IN THE SUPREME COURT OF THE STATE OF DELAWARE

DAVID PYOTT, HERBERT W. BOYER, LOUIS J. LAVIGNE, GAVIN S. HERBERT, STEPHEN J. RYAN, LEONARD D. SCHAEFFER, MICHAEL R. GALLAGHER, ROBERT ALEXANDER INGRAM, TREVOR M. JONES, DAWN E. HUDSON, RUSSELL T. RAY, DEBORAH DUNSIRE, and ALLERGAN, INC.,	)	
Defendants Below-Appellants,	)	No. 380, 2012
v.	)	On Appeal from the Court of Chancery of the State of Delaware, C.A. No. 5795-VCL
LOUISIANA MUNICIPAL POLICE EMPLOYEES' RETIREMENT SYSTEM and U.F.C.W. LOCAL 1776 & PARTICIPATING EMPLOYERS PENSION FUND,	)	
Plaintiffs Below-Appellees.	)	

APPELLANTS' CORRECTED OPENING BRIEF
IN SUPPORT OF INTERLOCUTORY APPEAL

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NATURE OF THE PROCEEDINGS

The Court of Chancery (Laster, V.C.) declined to grant full faith and credit to a final judgment of dismissal, based on materially identical allegations (founded on significant publicly available information and the same corporate books and records), entered by the U.S. District Court for the Central District of California. Allergan, Inc. and its directors—Defendants below and Appellants in this Court—respectfully submit that the court's order should be reversed, and the case remanded with directions to enter a judgment of dismissal with prejudice.

In this derivative suit, two stockholders of Allergan—Plaintiffs below and Appellees in this Court—seek to sue on behalf of Allergan to force the directors to reimburse the Company for payments totaling approximately $600 million made to the federal government to settle an investigation and related *qui tam* litigation. The plaintiffs in the California federal case were also stockholders who sought the identical relief based on the same events. Both complaints alleged that pre-suit demand on Allergan's Board would have been futile.

Allergan and its directors sought to stay the federal action in favor of this action, but their motion was denied. The California court thereafter dismissed the complaint for failure to adequately allege demand futility, giving leave to replead. The California plaintiffs amended their complaint after obtaining corporate books and records identical to those provided to Plaintiffs in this case. The California court again granted Defendants' motion to dismiss, holding that pre-suit demand would not have been futile because it would be unreasonable to infer from the books and records that Allergan's directors intended the Company to break the law. *In re Allergan, Inc. S'holder Deriv. Litig.*, 2012 WL 137457 (C.D. Cal. Jan. 17, 2012). The federal court reaffirmed that judgment after the plaintiffs moved for reconsideration. Defendants then supplemented their pending motions to dismiss in the Court of Chancery to raise collateral estoppel as an additional basis for dismissal.

The Court of Chancery denied Defendants' motions to dismiss. (1) The court declined to grant preclusive effect to the federal judgment, departing from a long line of authority on this issue, based on newly announced doctrines involving internal affairs, privity, and adequacy of representation. (2) Disagreeing with the federal court on the merits, the Court of Chancery also concluded that it was reasonable to infer that Allergan's directors intended the Company to break the law, and therefore that pre-suit demand would have been futile under Rule 23.1. (3) The Court of Chancery also held that because the complaint survived Defendants' Rule 23.1 motion, it survives a Rule 12(b)(6) motion to dismiss.

SUMMARY OF ARGUMENT

I. The Court of Chancery erred by refusing to give full faith and credit to the prior federal court judgment, opening Delaware corporations to successive derivative suits. In declining to recognize the preclusive effect of the previous judgment, the court committed three principal errors of law.

(1) The Court of Chancery erred by holding that the internal affairs doctrine permitted it to apply Delaware law to analyze the elements of collateral estoppel. No court has used the internal affairs doctrine in this manner because the preclusive effect of a prior judgment raises a question of collateral estoppel resolved by the law of the rendering jurisdiction, and does not implicate either the internal affairs doctrine or Delaware law.

(2) The Court of Chancery incorrectly created a new Delaware rule of privity, under which derivative shareholder plaintiffs are not in privity with one another (because they are not in privity with the Company), for collateral estoppel purposes, unless and until one of them establishes demand futility. This was erroneous because the individual identity of a derivative plaintiff is irrelevant to the question whether certain allegations show demand futility, and the Court of Chancery's approach would encourage duplicative litigation and discourage finality.

(3) The Court of Chancery improperly adopted and applied a new "fast-filer presumption," under which a shareholder plaintiff is presumed to be an inadequate derivative representative if it files suit before seeking corporate books and records pursuant to 8 *Del. C.* § 220. The adoption of that presumption, as well as its application in this case, conflicts with recent precedents of this Court, unjustly burdens companies and their directors, and is unworkable.

II. The Court of Chancery erred by holding that the allegations in the Complaint and the documents on which they are based give rise to a reasonable inference that Allergan's directors intended the Company to break the law. A fair reading of the documents cited by Plaintiffs and the court shows that the Board expected increased drug sales only in conjunction with expanding regulatory approvals.

