims, they're pled in our complaint as background
7 simply to show further evidence of defendants' history
8 of dishonesty to shareholders.

9 THE COURT: Do you really need me to
10 get into any of that?

11 MR. TAYLOR: Well, I guess that's
12 really up to you, Your Honor.

13 THE COURT: Well, it's up to you
14 because you're going to be the one who, if this goes
15 forward, is conducting discovery and that sort of
16 thing. I mean, part of what your friend says is that
17 there's this bigger scheme concept out in California
18 about pumping up stock, et cetera. Are you going to
19 be exploring things about that or asking me to make
20 rulings on things like that?

21 MR. TAYLOR: Your Honor, our claims
22 are really based on the spring-loading of the options,
23 so those facts are really minor, like I said,
24 background facts. Our focus here is on the

1 spring-loading. So to the extent that the background
2 facts can kind of elucidate the environment in which
3 the spring-loading happened, sure, but I don't think
4 we're going to need any -- I don't want to say we're
5 not going to need any rulings on those facts, but
6 certainly they're very minor, and the spring-loading
7 is really the meat of our case.

8 THE COURT: It seems to me that the
9 pumping is a different question. I mean, actually,
10 your point is that the stock price on the date that
11 these grants were made wasn't pumped.

12 And if you show pumping, it actually
13 decreases your damages claim because then there was --
14 so whatever the value of the stock was thought to be,
15 then there's the actual value of the stock, given what
16 was known by the directors about this Phase 2 result.
17 You want the delta between those two things. And if
18 the market price out there was higher because of
19 pumping, actually, that would get the market price
20 closer to what it should have been had there been full
21 disclosure, in your view.

22 So if you get into that stuff, if you
23 start saying, "Oh, DreamTeam was pumping up the
24 price," or whatever, you'd ironically be decreasing

1 your damages claim in terms what you could get in
2 front of me. So it doesn't seem to me like, in terms
3 of the Delaware matter, you really want to touch that
4 stuff.

5 MR. TAYLOR: Like I said, it's
6 certainly a minor part of our claims, and it's really
7 the damages on the spring-loading options that we're
8 going towards here in Delaware.

9 So the factual overlap, I mean, it's
10 like two ships passing in the night. It's really --
11 it's of no consequence to litigating our claims here
12 in Delaware. And there's really no reason, no
13 practical reason, to stay the Delaware litigation in
14 favor of the federal securities case.

15 And, I mean, as they pointed out, they
16 believe that these claims should be litigated here in
17 Delaware, and there is no reason for this Court to
18 delay important issues of Delaware law for a
19 securities case that hasn't even completed briefing
20 yet. I believe the hearing is set for sometime in
21 March on the motion to dismiss briefing, and the Court
22 has taken under advisement other issues in the federal
23 derivative cases. So --

24 THE COURT: What bad things could

1 happen if I waited?

2 MR. TAYLOR: Well, I mean, there's
3 always the risk -- well, I don't want to -- I don't
4 want to lock us into a position, but there is a risk
5 that the Court could make a decision on issues of
6 Delaware law where it's more -- I mean, it seems that
7 this Court would be better placed to make those
8 decisions.

9 The motion to dismiss has been
10 briefed, and the Court, like I said, has taken it
11 under advisement. So to the extent that the Court
12 does rule on the issues of demand futility, I mean,
13 obviously, we think that -- and defendants also
14 believe that those issues should -- are better decided
15 in this Court. So I think to the extent that we
16 could --

17 THE COURT: Let's say that I just
18 said, "You know What? California is likely to, if it
19 goes forward, come out with some factual answers on
20 some of this stuff, and I'm a utility-maximizing guy.
21 I'll have more leisure, more opportunity, to deal with
22 some of the other cases that Mr. Welch has brought in
23 front of me and that we have together if I just kick
24 back and let California deal with these things. And

1 then when California comes out with some findings of
2 fact about what the directors knew or didn't know and
3 what the market knew or didn't know, I can just plug
4 those in and then put a Delaware framework on top of
5 answers that I will have been given."

6 If that's what I could do, why not
7 wait? Why not chill out?

8 MR. TAYLOR: Well, Your Honor, I
9 think, like you said, I think the issues that are
10 going to be dealt with, the factual issues that are
11 going to be dealt with in the securities action, are
12 minor, play a minor role in our case. And I think
13 that maybe we've answered some of the questions about
14 knowledge with respect to -- with the 220 documents
15 that, obviously, have been placed under seal and I
16 can't discuss. So I think those issues are already in
17 front of the Court now.

