IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

PONTIAC GENERAL EMPLOYEES RETIREMENT SYSTEM, On Behalf of Itself and All Others Similarly Situated and On Behalf of Nominal Defendant HEALTHWAYS, INC., Plaintiff, v. JOHN W. BALLANTINE, J. CRIS BISGARD, MARY JANE ENGLAND, BEN R. LEEDLE JR., C. WARREN NEEL, WILLIAM D. NOVELLI, ALLISON TAUNTON-RIGBY, DONATO TRAMUTO, JOHN A. WICKENS, KEVIN WILLS, and SUNTRUST BANK, Defendants, and HEALTHWAYS, INC., Nominal Defendant.	REDACTED VERSION FILED ON: June 24, 2014 C.A. No. 9789-VCL

VERIFIED CLASS ACTION AND DERIVATIVE COMPLAINT

Plaintiff Pontiac General Employees Retirement System ("Plaintiff"), on behalf of itself and all other similarly situated public stockholders of Healthways, Inc. ("Healthways" or the "Company), brings the following Verified Class Action and Derivative Complaint (the "Complaint") against members of the Healthways board of directors (the "Board"), defendants John W. Ballantine, J. Cris Bisgard, Mary Jane England, Ben R. Leedle Jr., C. Warren Neel, William D. Novelli, Allison Taunton-Rigby, Donato Tramuto, John A. Wickens, and Kevin Wills, for breaching their fiduciary duties, against SunTrust Bank, the administrative agent for the Lenders under the Loan Agreement at issue, for aiding and abetting the same, and for a declaration that the so-called "Proxy Put" or "Dead Hand Proxy Put" in the Company's debt agreement is unenforceable. The Proxy Put is a provision in the Company's debt agreement that defines the election of a majority of directors whose initial nomination arose from an actual or threatened proxy contest to be an event of default thereby triggering the lender's right to accelerate (or put back) the debt.

The allegations of the Complaint are based on the knowledge of Plaintiff as to itself and on information and belief, including the investigation of counsel and review of publicly available information and internal Company documents produced in response to Plaintiff's March 20, 2014 demand for the production of books and records pursuant to Section 220 of the Delaware General Corporation Law ("DGCL"), as to all other matters.

NATURE OF THE ACTION

1. The Delaware courts have noted the deleterious effects of Proxy Put provisions in debt and credit instruments, such as the debt agreement at issue here. In *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, 983

A.2d 304 (Del. Ch. 2009), the Delaware Court of Chancery recognized that Proxy Puts "can operate as improper entrenchment devices that coerce stockholders into voting only for persons approved by the incumbent board."

2. Vice Chancellor Lamb explained that a debt instrument with "an eviscerating effect on the stockholder franchise would raise grave concerns":

> In the first instance, those concerns would relate to the exercise of the board's fiduciary duties in agreeing to such a provision. ***The court would want, at a minimum, to see evidence that the board believed in good faith that, in accepting such a provision, it was obtaining in return extraordinarily valuable economic benefits for the corporation that would not otherwise be available to it***. Additionally, the court would have to ***closely consider*** the degree to which such a provision might be unenforceable as against public policy.

(Emphasis added).

3. Vice Chancellor Lamb also "highlight[ed] the ***troubling reality*** that corporations and their counsel routinely negotiate contract terms that may, in some circumstances, impinge on the free exercise of the stockholder franchise." As the Court observed, "there are few events which have the potential to be more catastrophic for a corporation" than a default on the company's outstanding debt.

4. The Court highlighted the problem raised when boards provide corporate creditors with contractual rights whose exercise undermines the core franchise rights of the corporate stockholders. In this regard, the Court cautioned boards that "when negotiating with rights that belong . . . to the stockholders (i.e.,

the stockholder franchise), [the board] must be ***especially solicitous*** to its duties," and those upon whom the board relies must be "***especially mindful*** of the board's continuing duties."

5. In a subsequent opinion in the same case, Vice Chancellor Noble reiterated that the offending provisions of the debt instruments "deterr[ed] the stockholders from nominating and electing directors of their choosing." Accordingly, the Court held that "significant and substantial benefits ***unquestionably*** accrued" to the stockholders as a result of the removal and limitation of the "influences on the voting calculus" caused by the Proxy Put provisions. As then-Chancellor and now-Chief Justice Strine also held in *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242 (Del. Ch. 2013), "[s]uch contracts are dangerous," and the burden is therefore on the board to explain itself.

6. Especially in light of Vice Chancellor Lamb's and Vice Chancellor Noble's rulings, the Healthways Board and its advisors must have understood the director-entrenching and coercive effect that Proxy Puts could have on the stockholder franchise. Indeed, the *Amylin* Court observed that even the company's counterparties were on notice that these provisions could be "unenforceab[le]" before the *Amylin* decision issued.

7. Practitioners also took notice and cautioned boards about proxy put provisions. For instance, Ryan Thomas wrote an article in 2009, entitled "What

Amylin Means for Directors, Proxy Fights," which recognized that "[p]oison puts are ***no longer a dirty little secret***, and the *Amylin* case made clear that ***boards have a continuing duty to protect their stockholders' interests notwithstanding a need to incur indebtedness***." The article emphasizes that "[s]uch provisions can also restrict the ability of a board or stockholders to pursue a friendly takeover offer. The contractual, fiduciary and strategic issues that companies and boards may face are potentially daunting." Boards must "ensure the Company is receiving commensurate economic and other benefits by accepting these provisions." As Thomas presciently concluded, "Courts will likely apply greater hindsight scrutiny in future cases."