III. The Court of Chancery erred by holding that every complaint that survives a Rule 23.1 motion automatically states a claim upon which relief can be granted for every count in the complaint and as to every defendant. The Complaint here fails to state claims upon which relief can be granted, independent of the demand futility analysis.

STATEMENT OF FACTS

Allergan develops and commercializes specialty pharmaceuticals, biologics and medical devices. Op. 2.[1] Allergan manufactures BOTOX®, a prescription neurotoxin that safely and effectively produces a localized and temporary reduction in an overactive muscle or gland. A184 (¶ 49). Although BOTOX® is widely known for its cosmetic use, which was approved by the U.S. Food and Drug Administration ("FDA") under the trade name "BOTOX® Cosmetic" in 2002, the subject of this case is BOTOX® for therapeutic uses. *Id*.

Twenty years ago, the FDA approved BOTOX® for two eye muscle disorders. A185 (¶ 50). In addition, BOTOX® has been approved to treat abnormal head position and neck pain (*i.e.*, cervical dystonia) in adults and symptoms of severe underarm sweating. A185–86, A211 (¶¶ 50, 52 n.7, 125). Since 2005, the FDA has approved BOTOX® for the treatment of increased muscle stiffness in adults with upper limb spasticity. A250. In 2010, the FDA approved BOTOX® for the treatment of chronic migraine headaches. A256. Most recently, in August 2011, the FDA approved BOTOX® for the treatment of urinary incontinence due to overactive bladder associated with a neurological condition. A420. Allergan also is in discussions with the FDA regarding the use of BOTOX® to treat juvenile cerebral palsy, which has already been approved in 70 countries around the world, including in the United Kingdom, Canada, Brazil, Hong Kong, and Japan. A250.

BOTOX® has also been adopted by the medical community for a number of uses before they received FDA approval. A186 (¶ 52). Physicians may prescribe an approved pharmaceutical product for any use—including uses not approved by the FDA. These are commonly referred to as "off-label" uses, which are not only legal but can be the recognized standard of care for proper treatment of certain conditions. "'Off-label use is widespread in the medical community and often is essential to giving patients optimal medical care, both of which medical ethics, FDA, and most courts recognize.'" *Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 351 n.5 (2001) (quoting James M. Beck & Elizabeth D. Azari, *FDA, Off-Label Use, and Informed Consent: Debunking*

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[1] "Op." refers to the June 11, 2012 Opinion of the Court of Chancery denying Defendants' motion to dismiss, which is attached hereto as Exhibit A. "Tr." refers to the Court of Chancery's July 6, 2012 hearing on Defendants' application for interlocutory review, which is in the Appendix at A599–683. "Compl." refers to the Verified Second Amended Derivative Complaint in this case filed on July 8, 2011(the "Complaint"), which is in the Appendix at A162–248. Unless noted otherwise, "¶" refers to paragraphs of the Complaint.

Myths and Misconceptions, 53 Food & Drug L.J. 71, 72 (1998)); *see United States v. Caronia*, 576 F. Supp. 2d 385, 393 (E.D.N.Y. 2008) ("It is generally recognized (even by the FDA) that off-label prescriptions can constitute a medically recognized standard of care and, therefore, that it is important for physicians to have access to accurate information about off-label uses"). For this reason, BOTOX® has been regularly and lawfully prescribed by physicians for the therapeutic treatment of headaches, pain, and juvenile cerebral palsy, even at times when those uses were not approved by the FDA. A186 (¶ 52).

There is no provision in the Food, Drug, and Cosmetic Act (the "FDCA") prohibiting truthful, non-misleading communications to physicians that educate about off-label uses, and courts have rejected the FDA's efforts to prohibit the dissemination of information regarding off-label uses. *See Washington Legal Found. v. Friedman*, 13 F. Supp. 2d 51, 74–75 (D.D.C. 1998), *vacated as moot on other grounds by Washington Legal Found. v. Henney*, 202 F.3d 331, 336–37 (D.C. Cir. 2000). Thus, allegations that Allergan distributed certain educational information about BOTOX® to physicians do not imply any illegality. *See* 21 C.F.R. § 99.101 (detailing information regarding off-label uses that manufacturers are permitted to disseminate).

The government settlement that is the impetus of this lawsuit was the result of an investigation that started in 2007 after False Claims Act civil actions were filed against Allergan. A166, A207 (¶¶ 4, 115). Allergan publicly disclosed an investigation by the U.S. Department of Justice ("DOJ") in March 2008, after the Company received a subpoena. A239 (¶ 218). At no point did the government allege any involvement or wrongdoing by any of Allergan's directors.

The investigation concerned allegedly improper off-label marketing of BOTOX®. FDA regulations require drug manufacturers to provide "adequate information" for all "intended uses" of a drug. 21 C.F.R. § 201.100(c)(1). If a manufacturer "knows or has knowledge of facts that would give [it] notice" of an intended use for the drug, the manufacturer is required to provide adequate labeling for that use. 21 C.F.R. § 201.128. But the government prohibits manufacturers from including with their products instructions for off-label uses. 21 U.S.C. §§ 321(p), 355(a). Thus, it can be difficult for a drug company to comply with all regulations once it becomes aware that physicians are prescribing a drug for off-label uses, because the company risks violating the labeling regulations on one hand or the misbranding regulations on the other. This tension is partially relieved by regulations which provide safe harbors for certain forms of communications between drug companies and doctors. *E.g.*, 59 Fed. Reg. 59,820, 59,823 (Nov. 18, 1994). However, if the government believes

a company's conduct goes beyond the safe harbors, it can bring misbranding charges.