18 And to the extent that California has
19 to get to those issues, it doesn't make sense to wait
20 for them because we already have those issues in front
21 of the Court.

22 I'm sorry. Do you have any other
23 questions?

24 THE COURT: No. Not at the moment.

1 MR. TAYLOR: Great. Thank you, Your
2 Honor.

3 THE COURT: Thank you.
4 Reply?

5 MR. LANSTRA: Your Honor, if I may,
6 just a couple points in rebuttal.

7 Look, we can only go with what's in
8 the complaint. And it's not my job to figure out why
9 they've decided they only want to go with
10 spring-loading now that there's been a motion to stay,
11 but there are DreamTeam allegations throughout the
12 complaint.

13 The very first paragraph of the
14 complaint states, "Plaintiffs are bringing this
15 consolidated stockholder derivative action on behalf
16 of" the company's directors -- "on behalf of [the
17 company] ... to remedy defendants' wrongful conduct
18 of: (a) granting themselves spring-loaded stock
19 options ... and (b) secretly engaging a stock
20 promotion firm"

21 They may argue that we're really
22 pushing the stock options, but the DreamTeam is in
23 there, and I suppose someone could read the other case
24 that way.

1 I want to really point out the
2 primary -- just to make clear, if I didn't before, if
3 there are Delaware questions of law, we believe Your
4 Honor should answer them when the time comes. We do
5 not believe that the breach of fiduciary claims as a
6 matter of law are before the Court in California. We
7 do not believe they will be. They are exactly like
8 you said, Your Honor. They're questions of fact that
9 overlap: Was there spring-loaded option grants made
10 as a matter of fact? Were there misrepresentations?
11 Those are at issue in both cases.

12 THE COURT: Great. Why don't you
13 segue into the motion to dismiss.

14 MR. LANSTRA: Will do.

15 Your Honor, in essence, the plaintiffs
16 are alleging that the defendants learned of favorable
17 clinical trial results on December 9th. On
18 December 10th, the comp committee made option grants.
19 Thereafter, the clinical trial results were released
20 publicly and the stock price experienced a temporary
21 increase as a result. The way we read the complaint,
22 that is what is alleged.

23 We believe under both Tyson and
24 Desimone put together that that's not enough. There

1 is a test that's set forth. Were the options issued
2 according to a shareholder-approved comp plan? Yes.
3 We believe that they've alleged that. 2(a), did the
4 directors possess material nonpublic information soon
5 to be released that would impact the company's share
6 price? We believe they've alleged that. We've
7 conceded that.

8 It's Part 2(b) that is not alleged.
9 Did the directors issue these options with the intent
10 to circumvent otherwise valid shareholder-approved
11 restrictions? There are no allegations outside of,
12 frankly, the temporal relationship.

13 The plaintiffs are asking for the
14 intent to be inferred. They're relying on the
15 inferences that were made in Tyson and Weiss. We
16 don't think that that type of inference is there.

17 There are little pieces in all the
18 cases, including this one, but the facts supporting
19 inference of intent in Tyson and Weiss had a lot to do
20 with the repeated number. This doesn't mean you get a
21 free pass, as they were arguing in the opposition, but
22 it's the repeated number of times that they did this
23 and the moving of the dates of the stock options.

24 The allegations here, the only factual

1 allegations, actually suggest the opposite: that the
2 decision to grant was made in October; that decisions
3 of grants were annually made at the December meeting;
4 no options were exercised; and there are no
5 allegations that the announcement itself was moved.

6 THE COURT: Why does the failure to
7 exercise matter?

8 MR. LANSTRA: Well, it runs to intent.
9 I don't think it runs to the damages. I think that
10 was what we saw in the opposition, was a response that
11 doesn't mean that there aren't damages. But I think
12 it does matter when you're saying what's the intent.
13 The intent here is there is a deception. There is an
14 intent to take advantage of a situation. None of
15 these directors and none of the officers have taken
16 advantage of these allegedly low-ball options. And --
17 well, I'll leave it at that. And I think --

18 THE COURT: What's the life of these
19 options?

20 MR. LANSTRA: Ten years.

21 THE COURT: So, I mean, it just -- it
22 seems to me that if you get an option, I mean, having
23 it allegedly underpriced is nice, but you don't
24 necessarily have to go out and exercise it right away.