8. Numerous times prior to 2012, Healthways had entered into credit agreements and amendments to those agreements. Those agreements did not include a "Dead Hand Proxy Put" that would prevent the Board from approving directors initially nominated in connection with a proxy context or threatened proxy contest. But in 2012, the New York State Common Retirement Fund ("NYSCRF"), one of Healthways large institutional investors, submitted a stockholder proposal to declassify the Board. The Healthways Board opposed the proposal, but the stockholders nonetheless voted by a ten-to-one margin in support of the proposal. On June 8, 2012, barely a week after stockholders voted to de-stagger the Board, Healthways entered into a new amended revolving credit and

term loan agreement, with a $200 million revolving credit facility and a $200 million term loan (the “2012 Loan Agreement”). This 2012 Loan Agreement bound Healthways to a Dead Hand Proxy Put.

9. The 2012 Loan Agreement defines a “change of control” as an event of default. A change of control is triggered when, during any consecutive 24-month period, the majority of Directors are not “continuing directors.” The definition of “continuing directors,” in turn, excludes persons who become Board members as a result of “actual or threatened solicitation of proxies or consents for the election or removal of one or more directors.”

10. At the time Healthways’ Board approved the Company’s entry into the 2012 Loan Agreement that included the Dead Hand Proxy Put, the market for refinancing the credit agreement for Healthways was so favorable that the Company was refinancing before it had to do so. As Healthways described in its press release touting the 2012 Loan Agreement – but making no public mention of the Dead Hand Proxy Put:

> “Given the favorable interest rate environment that exists now and the uncertainty of market conditions over the next 18 months, we chose to refinance our facility early. Today’s announcement represents an important statement regarding both our current financial stability and growth expectations for Healthways over the next five years,” said Alfred Lumsdaine, Healthways Chief Financial Officer.

11. In 2013, Healthways issued $125 million and $20 million of notes, and both have cross-default provisions, so that a default under the 2012 Loan Agreement pursuant to the Dead Hand Proxy Put would also cause defaults under the two sets of notes. As such, any default under the Dead Hand Proxy Put would cause enormous economic harm to Healthways.

12. Rather than file suit immediately, Plaintiff sought to identify the Board's justification for its approval of the Dead Hand Proxy Put. While no convincing response was expected, Plaintiff gave the Board the opportunity to show that it negotiated for the "extraordinarily valuable" consideration discussed in Vice Chancellor Lamb's ruling that would justify employing franchise destructive debt provisions.

13. On March 20, 2014, Plaintiff served a Demand to Inspect the Books and Records of the Company pursuant to Section 220 of the DGCL (the "220 Demand"), a copy of which is attached hereto as Exhibit A. Undermining any basis for the Healthways Board to justify its actions, the Board minutes and other materials produced in response to the 220 Demand [redacted].

14. The Healthways Board breached their fiduciary duties by approving and maintaining the Dead Hand Proxy Put, which serves no purpose other than to entrench the incumbent Board.

PARTIES

15. Pontiac General Employees Retirement System ("Plaintiff") is a current stockholder of the Company, was a stockholder at the time of the misconduct complained of herein, and intends to hold Healthways shares at least through the resolution of this action.

16. Defendant Healthways provides specialized, comprehensive solutions to help people improve their physical, emotional, and social well-being. The Company provides specific and personalized interventions along with modeling capabilities that allow it to identify and sort participants who are most at risk of an adverse health event. The Company's stock trades on Nasdaq under the ticker symbol "HWAY."

17. Defendant John W. Ballantine ("Ballantine") has served as a director of the Company since 2003 and was Chairman of the Board of Directors from 2011 until June 12, 2014. Among other board positions, Ballantine served as a director of Enron.

18. Defendant J. Cris Bisgard ("Bisgard") has served as a director of the Company since 2003.

19. Defendant Mary Jane England ("England") has served as a director of the Company since 2004.

20. Defendant Ben R. Leedle Jr. ("Leedle") has served as a director of the Company and CEO since 2003. He has also served as President from 2002-2008 and 2011 through the present day. Over the nearly thirty years he has held numerous other positions with Healthways including COO from 1999-2003, Executive Vice President from 1999-2002, and Senior Vice President of Operations from 1997-1999.

21. Defendant C. Warren Neel ("Neel") has served as a director of the Company since 1991.

22. Defendant William D. Novelli ("Novelli") has served as a director of the Company since 2009.

23. Defendant Allison Taunton-Rigby ("Rigby") has served as a director of the Company since 2005.

24. Defendant Donato Tramuto ("Tramuto") has served as a director of the Company since 2013, and became Chairman of the Board on June 12, 2014. He was elected at the annual stockholder meeting held on May 30, 2013.

25. Defendant John A. Wickens ("Wickens") has served as a director of the Company since 2007.

26. Defendant Kevin Wills ("Wills") has served as a director of the Company since 2012. He was elected at the annual stockholder meeting held on May 31, 2012.