Ultimately, Allergan resolved the investigation by agreeing to plead guilty to a single misdemeanor "misbranding" charge, a strict liability offense, for the period of 2000 through 2005. A208–09 (¶¶ 118, 119). Allergan also agreed to pay the government $375 million and to pay $225 million to resolve related civil claims. The misbranding charge and Allergan's plea did not involve any admission that Allergan engaged in any false or deceptive conduct. A233 (¶ 204). Nor was any action, inaction, or decision by the Company's directors at issue.

After the government settlement was announced, shareholders filed derivative complaints based on materially identical allegations in three forums: California Superior Court, the U.S. District Court for the Central District of California, and the Delaware Court of Chancery. None of the plaintiffs sought corporate books and records pursuant to 8 *Del. C.* § 220 ("Section 220") before filing their complaints. It cannot be disputed that each complaint was founded on extensive public documents, including Allergan's guilty plea, the government's sentencing memorandum, and allegations drawn from the False Claims Act cases.

Allergan asked the plaintiffs in California state court and federal court to agree to stay their actions in favor of the Court of Chancery action. The California state court plaintiffs agreed, and that case has been stayed since 2010. A565–66.

The plaintiffs in the consolidated action in the California federal court refused to agree to a stay, so Defendants moved in the federal court for an order staying that action in favor of the action before the Court of Chancery. *See* A568–88; A592 at ¶ 11. Defendants argued that the federal court should allow the Court of Chancery to resolve the derivative claims because, among other things, failing to stay the federal action would run the risk of "inconsistent rulings" and "duplicative proceedings" (A584), and because of "consideration for federal-state comity" (A585 (citation omitted)). But because the federal complaint included claims under the Securities Exchange Act of 1934, the federal court felt itself bound by circuit precedent to deny the stay. A596 (holding that *Minucci v. Agrama*, 868 F.2d 1113 (9th Cir. 1989), required denying the stay).

The Company moved both the Court of Chancery and the California federal court (in November and December 2010, respectively) to dismiss the

complaints under Federal and Delaware Rules 23.1 and 12(b)(6) for failure to plead demand futility and failure to state a claim. Op. 13–14.

While those motions were pending, a shareholder that had not initially filed a derivative complaint, U.F.C.W. Local 1776 & Participating Employers Pension Fund ("UFCW"), sought and obtained from Allergan, pursuant to Section 220, books and records relating to the government settlement. UFCW also sought to intervene in the Court of Chancery action. UFCW was aware of the California federal action, but chose not to seek to intervene in that action. A77–78.

The Court of Chancery deferred ruling on the motion to intervene pending completion of the Section 220 production. Aware of the pending California federal action, the Court of Chancery stated that "it is simply not efficient from the perspective of judicial resources or, frankly, corporate resources to do things twice, to rule on the motion to dismiss twice," and that there should not be "multiple decisions on the same issues, whether those be seriatim in one proceeding or whether those be parallel and seriatim in different courts." A141–42. Accordingly, the Court of Chancery directed that the transcript be provided to the judge in the federal action, after which the Court of Chancery would "defer to the federal judge" as to which court should decide the pending demand futility issue. A142–43. In April 2011, the federal court granted Defendants' motion to dismiss the federal action, without prejudice, on the ground that plaintiffs had not adequately alleged demand futility. A151–58.

In Delaware, UFCW reached an agreement with the original Delaware plaintiff, the Louisiana Municipal Employees' Retirement System ("LAMPERS"), which had not sought books and records before filing its initial complaint. UFCW and LAMPERS, as co-plaintiffs, filed their amended complaint, in July 2011. That is the operative Complaint in this case. A162–248.

The plaintiffs in the California federal case subsequently indicated that they too intended to pursue a Section 220 demand. Rather than engaging in a duplicative Section 220 process, Allergan provided the same books and records as were provided to UFCW. Op. 13. Plaintiffs then filed an amended complaint in federal court in July 2011. A428–522.

As the Court of Chancery recognized, the two complaints were materially identical. Op. 18; A632–33 (Tr.). Both alleged, based on identical public documents and Section 220 materials, that the Company's directors had intentionally caused the Company to violate federal food and drug law and both

sought to cause those directors to personally reimburse the Company for the $600 million government settlement.

The individual defendants named in the Complaint are the twelve members of Allergan's Board at the time of the government settlement. A176–82 (¶¶ 22–39). Only one director, Allergan's CEO David Pyott, was (or is) a Company employee. *Id*. There is no allegation in the Complaint that any of Allergan's outside directors had any financial incentive to promote improper marketing of BOTOX®. Allergan's Amended and Restated Certificate of Incorporation contains an exculpatory provision consistent with 8 *Del. C.* § 102(b)(7), immunizing directors from liability except for actions implicating the duty of loyalty, constituting bad faith, violating 8 *Del. C.* § 174, or resulting in improper personal benefit. A262.