1 MR. LANSTRA: No. That's fair. I
2 think that's right. But, again, when you're being
3 asked to take an inference from something that's just
4 simply an allegation of the timing sequence and when
5 we're trying to figure out is there an inference
6 there -- you have other courts saying, "Well, they did
7 it a bunch of times. They moved dates."

8 I actually do think that the fact that
9 they didn't run out right away and exercise the
10 options and make immediate money does suggest
11 something. It certainly doesn't suggest the opposite.
12 I mean, if they had ran out and did the exercises,
13 then maybe we would have gotten some inference there.
14 Then there's something to hold onto.

15 THE COURT: Say they were just stupid.
16 Like even guys who rob a bank know to lay low for a
17 while and not to go out and spend a bunch of money
18 that would call attention to themselves. I mean, it's
19 sort of like shooting up a flare if you do that, isn't
20 it?

21 MR. LANSTRA: Fair enough.

22 I will say, Your Honor, the same thing
23 is being asked about on the timing. They did a 220
24 request. They got the minutes. And the same day,

1 December 9th, that the directors are talking about the
2 clinical results, they're also talking about option
3 grants. So if there is an inference to be made of
4 intent to deceive, that doesn't really make a lot of
5 sense either, the idea that they're going to talk
6 about both of them right out in the open while,
7 meanwhile, they have a deceptive scheme of fraud to do
8 this. So I think there's many different ways.

9 My basic point, though, is that all
10 they've alleged is this temporal sequence, and that
11 just doesn't seem enough. If that were the case, we
12 might as well remove 2(b), because the fact of the
13 directors possessing the material nonpublic
14 information would be enough and we wouldn't need an
15 intent to circumvent. The plaintiffs' argument is
16 that if you have (a), you necessarily have (b).

17 THE COURT: Anything else?

18 MR. LANSTRA: No, Your Honor.

19 THE COURT: Great.

20 MR. LANSTRA: Thank you.

21 MS. WINCHESTER: Good morning, Your
22 Honor. As we pled -- as we stated in our opposition
23 brief, we pled everything that is necessary under
24 Delaware law to satisfy the pleading burden at this

1 stage, which is that we raise a reasonable inference
2 that the board of directors intentionally violated the
3 stock option plan that was approved by the
4 stockholders which did not allow spring-loading. They
5 did so with the possession of material inside
6 information.

7 The Tyson case sets forth the factors
8 that need to be pled, and we pled each of those,
9 hands-down. One, the plaintiff has to establish that
10 grants were given pursuant to an options plan. That
11 was done. They were granted pursuant to the 2008
12 option plan. Two, the plaintiff establishes that the
13 directors who approved the plan or approved the
14 grants, one, possessed the material inside
15 information. We know that. We did a 220. They
16 received the information at the December 9 board
17 meeting.

18 Not only did the board receive that
19 information, but each of the option recipients
20 received that information. There is no question that
21 they knew that it was material inside information
22 because the general counsel told them, "This is
23 material inside information. You can't tell anybody
24 about it."

1 Then they decided to grant the
2 options. Not only did they decide to grant the
3 options, the following day, when, by the way, the
4 stock price was slightly lower than it was on the 9th,
5 but they also did so with 80,000 more per director
6 than they had agreed to several months prior. There
7 was no preset date here.

8 At the October board meeting, they
9 said, "We're going to grant options in December."
10 Even if they had said they were going to grant options
11 on December 10th, they still possessed material inside
12 information at the time that they made the grants,
13 and, importantly, and this goes to the second point,
14 they issued the options with an intent to circumvent
15 the stockholder-approved plans.

16 As the Weiss Court said, the fact that
17 they didn't disclose that they used this inside
18 information when they made the grants is enough to
19 raise a reasonable doubt and an inference that they
20 purposely violated the 2008 plan.

21 And here, unlike in Weiss and unlike
22 in Tyson, not only did they violate the terms of the
23 2008 plan, which did not allow spring-loading, which
24 specifically said the option grants had to be made at

1 fair market value, which was not fair market value
2 when you know the stock price is going to pop the next
3 day with the company's most important news in history,
4 but here you have an affirmative disclosure that "We
5 do not spring-load."

6 So taken together, there's certainly
7 at this stage of the pleadings enough to raise an
8 inference that the board cannot consider a demand.
9 Because not only do you have a majority of the
10 six-member board, four of them, granted the options,
11 but each of the six members received the options.
12 There is no Delaware case law at all that exists that
13 says that recipients of improper option awards get a
14 free pass one time that they do it.