27. The defendants listed in ¶¶ 17-26 above are collectively referred to herein as the "Individual Defendants" or the "Board."

28. Healthways and other members of the Board, including Mr. Leedle, are not strangers to the Delaware courts. *See Pfeiffer v. Leedle*, 2013 WL 5988416, at *5 (Del. Ch. Nov. 8, 2013) (holding demand excused and that plaintiff stated claims for breach of the duty of loyalty, unjust enrichment and misleading proxy disclosures after Healthways violated stock plan).

29. By virtue of their positions as directors of Healthways, and/or exercise of control and ownership over the business and corporate affairs of the Company, the Individual Defendants have, and at all relevant times had, the power to control and influence and did control and influence and cause the Company to engage in the practices complained of herein. Each Director Defendant owed and owes Healthways and its stockholders fiduciary obligations of care, candor, good faith, and loyalty and were and are required to: (1) use his or her ability to control and manage Healthways in a fair, just, and equitable manner; (2) act in furtherance of the best interests of Healthways and its stockholders; (3) govern Healthways in such a manner as to heed the expressed views of its public stockholders; (4) refrain from abusing his or her position of control; and (5) not favor his or her personal interests, or any third persons' interests, at the expense of the Company and its public stockholders.

30. Defendant SunTrust Bank (the "Lender") is the Administrative Agent under the June 2012 Loan Agreement, described below.

SUBSTANTIVE ALLEGATIONS

A. Procedural History

31. On March 20, 2014, Plaintiff served the 220 Demand seeking, *inter alia*, Company documents and records relating to the Dead Hand Proxy Put contained in its 2012 Loan Agreement and the reasons and justification for entering into the Dead Hand Proxy Put. Over the course of three months, Healthways has dribbled out documents to Plaintiff in response to the 220 Demand, but only when repeatedly pushed to do so. [redacted]

B. Healthways' 2010 Credit Agreement

32. In 2010 Healthways entered into a Fourth Amended and Restated Revolving Credit and Term Loan Agreement. This credit agreement had a change of control provision regarding the composition of the Board, which included a 24-month applicable period and a reference to "Continuing Directors." The provision is implicated when "during any period of 24 consecutive months, a majority of the members of the board of directors or other equivalent governing body of the

Borrower cease to be composed of Continuing Directors." The definition of "Continuing Directors" was as follows:

> ***"Continuing Directors"*** shall mean, with respect to any period, individuals (A) who were members of that board or equivalent governing body on the first day of such period, (B) whose election or nomination to that board or equivalent governing body was approved by individuals referred to in clause (A) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body, or (C) whose election or nomination to that board or other equivalent governing body was approved by individuals referred to in clauses (A) and (B) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body.

33. This prior credit agreement did not contain a Dead Hand Proxy Put.

C. The Stockholders Vote To De-Stagger The Board

34. The NYSCRF submitted to Healthways a stockholders proposal to declassify the Healthways election of Board members. The NYSCRF wrote, in relevant part, as follows:

> We believe that the ability to elect directors is the single most important use of the shareholder franchise. Accordingly, directors should be accountable to shareholders on an annual basis. The election of directors, by class, for three-year terms, in our opinion minimizes accountability and precludes the full exercise of the rights of shareholders to approve or disapprove annually the performance of a director or directors.

35. The proposal was included in Healthways' Proxy dated April 20, 2012. The Board opposed this stockholder proposal to declassify the Board. The Board wrote in its Proxy, in relevant part, as follows:

> After careful consideration of this proposal, the Board believes that the retention of a classified structure for the Board remains in the best long-term interests of the Company and its stockholders.
>
> The Board of Directors recommends a vote AGAINST this proposal for the reasons set forth above.

36. Nonetheless, on May 31, 2012, the Healthways stockholders approved by a ten-to-one margin the stockholder proposal to declassify the Board.

37. In the face of this massive stockholder opposition, the Board relented. On October 10, 2013, the Company amended the Company's Articles of Incorporation to phase out the staggered board over three years by making each successive election, starting in 2014, for a one (1) year term. This amendment makes it more likely the Proxy Put will be triggered as, starting in 2015, a majority of the Board (and starting in 2016 the whole Board), will be up for reelection at one time. The presence of the Proxy Put makes the Company less susceptible to a proxy fight that seeks to unseat a majority of the Board.

D. Healthways' Board Approves a Dead Hand Proxy Put Provision

38. The Board wasted little time devising an indirect way to deter a turnover of a majority of the Board. On June 8, 2012, Healthways entered into a

Fifth Amended and Restated Revolving Credit and Term Loan Agreement with U.S. Bank National Association and Fifth Third Bank as co-syndication Agents, JPMorgan Chase Bank, N.A. as documentation agent, and SunTrust Bank as administrative agent. The parties entered into three subsequent amendments to the 2012 Loan Agreement, on February 5, 2013, March 15, 2013, and July 1, 2013 (collectively with the 2012 Loan Agreement, the "Loan Agreement").

39. The credit facilities provided for in the Loan Agreement include (i) a $200 million revolving credit facility terminating on June 8, 2017 (including a $20 million swingline sub facility and a $75 million subfacility for letters of credit); and (ii) a $200 million term loan facility maturing on June 8, 2017.