After the amended complaints were filed in Delaware and California, Defendants again moved to dismiss each complaint pursuant to Rules 23.1 and 12(b)(6). Briefing was completed between September and November 2011.

In January 2012, the California federal court ruled that the complaint had failed to allege adequately that pre-suit demand would have been futile. In a detailed order, the court ruled that the documents cited in the complaint did not support an inference that the directors consciously caused Allergan to break the law. The court recognized that these documents—primarily Board presentations and business plans envisioning increased future sales of BOTOX® for therapeutic purposes—were "hardly suspect" because the same plans also envisioned "data collection" and future "government approval of new uses." A425. The federal court held that inferences of illegal intent from these plans and other documents were therefore "at best, a stretch of the imagination." *Id*. In February 2012, the federal court issued another detailed order denying plaintiffs' motion for reconsideration. A529–31.[2]

Defendants then supplemented their motion to dismiss in the Court of Chancery, asserting that the California federal judgment collaterally estopped Plaintiffs from relitigating the demand futility issue. Because this Court's precedents teach that collateral estoppel is applied in accordance with the law of the jurisdiction rendering the first decision, Defendants relied primarily on

[2] The plaintiffs in federal court appealed to the Ninth Circuit (No. 12-55516), and briefing is scheduled to take place between August and October 2012. The pendency of that appeal does not impact the finality of the federal district court's judgment for preclusion purposes. *Deposit Bank of Frankfort v. Bd. of Councilmen*, 191 U.S. 499, 514 (1903).

LeBoyer v. Greenspan, 2007 WL 4287646 (C.D. Cal. June 13, 2007), which holds that a Rule 23.1 dismissal is afforded preclusive effect in a subsequent or parallel suit brought by a different shareholder on the same allegations.

In June 2012, the Court of Chancery issued the order that is the subject of this appeal, disagreeing with a long line of cases, including *LeBoyer*, that granted preclusive effect to Rule 23.1 dismissals in subsequent litigation by a shareholder of the same company. First, the Court of Chancery identified the elements of collateral estoppel, and acknowledged that it was obligated to give the federal judgment the same preclusive effect that the judgment would be given by the rendering court. But the court then held that the "internal affairs doctrine" permitted it to turn to Delaware law (rather than California law or federal law) to analyze two elements of collateral estoppel. Op. 19–22. As the Court of Chancery explained its own decision, "two parts to the collateral estoppel analysis . . . turn on Delaware law: Privity and adequacy of representation." A632 (Tr.). Second, the Court of Chancery held that corporate shareholders are not in privity with one another until one of them "passes the Rule 23.1 stage," because they are not in privity with the corporation until that point. Op. 26. The Court of Chancery acknowledged that this holding conflicted with a "growing body of precedent." Op. 14, 23 (citing *In re Sonus Networks, Inc. S'holder Deriv. Litig.*, 499 F.3d 47, 63–64 (1st Cir. 2007), and seven other cases, each of which applied the doctrine of collateral estoppel to preclude a second stockholder from relitigating demand futility). Third, as an independent basis for its decision, the Court of Chancery announced a new "fast-filer presumption" and proceeded to apply that presumption to hold that the plaintiffs who had litigated in federal court were inadequate derivative representatives, and "failed to fulfill the[ir] fiduciary duties," because they filed suit without having made a Section 220 demand. Op. 37–65.

Having concluded that the federal court's judgment was not preclusive, the Court of Chancery further found that court's reasoning "unpersuasive" and ruled, directly contrary to the federal court, that the complaint adequately alleged that pre-suit demand would have been futile. Op. 77.

Like the federal court, the Court of Chancery based its demand futility analysis on two documents. The court discussed a strategic plan, adopted by the Board in 1997, covering the years 1997-2001, reflected in a "Written Plan" and associated "Plan Slides." Op. 69–73 (citing A267–414). The court also discussed a 2006 e-mail from the Company's general counsel to the Board describing the Company's response to a regulatory incident that it discovered, which involved a non-employee physician, Dr. Schim (the "Schim incident"). Op. 73–74 (citing A417–18). On the basis of certain excerpts from these

documents, the Court of Chancery found it reasonable to infer that, for a period of about a decade, every single one of the Company's directors consciously intended the Company to violate federal food and drug law. Op. 77.

The Court of Chancery acknowledged that the federal court had already reviewed the same documents and concluded that they did not show Board involvement in or approval of unlawful activity. *Compare* Op. 77–81, *with* A151–58; A422–26; A529–31. But, in the Court of Chancery's view, the federal court had erred by adopting a "defendant-friendly interpretation" of the Written Plan, Plan Slides, and the Schim incident. Op. 80–81. At the pleading stage, the Court of Chancery thought that excerpts from the 1997 plan and 2006 Schim incident were sufficient to give rise to a reasonable inference of intentional law-breaking at the Board level. Op. 81.