15 Your Honor, there's nothing more that
16 I need to add unless you have any questions.

17 THE COURT: I don't. Thank you.

18 MS. WINCHESTER: You're welcome.

19 THE COURT: Reply?

20 MR. LANSTRA: Just briefly, Your
21 Honor, I would just point out that there are no facts,
22 again --

23 THE COURT: What would have happened
24 if the CEO had traded on December 10th, bought shares?

1 MR. LANSTRA: If the CEO traded on
2 December 10th and bought shares. Well, that would
3 be -- we're talking about options being exercised. I
4 go back to my earlier point. I think maybe there's
5 something there for an inference.

6 THE COURT: If he bought those
7 shares -- I mean, you're accepting that he -- I assume
8 you'd be accepting that he was in possession of
9 material nonpublic inside information at the time he
10 would have acquired those shares.

11 And it seems to me that the logic of
12 your position would be that there would be no claim,
13 no indication of scienter, and no possible claim,
14 unless and until he sold for profit. You know?

15 MR. LANSTRA: Well, I would have to
16 know what the strike price was. I think there would
17 have to be other facts.

18 THE COURT: No. He just goes out in
19 the market and buys.

20 MR. LANSTRA: He's not taking the
21 options?

22 THE COURT: I'm slightly varying the
23 facts. So instead of getting beneficial ownership of
24 shares through options, our CEO actually goes out and

1 buys in the market on the 10th, so at a time when he
2 knows about the study but there isn't yet disclosure
3 of the study.

4 Again, it seems to me that the
5 implication of your argument is that he would have no
6 potential insider trading liability because one could
7 not infer scienter.

8 MR. LANSTRA: I don't think that's
9 fair. I know where you're heading, but I think in our
10 scenario, which I think is what we have to bounce this
11 off of, you do have regular early times for things.

12 Let's say we take your position but we
13 also say that December 10th is his son's birthday, and
14 on December 10th every year, he's made either a
15 commitment or he's told his son --

16 THE COURT: Let's make it a little bit
17 more analogous. Let's say in December, he buys,
18 because that's what they agreed to do in October.
19 They said, "Let's price in December. We've
20 historically done this stuff at year-end." So let's
21 say that he has a historical pattern and practice of
22 buying shares in December. Sometimes he does it on
23 the 5th. Sometimes he does it on the 15th. Sometimes
24 he's a little bit slow. He does it after Christmas,

1 before New Year's. He's a December guy. So let's
2 assume that that's the case.

3 MR. LANSTRA: Right. But he gets to
4 act unilaterally. I think we have to separate the
5 facts. He's acting unilaterally. He's not acting as
6 a committee that needs to convene, that has set a
7 schedule. And I think that that does matter here.

8 Yes. Look, I think you're probably
9 closer if you had a committee that didn't have a
10 meeting scheduled; that hadn't done this at their
11 meetings for three straight years; that hadn't
12 indicated in October that they were going to issue
13 grants; and then just a one-member compensation
14 committee acts on December 10th. But, again, you're
15 being asked to take an inference from allegations that
16 just aren't applied.

17 THE COURT: All right. Great. I
18 interrupted you with my question, so I don't know if
19 there were other points you wanted to make.

20 MR. LANSTRA: Actually, I believe the
21 point I make got embodied in my answer. Thank you for
22 your time, Your Honor.

23 THE COURT: You're a good advocate.

24 MS. WINCHESTER: If I can address one

1 thing.

2 THE COURT: Sure.

3 MS. WINCHESTER: They found out on the
4 9th the material information. They could have
5 disclosed the information on that date and granted the
6 following day, which was when they granted, and then
7 we wouldn't be here today.

8 THE COURT: I assume you'd say they
9 could have done other things. They could have
10 rescheduled the meeting.

11 MS. WINCHESTER: Well, they met on the
12 9th and they met on the 10th. They found out the
13 information on the 9th.

14 THE COURT: Right. But on the 10th,
15 they could have said, "You know what? Now is not the
16 right time to do this."

17 MS. WINCHESTER: "We have inside
18 information we're not allowed to use to our
19 advantage."

20 THE COURT: "We ought to come back
21 right after Christmas and do this," or something like
22 that.

23 MS. WINCHESTER: Or when we file our
24 proxy with the disclosure of the grants and say that

1 we don't spring-load, they could have said, "Hey, by
2 the way, we spring-loaded a couple of months ago,"
3 which they didn't do.