40. Pursuant to the Loan Agreement, if more than half of the incumbent Board is replaced through a contested election or threatened contested election, the lenders under the Loan Agreement may, through the administrative agent, declare a default and cause the principal and any accrued interest on any outstanding loans made pursuant to the Loan Agreement immediately due and payable.

41. Specifically, Section 8.1(m) of the Loan Agreement defines a "Change in Control" as an "Event of Default." Section 8.1 goes on to say that upon the occurrence of an Event of Default and throughout its continued existence:

> the Administrative Agent may, and upon the written request of the Required Lenders shall, by notice to the Borrower, take any or all of the following actions, at the same or different times: (i) terminate the

> Commitments, whereupon the Commitment of each Lender shall terminate immediately; (ii) declare the principal of and any accrued interest on the Loans and all other Obligations (excluding the Hedge/Cash Management Exposure) to be, whereupon the same shall become due and payable immediately, without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Borrower and (iii) exercise all remedies contained in any other Loan Document[.]

42. In turn, Section 1.1, as amended by the Third Amendment to the June 2012 Loan Agreement, defines Change in Control as:

> the occurrence of one or more of the following events: . . . (c) during any period of 24 consecutive months, a majority of the members of the board of directors or other equivalent governing body of the Borrower cease to be composed of individuals who are Continuing Directors; . . . .

43. Unlike the definition used in Healthways' prior debt agreements, Section 1.1 of the June 2012 Loan Agreement defines Continuing Directors as:

> with respect to any period, any individuals (A) who were members of the board of directors or other equivalent governing body of the Borrower on the first day of such period, (B) whose election or nomination to that board or equivalent governing body was approved by individuals referred to in clause (A) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body, or (C) whose election or nomination to that board or other equivalent governing body was approved by individuals referred to in clauses (A) and (B) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body ***(excluding, in the case of both clauses (B) and (C), any individual whose initial nomination for, or assumption of office as, a member of that board or equivalent governing body occurs as a result of an actual or threatened solicitation of proxies***

> ***or consents for the election or removal of one or more directors by any person or group other than a solicitation for the election of one or more directors by or on behalf of the board of directors)***.

(Emphasis added).

44. These provisions are contained in the initial 2012 Loan Agreement and have not been altered by subsequent amendments.

45. Therefore, Healthways risks default under the Loan Agreement if a majority of the Board during any given twenty-four (24) month period consists of stockholder nominees or similar insurgents. In other words, while the Board will no longer be staggered under the Company's foundational documents, stockholders effectively must treat the Board as super-staggered. Stockholders cannot force the unseating of a majority of directors in fewer than three election cycles (*i.e.*, 24 months) without incurring potentially catastrophic financial harm.

46. On July 8, 2013, Healthways issued $125,000,000 of 1.50% Cash Convertible Senior Notes. The indenture for these notes provides that it is an "event of default" if the Company defaults on any other loans in excess of $10,000,000. Accordingly, a default under the Loan Agreement would result in a cross default of these notes.

47. On October 1, 2013, Healthways issued a $20,000,000 Convertible Senior Subordinated Note. The note provides that it is an "event of default" if the

Company defaults on any other loans in excess of $10,000,000. Accordingly, a default under the Loan Agreement would result in a cross default of these notes.

48. According to the Company's annual Form 10-K (the "10-K") filed on March 14, 2014, the Company had $283.6 million in long-term debt outstanding as of December 31, 2013. On the same date the Company had Total current assets of $119.2 million and Total assets of $749 million.

49. Therefore, should any stockholder wage a successful proxy fight, or threaten to wage one, that results in the election of a majority of new directors, such an election would be an Event of Default under the Loan Agreement and would subject Healthways to a large and immediate payment of all loan principal and accrued interest incurred under the Loan Agreement, as well as under the two convertible notes.

50. In light of the language highlighted above, the Board has disabled itself from avoiding this Event of Default. Thus, at a minimum, the price to the Company of stockholders launching a proxy fight would be a payment to the lenders for waiving such an Event of Default. It is both wasteful and bad faith for the Board to impose this cost on the Company.

51. Moreover, there can be no assurance that lenders will agree to a waiver of their default rights for any fee. Indeed, a proxy contest is most likely when a company's financial performance is at its nadir. So, too, lenders' desire to

enforce default provisions or extract significant concessions in exchange for a waiver is at its greatest when a company's financial performance is at its nadir. Thus, the Board has approved a Dead Hand Proxy Put that will predictably have the greatest deterrent effect when the likelihood of stockholder efforts to exercise their franchise rights is at its peak.

E. The Record Undermines Any Justification for the Proxy Put

52. The message of the Court of Chancery's 2009 *Amylin* decision is clear. Unless the Board believed in good faith that it was receiving extraordinary consideration specifically in exchange for the Dead Hand Proxy Put, as opposed to the other terms of the Loan Agreement, it should not have agreed to its inclusion.