Finally, the Court of Chancery summarily denied the motion to dismiss the Complaint pursuant to Rule 12(b)(6) for failure to state a claim upon which relief can be granted. The court held that a complaint that survives a Rule 23.1 motion also (entirely) survives a Rule 12(b)(6) motion. Op. 81.

ARGUMENT

I. THE FEDERAL COURT JUDGMENT PRECLUDES RELITIGATION OF DEMAND FUTILITY.

A. Question Presented.

Did the Court of Chancery err in failing to give preclusive effect to the final judgment previously entered by the federal court? *See* Defs. Mem. Regarding the Preclusive Effect of the Calif. Dist. Ct.'s Dismissal of the Fed. Deriv. Action (D.I. 84) at 1–10; *see also* A532–61.

B. Scope of Review.

This Court reviews the trial court's conclusions of law *de novo*. *King v. VeriFone Hldgs., Inc.*, 12 A.3d 1140, 1145 (Del. 2011) ("*King II*").

C. Merits of Argument.

This Court has explained the practical considerations underlying preclusion: "The doctrine of *res adjudicata* is recognized by all civilized nations as a rule of expediency, justice and public policy which demands that there be an end of litigation." *Iowa-Wis. Bridge Co. v. Phoenix Fin. Corp.*, 25 A.2d 383, 391 (Del. 1942). The Court went on to explain that these practical considerations take on constitutional weight in our federal system: "The full faith and credit clause of the Federal Constitution affords a useful means to [the practical] end[s]." *Id*. This is because, otherwise, "the judgment of a court of one state would stand in the tribunals of other states of the United States in no better position than would a judgment of a foreign country, to be respected, if at all, on the principles of comity." *Id*. But "[w]ith the [full faith and credit requirement], the judgment of a state court having jurisdiction of the parties and subject matter is accorded in the courts of sister states the same faith and credit which it has by law or usage in the court where it was rendered." *Id*. This Court therefore extends full faith and credit equally to the judgments of federal courts and sister state courts: "The same sanctity and effect is granted to a judgment of a federal court, rendered in a like case and in similar circumstances, as is conceded to a judgment of a state court." *Iowa-Wis.*, 25 A.2d at 391; *accord Hancock Nat'l Bank v. Farnum*, 176 U.S. 640, 645 (1900); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1141 (Del. 1989); *Thompson v. D'Angelo*, 320 A.2d 729, 734–35 (Del. 1974).

Accordingly, the Court of Chancery correctly recognized that it was obligated to "give a judgment the same force and effect that it would be given by

the rendering court"—in this case, the Central District of California. Op. 16. The Court of Chancery also correctly recognized that California courts and federal courts apply a multi-factor test (including elements of "privity" and "adequate representation") to determine whether collateral estoppel bars relitigation of a previously settled issue. Op. 17, 37.

The Court of Chancery did not need to speculate about the preclusive effect that the federal court would grant its own judgment. That is because a recent decision from the same court, *LeBoyer v. Greenspan*, 2007 WL 4287646 (C.D. Cal. June 13, 2007), squarely held that all of the elements of collateral estoppel are met when a new plaintiff files a derivative action based on the same demand futility allegations that another court has already finally dismissed as inadequate under Rule 23.1. *LeBoyer* explained that "the differing groups of shareholders who can potentially stand in the corporation's stead are in privity for purposes of issue preclusion." *Id.* at *3 (citing *Goldman v. Northrop Corp.*, 603 F.2d 106, 109 (9th Cir. 1979)). In the opinion below, the Court of Chancery candidly acknowledged that *LeBoyer* was in conformity with every other case to have addressed this issue, including five other federal court cases and two state court cases (including one from Delaware). Op. 14 n.1. Had the Court of Chancery followed *LeBoyer*, then, Defendants' motion to dismiss would have been granted.

The Court of Chancery did not disagree that, under *LeBoyer*, the rendering court <u>would</u> grant preclusive effect in these circumstances. Instead, the Court of Chancery thought that the federal court "<u>should</u>" not do so. Op. 15 (emphasis added). As the court later stated, it was "predict[ing]" what was "most likely under the circumstances if the controlling Delaware Supreme Court precedents on privity were presented to the California Federal Court." A647 (Tr.). The court did not cite in its Opinion any authority for the notion that it was entitled to predict what the California court should do in the future, and such anticipatory overruling is foreign to American jurisprudence. *Cf., e.g., State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997) (It is the Supreme "Court's prerogative alone to overrule one of its precedents."). It is particularly alien to the law of collateral estoppel, which protects litigants' interests in certainty and finality.

The Court of Chancery reached its conclusion based on three legal errors. (1) The court erroneously invoked the "internal affairs doctrine" to apply Delaware law, instead of California law or federal common law, in analyzing the privity and adequacy of representation elements of collateral estoppel. (2) The court erroneously equated privity for collateral estoppel purposes with demand futility for Rule 23.1 purposes. (3) The court erroneously created and simultaneously applied a new "fast-filer presumption" within the adequacy of

representation element of collateral estoppel that is unsupported and unworkable. Correcting these errors requires reversal of the decision below.