4 THE COURT: Thank you, everyone. I'm
5 going to go ahead and give you my answer now.

6 There's two things for us to address
7 today, collectively: the motion to stay and the motion
8 to dismiss. So for the reasons I'm going to give you,
9 I'm going to grant in part the motion to stay and I'm
10 going to deny in its entirety the motion to dismiss as
11 to the aspects of the claims that I am not staying.

12 The factual background is as follows:
13 The plaintiffs are stockholders of CytRx Corporation.
14 The nominal defendant, CytRx, is a Delaware
15 corporation with its principal place of business in
16 Los Angeles. It's a biopharmaceutical research and
17 development company specializing in oncology, so
18 cancer-related things. The defendants are directors
19 and officers of CytRx.

20 The key facts are as follows: In
21 December 2011, the company commenced a -- I should
22 say, these are allegations. They're not facts, but I
23 have to assume they're true for purposes of today, so
24 that's why I call them facts.

1 In December 2011, the company
2 commenced a Phase 2b clinical trial to evaluate the
3 preliminary efficacy and safety of its primary drug,
4 aldoxorubicin. During the March and September 2013
5 time frame, there was indications from analysts and
6 investors that the effect of the results, the
7 implications of the results of the Phase 2b trial,
8 would be critical.

9 On December 9, 2013, all of the
10 individual defendants attended a board meeting during
11 which they were informed that the Phase 2b clinical
12 results were positive. They were informed that the
13 results of the trial would be "transformational."
14 They were also reminded that this information was
15 nonpublic and confidential.

16 The very next day, December 10, 2013,
17 the compensation committee granted options to purchase
18 2,925,000 shares of the company's common stock at a
19 strike price of \$2.39 per share. That at the time was
20 the trading price of the company's stock. At the
21 time, the company had not released any information
22 about the very positive and transformational clinical
23 results of the Phase 2b trials. After the market
24 closed, the company indicated that it would announce

1 the results the next day.

2 On the next day, the company issued a
3 press release before the market opened touting the
4 positive results of the trials. The market reacted
5 favorably, with the company's stock price gapping up
6 to \$3.90 per share on the open and closing at \$4.02
7 per share. The company stock price reached a two-year
8 high of \$6.12 per share the next day.

9 So just to review, December 9th, you
10 find out about these great transformational results.
11 December 10th, before the results are disclosed and at
12 a time when you know these results are confidential
13 and that the information is not public, you grant
14 yourself and your senior officers approximately
15 3 million options at a strike price reflecting the
16 price of the stock without any market knowledge of
17 this information. And then the next day, you release
18 the information, and then, indeed, the stock price
19 spikes.

20 There has been this lawsuit here as
21 well as lawsuits elsewhere filed regarding this
22 behavior, as well as some others regarding the
23 company's disclosures.

24 For example, on January 30, 2014, the

1 company announced a stock offering and filed a
2 prospectus with the SEC. The stock price increased to
3 \$7.98 per share after that announcement.

4 In March 2014, it was disclosed that
5 the company had hired a firm called the DreamTeamGroup
6 to promote the company's stock. There are reports
7 that alleged that insiders were involved in drafting
8 or editing the DreamTeam articles and that those
9 articles were designed to pump up the company's stock
10 price.

11 There are currently three federal
12 securities class actions pending in Federal Court in
13 California addressing the DreamTeam allegations and
14 the alleged pumping up of the stock price. There are
15 also some derivative actions in California.

16 The complaint here focuses principally
17 on the grant by the insiders of the stock options to
18 themselves. It does mention secondarily the DreamTeam
19 allegations.

20 The first motion, the motion to stay,
21 seeks to stay this action in deference to the
22 California federal securities actions.

23 It is certainly true that this Court
24 often stays derivative actions that have been filed as

1 follow-on indemnification-oriented proceedings that
2 seek to recover the damages suffered by a company as a
3 result of bad disclosures. In that type of scenario,
4 it makes eminent sense for the disclosure claims to go
5 first.

6 Part of what you have to figure out in
7 the indemnification action is, A, whether the company
8 suffered any harm and, B, the amount that it suffered
9 before you can figure out whether there's anything to
10 indemnify. So in that type of context, it makes
11 eminent sense for the Delaware derivative action to be
12 stayed.