53. Healthways' Board's approval of a Dead Hand Proxy Put, more than three years after *Amylin* and based on the documents produced by the Company, was a breach of fiduciary duty. Despite Vice Chancellor Lamb's warning, or perhaps because *Amylin* highlighted the "eviscerating effect" that proxy puts can have on the stockholder franchise, Healthways' Board endorsed the Loan Agreement and its Dead Hand Proxy Put.

54. First, at the time Healthways' Board approved the entry into the 2012 Loan Agreement that included the Dead Hand Proxy Put, the market for refinancing Healthways' credit agreement was very favorable. Indeed, Healthways was refinancing debt well before it had to do so. Healthways touted in its press

release about the 2012 Loan Agreement the favorable financial conditions both in the market and at the Company.

55. Second, Plaintiff's review of the Board minutes and materials produced in response to the 220 Demand reflects [redacted]. Similarly, a review of the Board minutes and materials produced in response to the 220 Demand reflects [redacted].

56. As such, despite this Court's warning in *Amylin*, there is no such evidence here that the Board received, or negotiated for, extraordinary consideration. To the contrary, as Healthways and the Board stated, the market conditions were extremely favorable when it negotiated and entered into the 2012 Credit Agreement with the Dead Hand Proxy Put, and there is no reason to believe the lenders extended extraordinary consideration in exchange for the Proxy Put. Therefore, the only end the Dead Hand Proxy Put serves is to entrench the current Board.

57. The Lenders aided and abetted the Board's breach by including a contractual provision that they knew or should have known was invalid. After *Amylin*, the lender community was put on notice that entering into Dead Hand

Proxy Puts would likely violate directors' fiduciary duties unless the borrower was aware of and extracted significant concessions in exchange for agreeing to such provisions. The Lender nonetheless allowed the Loan Agreement, which included no such concessions, to include the Dead Hand Proxy Put. Thus, the Lenders have no justifiable expectation that the Dead Hand Proxy Put is enforceable.

58. Indeed, considering the multitude of financial covenants and representations in the 2012 Loan Agreement, the lenders already have protection in the event of changes on the Board.

F. Investors Have Expressed Their Discontent with the Board

59. For the past several months, North Tide Capital LLC ("North Tide") has expressed, through public letters to the Board, its strong displeasure regarding the Company's recent performance and the Board's management thereof. North Tide, together with its affiliates, currently owns approximately 11% of the outstanding common stock of Healthways.

60. North Tide began actively to engage Healthways concerning the direction of the company in late 2013. On December 2, 2013, it issued a public letter to the Board in which it strongly criticized the performance and leadership of the Company and called on the Board to, among other things, remove Leedle from his position as CEO. North Tide stated, in relevant part:

> The value destruction for Healthways shareholders during Mr. Leedle's tenure as CEO is irrefutable. Since Mr. Leedle was appointed CEO in September 2003, Healthways' share price performance has been abysmal on both an absolute and relative basis. From its peak in early 2008, the company's market capitalization has declined more than 80% from $2.7 billion to less than $500 million today (and less than $350MM in late October). EBITDA will be lower in 2013 than it was in his first full year as CEO, despite more than $600 million in acquisitions and an increase in the Company's debt balance from $0 to $260 million. Revenue has yet to recover from the 2008 peak, and based on the recently lowered guidance, ***Mr. Leedle and his senior management team will miss internally established EPS targets, published in annual proxy statements on file with the SEC, for the third year in a row, the fourth year in the last six, and the sixth year in the last ten***.
>
> ***
>
> The Board's tolerance for Mr. Leedle's performance is perplexing, and any conclusion other than "enough is enough" is unacceptable. With the latest disappointment, we believe ***Mr. Leedle has lost all remaining credibility in the investment community, and the Board needs to recognize what that means from a shareholder value standpoint looking forward***. In fact, it seems clear to us that the magnitude of the recent sell-off was more an indictment of the management team and its inability to deliver on expectations, than a material degradation in the business or long term growth opportunity. The stock lost more than a third of its value on just an 8% reduction in 2014 consensus revenue and 12% reduction in consensus EBITDA. ***Healthways shareholders deserve a CEO who can set and execute against realistic financial targets and restore the Company's credibility in the investment community***. It is time for a change.

61. North Tide's efforts were rebuffed when Ballantine, then Chairman of the Board, stated on December 4, 2013 that:

> The Board of Healthways is fully supportive of the CEO and the management team and is fully aligned with management on the company's strategy. We are always mindful of the views of investors as we focus on serving the best interests of our shareholders. We look forward to continuing a constructive dialogue with all of our shareholders.

62. Unsurprisingly, the Board’s lack of concern about the issues North Tide raised did not sit well with North Tide. Rather, it prompted North Tide to issue another public letter to the Board on January 14, 2014, in which it rebuked the Board’s lack of concern and expressed shock at the “laissez-faire attitude toward the need for change at Healthways and unwavering support for CEO Ben Leedle despite the substantial value destruction that stockholders have suffered during his tenure.” Moreover, North Tide announced its intention to wage a proxy fight and nominate its own directors for the Board.