1. The Court of Chancery's application of the internal affairs doctrine was erroneous.

The Court of Chancery first erred by holding that "whether a stockholder can sue derivatively after another stockholder attempted to plead demand futility" is "a matter involving the managerial prerogatives within a corporation" and is therefore "controlled by the internal affairs doctrine." Op. 20. The court relied on this erroneous principle to justify turning to Delaware law to analyze two sub-elements of collateral estoppel.

The preclusive effect of a prior federal judgment is a matter of federal common law; this is true whether the basis of federal jurisdiction is diversity of citizenship (*Semtek Int'l, Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 506–09 (2001)) or a federal question (*Stoll v. Gottlieb*, 305 U.S. 165, 170–71 (1938)). For state law claims, federal common law will adopt the law of the forum state as long as that law is not "incompatible with federal interests." *Semtek*, 531 U.S. at 509.

Semtek accords with this Court's opinion in *Cavalier Oil*, which involved an appraisal action against a Delaware corporation, raising an issue of the preclusive effect of a prior judgment of a federal court sitting in Virginia. This Court's analysis of the "preclusive effect, if any" of the earlier judgment was solely a matter of "Virginia law." *Cavalier Oil*, 564 A.2d at 1141. This Court applied Virginia law to all preclusion sub-elements—including the permissibility of partial settlements and the burden of proof in establishing *res judicata*. *Id.* at 1141–42 (citing *Bates v. Devers*, 202 S.E.2d 917 (Va. 1974)). The internal affairs doctrine played no role in this Court's analysis.

Under *Semtek*, *Stoll*, and *Cavalier Oil*, the Court of Chancery was obligated to apply California law or federal common law to analyze every element of collateral estoppel. And because the demand futility analysis in the federal case involved state law claims (not the federal securities law claims), California law governs its preclusive effect. *Semtek*, 531 U.S. at 509.

Cavalier Oil shows that the Court of Chancery's use of the internal affairs doctrine cannot be justified by reference to Delaware law. Neither can it be justified by reference to California law or federal law. No case applying California law or federal common law has ever held that any sub-element of collateral estoppel should be resolved by reference to the state of incorporation

by operation of the internal affairs doctrine. In particular, *LeBoyer*, which involved a Delaware corporation that had already obtained a Rule 23.1 dismissal in California state court, did not use the internal affairs doctrine in any manner to analyze the preclusive effect of that first judgment.

The Court of Chancery's invocation of the internal affairs doctrine here required extending several cases far beyond their holdings. Most of these cases stand only for the undisputed principle that demand futility itself is a matter of substantive law of the state of incorporation. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96–97 (1991); *Braddock v. Zimmerman*, 906 A.2d 776, 784 (Del. 2006); *Ainscow v. Sanitary Co. of Am.*, 180 A. 614, 615 (Del. Ch. 1935). The court's other citations on this point relate to even more remote principles of corporation law that fail to support the Court of Chancery's approach. *See CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987) (voting rights of shareholders are internal affairs); *Cort v. Ash*, 422 U.S. 66, 84 (1975) (state law governs the internal affairs of a corporation except where federal law creates additional requirements); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) ("Tender offers . . . do not themselves implicate the internal affairs of the target company"); *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1116 (Del. 2005) (merger voting rights are internal affairs).

The Court of Chancery thought that the First Circuit's decision in *Sonus Networks*, 499 F.3d at 64, supported the use of the internal affairs doctrine to analyze the elements of collateral estoppel. Op. 19; *see also* A650, A655 (Tr.). 57). That is not correct. *Sonus Networks*, which applied collateral estoppel to preclude relitigation of the demand futility issue, did not rely on the law of the state of incorporation (Delaware) to determine the privity question. It applied Massachusetts law to assess privity. 499 F.3d at 64. Nor did it use the internal affairs doctrine to determine adequacy of representation. It applied the standard articulated in the Restatement (Second) of Judgments. *Id*. at 65–66. The term "internal affairs" does not even appear in the *Sonus Networks* opinion. *Sonus Networks* turned to Delaware law solely to determine "[s]tanding to represent a foreign corporation"—not <u>any</u> of the collateral estoppel elements. *Id.* at 64. Neither *Sonus Networks* nor any other case in the history of American jurisprudence has used the internal affairs doctrine to determine any sub-elements of collateral estoppel.

The Court of Chancery's error in this respect is encapsulated in one sentence from its opinion: "Whether a stockholder in a Delaware corporation can sue derivatively <u>after another stockholder attempted to plead demand futility</u> raises a question of demand futility law." Op. 20 (emphasis added). Where the court went astray was in equating collateral estoppel with demand futility. Once

a court of competent jurisdiction has issued a final judgment, a successive case is governed by collateral estoppel principles, not "demand futility law." Putting it differently, a Rule 23.1 motion is about corporate governance (which implicates the internal affairs doctrine), while a collateral estoppel motion is about federalism, comity, and finality (which do not implicate the internal affairs doctrine). Under this Court's precedents, the undisputed interest that Delaware has in governing the internal affairs of its corporations gives way to the stronger interests that all state and federal courts have in respecting each other's judgments. *See Iowa-Wisconsin*, 25 A.2d at 391; *Cavalier Oil*, 564 A.2d at 1141.