13 In this case, however, that is not
14 what the principal claims are doing. The principal
15 claims in this case allege a self-interested
16 compensation decision by the fiduciaries of a Delaware
17 corporation. This is alleged to be a substantive
18 Delaware law wrong.

19 The primary issue here is not one of
20 disclosure. One can reframe it as disclosure, and
21 enterprising plaintiffs' lawyers are very good at
22 reframing substantive wrongs as disclosure claims so
23 as to get them into Federal Court. So if you have the
24 substantive wrong and you don't accurately disclose

1 that you have engaged in the substantive wrong, a
2 plaintiff can allege that you have a disclosure claim
3 because you failed to disclose that you were doing
4 these bad things.

5 The meat of the claim, though, is the
6 underlying substantive wrong, and the disclosure claim
7 only rises or falls based on what is a matter of
8 Delaware law and substantive corporate law. That's
9 the exact opposite of a case like a tagalong
10 indemnification claim, where the substantive wrong is
11 one of disclosure and the Delaware law issue only
12 arises depending on the outcome of the federal
13 disclosure claim.

14 Here, in my view, as to the
15 overcompensation claims, the self-interested
16 compensation claims, the core wrong is a Delaware one.
17 In my view, there is no reason to defer and it would
18 be bad policy to defer to a federal securities action
19 that is primarily concerned with disclosures over a
20 broader period of time and concerned with potentially
21 moving money from one group of stockholders to
22 another. What the Delaware case is about is the
23 behavior of fiduciaries, which is a quintessentially
24 Delaware concern.

1 If I reframe this analysis in the
2 technical language of the McWane doctrine, which is
3 the framework in which it has been briefed, the McWane
4 doctrine seeks to address when a second-filed action
5 should defer to a first-filed action. What you don't
6 want is duplicative lawsuits. What you want is to
7 minimize overall litigation costs.

8 Here, the federal securities law
9 action, although it touches on some similar factual
10 issue, it is not sufficiently overlapping with the
11 Delaware action to, in my view, be treated as
12 first-filed under McWane. And that's for the reasons
13 that I've already addressed.

14 Another important factor in
15 determining whether a stay is appropriate is the first
16 Court's ability to render justice. The federal
17 securities action is involved in rendering justice on
18 different theories to different stockholders regarding
19 different claims. It does not address the core issue
20 of this case, which is self-dealing by Delaware
21 fiduciaries.

22 I could also analyze this under the
23 guise of forum non conveniens, which asks which Court
24 is best suited to address the matter and whether there

1 would be overwhelming prejudice to the defendants from
2 litigating here. Certainly, I don't think there is
3 overwhelming prejudice to fiduciaries of a Delaware
4 corporation to litigate breach of fiduciary duty
5 claims in Delaware.

6 Now, where I do think the defendants
7 have a point is as to the allegations of the complaint
8 relating to the secondary stock offering or the
9 DreamTeam. Those, I think, are primarily federal
10 issues about the disclosures that were made to
11 stockholders and whether those disclosures pumped up
12 or otherwise manipulated the stock price. That's
13 primarily a federal concern, not a Delaware concern.
14 Disclosure is historically principally a federal
15 concern, at least in terms of companies on the public
16 markets.

17 It is not clear, or not entirely
18 clear, from the complaint to what degree the
19 plaintiffs intend to litigate those matters. There
20 are some allegations in the complaint that suggest
21 they do intend to litigate some of those things here.

22 To avoid any confusion, I am going to
23 grant the motion to stay to the extent the plaintiffs
24 seek to litigate anything about the DreamTeam or the

1 secondary offering. I think those allegations overlap
2 with, to a greater degree, and should be litigated in
3 the federal securities action.

4 By contrast, I am going to deny the
5 stay to the extent the complaint attacks the allegedly
6 self-interested decision that was made on December
7 10th and the sequence of events that occurred on the
8 9th, 10th, and 11th that resulted in the receipt by
9 the insiders of stock options with a strike price of
10 \$2.39 per share at a time when, according to the
11 allegations of the complaint, those insiders were
12 possessing material nonpublic information about a
13 Phase 2 trial that would be transformational for the
14 company and the single biggest event in the company's
15 history.