63. Investors have not been the only ones dissatisfied with the Board’s performance and actions. Thomas Cigarran (“Cigarran”) was a co-founder of the Healthways and had played a major role in the Company since 1981. He served as CEO from 1988-2003, President from 1981-2001, Chairman from 1988-2011, and a director from 1981 until February 2014. Despite his long ties and integral role in the history of Healthways, his frustration with the actions, or lack thereof, of the Board led him to resign from the Board on February 14, 2014, after over thirty (30)

years of service. Cigarran lambasted the current leadership of the Company in a resignation letter to then-Chairman Ballantine that stated in full:

> It is with great regret that I must resign from the Board of Directors of Healthways, Inc. effective immediately. Over the last 3 years, I have tried directly through you, at board meetings and directly with our CEO to have the necessary steps taken to improve the Company's unacceptable operating and financial performance. Healthways is very well positioned strategically, has many great and dedicated people and can still become not just a good but a great company. As a director and shareholder, I do not believe this can be accomplished without changes in company focus and direction. ***I am no longer willing to continue as a director and watch this company fail to meet its potential and the reasonable expectations of its shareholders***.

64. Shortly thereafter, North Tide rejected an offer from the Board that would have increased the size of the Board from eleven (11) to twelve (12). In light of Cigarran's recent resignation and the fact that three (3) other members of the Board are up for election at this year's upcoming annual meeting, that would have left five (5) director seats to fill. To fill those seats, North Tide would have been given the right to select two (2) qualified directors, two (2) would come from the existing directors up for reelection, and one (1) would be a new independent director chosen by the Board and reviewed by North Tide. The Board would have also set up a strategic review committee to review the Company's long-term strategy. The deal also would have required North Tide to sign standstill and voting commitments that would be set to expire before the nomination deadline for the 2015 annual meeting.

65. North Tide was not satisfied with the level of change the Board was willing to embrace, as evidenced by its offer described above, that would have provided North Tide with only two (2) out of twelve (12) seats on the Board. To that end, North Tide issued another public letter to the Board on February 28, 2014 in which it continued to express its dissatisfaction with the Board. In response to the Board's offer, the letter stated:

> Unfortunately, the Board has been unwilling to embrace the level of change required at Healthways. Our discussions with Chairman John Ballantine have indicated that despite years of poor performance and no accountability, Mr. Ballantine appears interested only in protecting his job and that of Mr. Leedle's. The Board's settlement proposals have been woefully inadequate and appear to have been designed to preserve the unacceptable status quo while giving the illusion that the Board is open to change. Healthways' shareholders, employees, and customers deserve better, and allowing the Board to perpetuate management's underperformance would be a deep disservice to each of these stakeholders.

66. The letter went on to nominate four (4) candidates, Edwin 'Mac' Crawford, Bradley S. Karro, Paul H. Keckley, and Conan J. Laughlin to stand for election to the Board in the Company's upcoming annual meeting. Due to the staggered nature of the Board, four (4) directors will be elected at the upcoming annual meeting.

67. On March 13, 2014, the Board elected a new director, Daniel J. Englander ("Englander") to fill Cigarran's open seat. Englander's initial term will

expire at the Company's upcoming annual meeting, at which time he would need to be elected to continue serving as a director.

68. On June 3, 2014, the Board capitulated and agreed to nominate for election to the Board three of the four designees from North Tide's threatened proxy solicitation.

G. The Dead Hand Proxy Put Materially Limits Stockholder's Voting Rights

69. The Company's Board of Directors is divided into three (3) classes. Class I contains three (3) directors and is next up for reelection in 2016. Class II contains four (4) directors and is next up for reelection this year, 2014. Finally, Class III contains four (4) directors and is next up for reelection in 2015. Therefore, four (4) director seats are subject to election at this year's annual meeting, and three of the seats likely will be occupied by persons who participated in a threatened proxy solicitation.

70. As stated above, if at any time during a twenty-four month period, the Board consists of a majority of directors who won their seats after being nominated by any stockholder other than the Board, the Company will default under the Loan Agreement at the discretion of the lenders thereof.

71. Although the current staggered nature of Healthways' Board makes it impossible to trigger the Dead Hand Proxy Put solely by the election of the North

Tide directors at the upcoming annual meeting, it necessarily must be a factor stockholders will consider in placing their votes. Three (3) out of eleven (11) directors will not be Continuing Directors as defined in the Loan Agreement. At that point, should three (3) of the other directors happen to resign, die or be replaced, an Event of Default will have occurred under the Loan Agreement.

72. Of greater concern, the Dead Hand Proxy Put serves to preclude North Tide or any other stockholder from seeking to replace the four (4) Class III directors up for reelection next year. If stockholders want to change a majority of the Board of Directors without subjecting the Company to substantial financial harm, the Dead Hand Proxy Put forces them to wait years to do so. Thus, the Dead Hand Proxy Put serves solely to entrench the current Board and significantly limit the franchise and voting rights of stockholders to choose the directors.

73. The Proxy Put has a present depressing effect on stockholder interests, regardless of whether the Proxy Put is ever triggered. Because of its deterrent features, the Proxy Put presently affects fundamental stockholder rights. The "dead hand" feature depresses and deters the stockholders' present entitlement to vote for a board of directors capable of exercising the full array of powers provided by statute, including managing the business and affairs of the corporation. The Proxy Put provision makes an offer for the company much more unlikely because

it effectively eliminates the use of a proxy contest as a possible means to gain control.