In sum, the Court of Chancery should have applied California law or federal common law to analyze all elements of collateral estoppel. It is beyond dispute that if the court had done so—that is, if it had not invoked the internal affairs doctrine as it did—*LeBoyer* would have compelled it to dismiss the case on collateral estoppel grounds.

Moreover, as the Court of Chancery recognized, a "growing body of precedent," in addition to *LeBoyer*, holds that a final judgment holding that a given set of allegations does not establish demand futility should be given preclusive effect against successive suits. Op. 14 (citing *Sonus Networks*, 499 F.3d 47; *Arduini v. Hart*, 2012 WL 893874 (D. Nev. Mar. 14, 2012); *In re Bed Bath & Beyond Inc. Deriv. Litig.*, 2007 WL 4165389 (D.N.J. Nov. 19, 2007); *Hanson v. Odyssey Healthcare, Inc.*, 2007 WL 5186795 (N.D. Tex. Sept. 21, 2007); *LeBoyer*, 2007 WL 4287646; *Henik v. LaBranche*, 433 F. Supp. 2d 372 (S.D.N.Y. 2006); *Carroll v. McKinnell*, 2008 WL 731834 (N.Y. Sup. Mar. 17, 2008); *In re Career Educ. Corp. Deriv. Litig.*, 2007 WL 2875203 (Del. Ch. Sept. 28, 2007)). (Subsequent to the Court of Chancery's decision in this case, another federal district court has dismissed a successive derivative action on collateral estoppel grounds. *Holt v. Golden*, 2012 WL 3059387, at *2–3 (D. Mass. July 25, 2012).)

These cases reason that because the corporation is the real party in interest, the identity of the specific shareholders in the first and second suits is irrelevant to the applicability of the preclusion doctrines, because shareholders who seek to sue derivatively on behalf of the same corporation have no individual or distinct interests. The only relevant question is "whether demand on the board of directors would have been futile, which is an issue that would have been the same no matter which shareholder served as nominal plaintiff." *Sonus Networks*, 499 F.3d at 64. That is equally true here.

The Court of Chancery refused to follow this unbroken line of precedent on the ground that these authorities all "miss that as a matter of Delaware law, a

stockholder whose litigation efforts are opposed by the corporation does not have authority to sue on behalf of the corporation until there has been a finding of demand excusal or wrongful refusal." Op. 23. But ten prior cases did not "miss" a fundamental precept of Delaware law; rather, they carefully considered that principle and determined that it was not applicable to the collateral estoppel issue.

Sonus Networks is typical. The plaintiff there argued that there was no privity because the first plaintiff was never authorized to act on behalf of the corporation, and therefore, "the state court judgment did not adjudicate the corporation's rights." 99 F.3d at 64. (Plaintiffs made, and the Court of Chancery accepted, the same argument in this case. Op. 36.) The First Circuit did not "miss" this argument. The court considered it and held that it did not govern because the relevant question is not whether the first stockholder could bind the corporation; rather, "[t]he question was whether demand on the board of directors would have been futile, which is an issue that would have been the same no matter which shareholder served as nominal plaintiff." *Sonus Networks*, 99 F.3d at 64. As the court correctly concluded, "[t]he defendants have already been put to the trouble of litigating the very question at issue, and the policy of repose strongly militates in favor of preclusion." *Id.*

The other precedents similarly did not "miss" the principle identified by the Court of Chancery, but rather held it inapplicable in the collateral estoppel context. *E.g.*, *LeBoyer*, 2007 WL 4287646, at *3; *Henik*, 433 F. Supp. 2d at 381. As the Court of Chancery itself acknowledged in an earlier case, the "unique" nature of derivative suits results in "commonality" among stockholders, which "lends itself to the application of collateral estoppel" concerning demand futility. *Career Educ.*, 2007 WL 2875203, at *10. So, too, here.

Accordingly, the Court of Chancery erred in its choice of law analysis, and its decision cannot be justified on alternative grounds by reference to federal or California law. This Court should therefore reverse the Court of Chancery and remand with instructions to dismiss. *Sonus Networks*, 499 F.3d at 63–64; *LeBoyer*, 2007 WL 4287646, at *1–4; *Career Education*, 2007 WL 2875203, at *10–11. The federal judgment should be given collateral estoppel effect on the question of demand futility.

2. Even under Delaware law, the Court of Chancery's privity analysis was erroneous.

Even if the preclusive effect of the federal judgment should be resolved by reference to Delaware law (which it should not, as explained above), the

Court of Chancery's new and unprecedented privity rule is unwise and unworkable because it invites serial relitigation. In brief, the Court of Chancery reasoned that a shareholder derivative plaintiff who does not survive a Rule 23.1 motion speaks only for itself; it does not speak for the corporation, and thus should not be considered "in privity" with other shareholders.

The Court of Chancery's analysis is incorrect because it ignores the difference between two distinct concepts. The first concept is the truism that a shareholder cannot control corporate litigation—and in that sense does not speak for the corporation—until the shareholder survives a Rule 23.1 motion. The second concept is that a Rule 23.1 motion requires the court to determine whether a given set of allegations establishes that a majority of directors is incapable of independently and disinterestedly considering a pre-suit demand.