16 My discussion of the facts has likely
17 foreshadowed the reasoning that goes into my denial of
18 the motion to dismiss under Rule 23.1. Rule 23.1 is
19 designed to ensure that the appropriate corporate
20 decision-makers have the ability to decide whether to
21 bring a corporate claim. A stockholder should not be
22 able to divest the appropriate corporate
23 decision-maker of its ability to decide what to do
24 with a claim simply by bringing suit. Where, however,

1 the appropriate corporate decision-makers are disabled
2 because of self-interest, demand is excused.

3 Here, there was a six-member board.
4 Four of the members were part of the compensation
5 committee that granted the options, including to
6 themselves. All of the directors received options.
7 This is quintessentially self-interested conduct to
8 which entire fairness applies.

9 To the extent that there is a need for
10 scienter, I do think that in this case, there is an
11 inference of scienter. It may well be that in a case
12 where you're talking about, generally, whether
13 directors had knowledge about inside information, such
14 as quarterly results, a periodic granting of options
15 on a regular date, according to a preset time, is a
16 countervailing factor that mitigates the inference of
17 scienter.

18 Here, we're talking about a situation
19 where people got news about the company that was going
20 to be transformational, knew it was nonpublic, knew it
21 was material. The very next day, before there was any
22 disclosure, they granted themselves and senior
23 officers 3 million options. They granted themselves
24 not the 100,000 options each that originally were

1 contemplated in October but actually bumped the number
2 up to 180,000 options each. There would have been
3 myriad ways for them to not act so as to receive this
4 rather substantial benefit in terms of the strike
5 price below where the market price was likely to
6 settle and what the intrinsic value of the share
7 likely was. One easy method of doing so would have
8 been to simply postpone the meeting until after the
9 news was released. By that I mean postpone the
10 December 10th meeting at which the options were
11 granted.

12 When you have this type of
13 eyebrow-raising self-interested conduct, the fact that
14 you haven't done it a lot doesn't defeat an inference
15 of scienter. The fact that you may have planned
16 historically to grant options in December doesn't
17 defeat an inference of scienter.

18 Nobody said you had to do it on
19 December 10th when you knew this stuff and the market
20 didn't. How about December 20th? At that point, the
21 market would have known it. If you really had to do
22 it on December 10th, you might have tried to make a
23 determination about what the fair market value was on
24 that date, assuming full knowledge by a willing buyer

1 and seller of all material information and a buyer and
2 seller not under any compulsion to buy or compulsion
3 to sell.

4 So both for purposes of the first and,
5 indeed, the second prong of Aronson, I think demand is
6 futile.

7 Likewise, for purposes of Rule
8 12(b)(6), having withstood the higher standard of Rule
9 23.1, the complaint states a claim.

10 Just so I'm not accused of glomming
11 everything together, I will go through, briefly, each
12 of the counts.

13 Count I is framed precisely as a
14 granting-of-spring-loaded options claim. In my view,
15 this case is controlled by Weiss and Tyson. A case
16 like Desimone, which involves much less egregious
17 allegations, is clearly distinguishable.

18 It really would be difficult to design
19 a fact pattern that would more graphically capture
20 what spring-loading is all about. It's almost like a
21 law school hypothetical in terms of what you would
22 want to have factually to really put the policy
23 question directly at issue as to whether this is the
24 type of permissible behavior in which fiduciaries can

1 engage.

2 So Count I states a claim.

3 Count II alleges waste. Waste is
4 normally really hard to allege. I mean it's easy to
5 allege. It's hard to survive a motion to dismiss
6 because you have to allege a transaction that no
7 reasonable person would approve. In other words,
8 economic terms so one-sided as to create an inference
9 that people weren't acting in good faith.

10 Here, you actually have it, because,
11 basically, what the allegation is, is that the
12 directors found a way to give themselves dollars for
13 25 cents. In other words, the stock at the time,
14 because of the transformational news that they knew
15 and the market didn't, had a fair market value far
16 greater than the \$2.39 strike price. Indeed, it
17 ultimately went up to 7-ish bucks a share. But
18 because they used the market price where the market
19 did not know about this information, they were able to
20 price the options for approximately 25 percent or a
21 third of that. So they got dollars for 25 cents or 33
22 cents.

23 Would an ordinary person swap dollars
24 for 25 cents? No. An ordinary person, if you go up

1 to them and say, "I've got \$5. How about you give me
2 \$1," they're not going to do that deal.