74. The Proxy Put is a disproportionate defensive measure that interferes with the stockholder voting franchise without any compelling justification, and would embed structural power-related distinctions between groups of directors not found in the certificate of incorporation. The Proxy Put implicates the doctrine that prohibits a board from entering into contracts or other arrangements that would amount to an abdication or substantial restriction of the board's power to manage the corporation. The stockholders may be forced to vote for incumbent directors whose policies the stockholders reject because only those directors have the effective power to change them. The Proxy Put disenfranchises stockholders by forcing them to vote for incumbent directors or their designees if stockholders want to be represented by a board entitled to exercise its full powers without the threat of financial catastrophe.

75. As Vice Chancellor Lamb stated in *Amylin*, a board must believe in good faith that it is obtaining some form of extraordinary consideration in exchange for agreeing to such a provision. The reasoning behind this is obvious: Dead Hand Proxy Puts are devices that inherently serve to entrench a Board of Directors while simultaneously eviscerating the stockholder franchise. [redacted]

[redacted]

CLASS ALLEGATIONS

76. The right to exercise a free and unfettered vote for or against director candidates is a direct stockholder right, enforceable in a direct individual or class action.

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

78. The action is properly maintainable as a class action.

79. The Class is so numerous that joinder of all members is impracticable. The number of shares of Healthways common stock outstanding as of May 5, 2014 was 35,272,245. Plaintiff believes there are thousands of beneficial holders of Healthways stock dispersed across the country and internationally.

80. There are questions of law and fact common to the Class that predominate over questions affecting any individual class member. The common questions include, *inter alia*, the following:

a. Whether the Individual Defendants have fulfilled, and are capable of fulfilling, their fiduciary duties to Plaintiff and the other members of the Class, including their duties of good faith, loyalty, due care, and candor;

b. Whether the Individual Defendants breached their fiduciary duties by approving the Company's entry into the Loan Agreement, which contains a Dead Hand Proxy Put;

c. Whether the Lender aided and abetted the Individual Defendants' breaches of fiduciary duties;

d. Whether the Dead Hand Proxy Put provision in the Loan Agreement should be invalidated; and

e. Whether Plaintiff and the other members of the Class would be irreparably harmed by the conduct of the Individual Defendants; and

f. Whether Plaintiff and the other members of the Class are entitled to injunctive relief.

81. Plaintiff anticipates that there will be no difficulty in the management of this litigation as a class action.

82. The Individual Defendants have acted on grounds generally applicable to the Class with respect to the matters complained of herein, thereby making appropriate the relief sought herein with respect to the Class as a whole.

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

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

DEMAND FUTILITY

85. Plaintiff alleges and believes all the claims contained herein, which seek to vindicate the personal franchise rights of the stockholders, to be direct. In

the alternative, and only to the extent the Court deems the claims stated herein to be derivative, Plaintiff also brings the claims stated herein as derivative claims.

86. Plaintiff has not made a demand on the Healthways Board to assert these claims against the defendants. Such a demand would be futile and useless, and is thereby excused because the allegations herein, at a minimum, permit the inference that the directors lack the requisite disinterest to determine fairly whether the claims should be pursued.

87. Currently, the Individual Defendants constitute ten (10) of the eleven (11) members of the Company's Board. The claims herein allege that each one of those Individual Defendants breached their fiduciary duties in bad faith disregard of the warnings issued by this Court in *Amylin*. Each Individual Defendant was a member of the Board when at least part of the Loan Agreement was authorized and maintained.

88. As explained above, the Loan Agreement consists of four (4) separate contracts. The initial agreement was executed on June 8, 2012. Furthermore, three subsequent amendments to the June 2012 Loan Agreement were executed on February 5, 2013, March 15, 2013, and July 1, 2013 respectively. Each amendment maintained the Dead Hand Proxy Put.

89. At the time of the execution of the June 2012 Loan Agreement, every Individual Defendant, except Tramuto, was serving on the Board of Directors.

Furthermore, Tramuto was elected on May 30, 2013 and he thus was a director when the Board approved the most recent Loan Agreement Amendment.

90. Therefore, each Individual Defendant ratified the Dead Hand Proxy Put complained of herein and thus breached his or her fiduciary duties. In light of this, the vast majority of the Board lacks the disinterest necessary to fairly and impartially evaluate whether the Board breached its fiduciary duties by agreeing to the Dead Hand Proxy Put. Pursuing a claim against themselves would be tantamount to self-indictment.

91. Moreover, this suit seeks to invalidate the Dead Hand Proxy Put. As the Proxy Put's primary function is to entrench the Board, such an outcome is against the interests of the Individual Defendants.

92. Accordingly, the Board would be neither willing nor able to prosecute these claims vigorously, and thus, demand is futile.

COUNT I
(Against the Individual Defendants for Breach of Fiduciary Duty)

93. Plaintiff repeats and realleges the allegations set forth above as if fully set forth herein.

94. As directors of Healthways, the Individual Defendants owe the Company and its stockholders the highest duties of care, loyalty, good faith, and candor.

95. As set forth above, in *Amylin*, then-Vice Chancellor Lamb made clear that a board of directors should not agree to a proxy put unless the board is "obtaining in return extraordinarily valuable economic benefits for the corporation that would not otherwise be available to it."

96. Here, the Healthways Board did not obtain extraordinarily valuable economic benefits in exchange for agreeing to the Dead Hand Proxy Put.

97. As a result of the Individual Defendants' decision to agree to a Dead Hand Proxy Put, Healthways' stockholders have seen their franchise and voting rights diminished so that the Board can entrench itself.

98. Defendants' breaches of their fiduciary duty of care and loyalty have caused and are continuing to cause harm to Plaintiff and the Class by, *inter alia*, depriving them of the opportunity to exercise their franchise rights free of coercion and to elect a new board majority if they see fit.

99. Plaintiff is entitled to a declaration that the Individual Defendants breached their fiduciary duties by embedding the Dead Hand Proxy Put in the Loan Agreement and Plaintiff is entitled to injunctive relief to rectify such breach.

100. Plaintiff has no adequate remedy at law.

<u>COUNT II</u>
(Against the Lender For Aiding and Abetting The Individual Defendants' Breach of Fiduciary Duty)

101. Plaintiff repeats and realleges the allegations set forth above as if fully set forth herein.

102. As alleged above, the Individual Defendants breached their fiduciary duties to Healthways stockholders by approving the Dead Hand Proxy Put provision in the Loan Agreement.

103. The Lender allowed the Individual Defendants to embed a provision in the Loan Agreement that the Lender knew or had reason to know was a breach of the Individual Defendants' fiduciary duties.

104. As a result of the Lender's aiding and abetting the Individual Defendants' breaches of fiduciary duty, Healthways' stockholders have seen their franchise and voting rights diminished so that the Board can entrench itself.

105. Plaintiff has no adequate remedy at law.

<u>COUNT III</u>
(Declaratory Judgment Respecting the Proxy Put)

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

107. Delaware law entitles stockholders to nominate and elect directors of Healthways, free from coercion.

108. Section 141(a) of the Delaware General Corporation Law prohibits contractual arrangements that commit the board of directors to a course of action that would preclude them from fully discharging their fiduciary duties to the corporation and its stockholders.

109. The Proxy Put in the Credit Agreement removes from the board of directors the power to disable the Proxy Put by approving any new director whose nomination or assumption of office "occurs as a result of an actual or threatened solicitation of proxies or consents for the election or removal of one or more directors."

110. The Proxy Put in the Credit Agreement impermissibly prevents the board of directors from exercising their full managerial power and duty to approve nominations of qualified individuals by a stockholder and thereby avoid creating financial penalties that hinder a full and fair election.

111. The Proxy Put in the Credit Agreement, irrespective of whether it was the product of arm's-length negotiation, deters any effort by stockholders to elect a majority of new directors of Healthways at an annual meeting.

112. Under the Delaware Declaratory Judgment Act, Delaware courts "have power to declare rights, status and other legal relations, whether or not further relief is or could be claimed." 10 *Del. C.* § 6501. According to the Act, "[a] person ... whose rights, status or other legal relations are affected by a statute,

municipal ordinance, contract or franchise, may have determined any question of construction or validity arising under the instrument, statute, ordinance, contract or franchise and obtain a declaration of rights, status or other legal relations thereunder." *Id*. § 6502. The power of Delaware courts to grant declaratory relief is to "be liberally construed and administered." *Id.* § 6512.

113. The Proxy Put has a present effect on the stockholders' entitlement to participate in or to support a proxy solicitation and to exercise their fundamental franchise rights. The Proxy Put has a present and continuing adverse effect upon the stockholders' interests, and makes its claim for invalidation of the provision ripe for adjudication.

114. The existing controversy as to the enforceability of the Proxy Put is substantial and justiciable because it affects the parties in a concrete manner so as to provide the factual predicate for reasoned adjudication. The controversy is also of sufficient immediacy and reality to warrant the issuance of a declaratory judgment. A declaratory judgment in this matter will conclusively clarify the legal rights and obligations of the parties, and will be of practical assistance to them. The judgment sought "will terminate the controversy" and "remove an uncertainty" regarding the enforceability of the Proxy Put. *See* 10 *Del. C.* § 6505.

115. Plaintiff and the Class are entitled to an order declaring that the Proxy Put in the Credit Agreement is invalid and unenforceable under Delaware law and severable from the remainder of the Credit Agreement.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff demands judgment as follows

(a) Declaring this action is properly maintainable as a class action;

(b) In the alternative, declaring that demand on the Board would be futile and is excused;

(c) Declaring that the Individual Defendants breached their fiduciary duties by approving the Company's entry into the Loan Agreement that contains a Dead Hand Proxy Put;

(d) Declaring that the Lender aided and abetted the Individual Defendants' breaches of fiduciary duty in approving the Dead Hand Proxy Put;

(e) Declaring that the Dead Hand Proxy Put is invalid, unenforceable, and severable;

(f) Permanently enjoining Healthways' Lender from enforcing the Dead Hand Proxy Put;

(g) Awarding Plaintiff the costs and disbursements of this action including Plaintiff's attorneys' and experts' fees; and

(h) Granting such other and further relief as this Court may deem to be just and proper.

FRIEDLANDER & GORRIS, P.A.

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DATED: June 19, 2014