3 For fiduciaries to say, "Yes, we will
4 do that deal" raises an inference of waste. That is
5 the type of transaction that no reasonable person
6 would agree to. That doesn't mean you can't
7 eventually prove it's not a waste, but for pleading
8 purposes, giving yourself dollars for 25 cents or 33
9 cents or whatever the exact number works out to be,
10 that's waste.

11 Count III alleges more generally a
12 breach of the duty of loyalty. That's really what
13 we're talking about here. When you engage in behavior
14 that, based on the allegation of the complaint,
15 appears self-interested such that you give yourself
16 assets for less than their fair value, that's classic
17 breach of the duty of loyalty stuff. So Count III
18 certainly states a claim.

19 And Count IV reframes these theories
20 as unjust enrichment. That is a fallback claim,
21 assuming that none of the other theories apply. But
22 the idea of unjust enrichment is the unjust retention
23 of a benefit that you really shouldn't have gotten.
24 When you get dollars for whatever it works out to be,

1 25 cents, 33 cents, because you priced at the market
2 when you hadn't told the market about this
3 transformational information, you're unjustly
4 enriching yourself. So Count IV states a claim.

5 I doubt it's the claim that ultimately
6 would justify relief in this case. Indeed, if I had
7 to bet, assuming the allegations prove out as they've
8 been alleged, I would expect to rest on Count I or
9 Count III without having to reach Count II and Count
10 IV. But it's there. It states a claim.

11 Lastly, in terms of Section 102(b)(7),
12 this is self-interested conduct to which exculpation
13 under Section 102(b)(7) doesn't apply.

14 So those are my rulings. Whatever you
15 all want to do about implementing this is fine with
16 me. I can't remember whether I have things in my
17 queue on this or not. But I do think it would
18 probably be good to have something shorter and more to
19 the point than this transcript making clear that I
20 have stayed as to the secondary offering and the
21 DreamTeam.

22 What's going to go forward here and
23 what I would like you all to work out a schedule on so
24 that this will get promptly to trial is the events of

1 December 9th, 10th and 11th and the stock option
2 grants.

3 And I say get promptly to trial
4 because this is a complaint that was based on some
5 books and records obtained pursuant to Section 220.
6 When you've got this sequence -- and again, if it
7 turns out that the plaintiffs have made this stuff up
8 and the board actually didn't have the study on
9 December 10th, that's a different story. Then there's
10 all kinds of bigger problems. But if the sequence is
11 as pled here, I don't think you have a viable summary
12 judgment motion. I think you have facts and evidence
13 from which one could infer bad behavior.

14 Now, somebody may prove at trial, no,
15 those inferences shouldn't be drawn. Everything was
16 on the up and up. But those aren't determinations
17 that could be made on a summary judgment record.

18 Perhaps you all can convince me
19 otherwise. But what I think, as a case management
20 matter, you all ought to do is figure out a way to get
21 this to trial this year, ideally, maybe third quarter.
22 We could all get back together around the time that
23 school is starting. And we can find out what the real
24 deal was and what ended up happening.

1 All right. So Mr. Lanstra, you're the
2 movant. Do you have any questions about my rulings?
3 Is there anything I can elaborate on? Is there
4 anything I haven't sufficiently covered?

5 MR. LANSTRA: No, Your Honor. Thank
6 you.

7 THE COURT: Great.

8 Ms. Winchester and Mr. Taylor, how
9 about you?

10 I guess, Ms. Winchester, since I
11 basically agreed with you, you probably don't have any
12 concerns.

13 Mr. Taylor, is there anything in the
14 first instance that you are unclear about, about what
15 I have stayed and haven't stayed?

16 MR. TAYLOR: No, Your Honor. Very
17 clear. Thank you.

18 THE COURT: Ms. Winchester, how about
19 you?

20 MS. WINCHESTER: I have no questions,
21 Your Honor.

22 THE COURT: Great. Thank you,
23 everyone, for coming in. I'll look forward to seeing
24 you all in due course and getting a schedule. I

1 appreciate everyone's time and stay warm.

2 (Court adjourned at 11:55 a.m.)

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CERTIFICATE

I, JEANNE CAHILL, RDR, CRR, Official Court Reporter for the Court of Chancery of the State of Delaware, do hereby certify that the foregoing pages numbered 3 through 44 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF I have hereunto set my hand at Wilmington, Delaware, this 8th day of January, 2015.

/s/ Jeanne Cahill

Jeanne Cahill, RDR, CRR
Official Chancery Court Reporter
Registered Diplomat Reporter
Certified Realtime Reporter