The Court of Chancery incorrectly equated the two concepts under the privity umbrella by assuming that a shareholder's ability to seize control of corporate litigation is precisely the same thing same as a shareholder's ability to represent other shareholders in a derivative case. But in reality, the important question is <u>whether the specific allegations show demand futility</u>. That question can have but one answer. And the answer to that question does not depend upon the identity of the first or successive shareholders, as numerous courts have held. *E.g.*, *Sonus Networks*, 499 F.3d at 64 ("The question was whether demand on the board of directors would have been futile, which is an issue that would have been the same no matter which shareholder served as nominal plaintiff"); *LeBoyer*, 2007 WL 4287646, at *3 ("The differing groups of shareholders who can potentially stand in the corporation's stead are in privity for the purposes of issue preclusion"); *Henik*, 433 F. Supp. 2d at 380. That is equally true here.

The conclusion that shareholders are "in privity" with each other in a derivative case for collateral estoppel purposes even before one of them survives a Rule 23.1 motion, although never squarely presented to and decided by this Court, is fully supported by the precedents of the U.S. Supreme Court, other state and federal courts, and this Court.

The U.S. Supreme Court has articulated six categories of cases in which "nonparty preclusion" has been found constitutionally acceptable. *Taylor v. Sturgell*, 553 U.S. 880, 893–95 (2008). Preclusion of other shareholders by one shareholder's attempt to show demand futility fits comfortably within several categories identified by the Court, including: where the parties have "pre-existing substantive legal relationships," where the nonparty was "adequately represented by someone with the same interests who was a party," and "special statutory scheme[s] [that] expressly foreclose successive litigation by nonlitigants . . . if

the scheme is otherwise consistent with due process." *Id*. at 894–95 (internal alterations and quotation marks omitted).

These principles were applied in the Rule 23.1 context by Vice Chancellor Parsons in the *Career Education* case, with which the decision below is irreconcilable. In *Career Education*, the Court of Chancery dismissed a shareholder derivative case on collateral estoppel grounds because a federal court in Illinois had previously reached a final judgment finding that the same allegations did not show demand futility. 2007 WL 2875203, at *10–15. The *Career Education* court agreed with the reasoning of the federal cases cited above (*e.g.*, *Sonus Networks*, *LeBoyer*, and *Henik*): "Because the corporation is the true party in interest in a derivative suit, courts have precluded different derivative plaintiffs in subsequent suits." *Career Educ.*, 2007 WL 2875203, at *10; *accord, e.g.*, *In re M&F Worldwide Corp. S'holders Litig.*, 799 A.2d 1164, 1174 n.31 (Del. Ch. 2002) (quoting *In re MAXXAM, Inc./Federated Dev. S'holders Litig.*, 698 A.2d 949, 956 (Del. Ch. 1996) ("Because the corporation is always the real party in interest, the identity of the specific representative shareholder plaintiff is not a paramount concern")). The court acknowledged that a successive suit might not be precluded if it asserted different allegations or legal theories, but held that there was no real difference between the federal and Delaware plaintiffs in those respects, and therefore the successive suit was barred. *Career Educ.*, 2007 WL 2875203, at *14. The same analysis leads to preclusion here.

The privity analysis in *Career Education* is in accordance with the standards set forth in the Restatement (Second) of Judgments, which this Court has long relied upon in articulating preclusion principles. *LaPoint v. AmerisourceBergen Corp.*, 970 A.2d 185, 193 n.29 (Del. 2009); *Bailey v. City of Wilmington*, 766 A.2d 477, 481 n.12 (Del. 2001); *Grimes v. Donald*, 673 A.2d 1207, 1219–20 (Del. 1996); *Taylor v. State*, 402 A.2d 373, 375–76 (Del. 1979); *New Castle Cnty. v. Sterling Props., Inc.*, 379 A.2d 1125, 1127–28 (Del. 1977); *Lewis v. Hanson*, 128 A.2d 819, 833 (Del. 1957).

Contrary to the approach taken by the Court of Chancery, the Restatement discourages a formalistic use of the word "privity" to determine whether entities that were not parties in an earlier action should be bound by the judgment in that action. Restatement § 62 cmt. c. "[T]he term 'privity' . . . is so amorphous that it often operates as a conclusion rather than an explanation." *Id*. Instead of following a formalistic analysis scrutinizing the word "privity," a party in the first action should be entitled to rely on the first judgment if a successive action could lead to an "incompatible . . . judgment" of its "rights and duties" (*id.* § 62(1) (emphasis added)), as long as the defendant "[w]as reasonably induced to

believe . . . that [successive plaintiffs] would govern [their conduct] by the judgment in the original action" and "[j]ustifiably abstained from employing procedures, such as joinder" that could have resolved the second plaintiff's claims in the first action (*id.* § 62(2)).

Thus, even if the "privity" question here is controlled by Delaware law (which it is not), under the Restatement, the question must be resolved on the basis of sound public policy, not under a formalistic definition of the word "privity." Does it make more sense for a Delaware corporation, including both its directors and its shareholders, to litigate the question of demand futility once, or multiple times, on a given set of factual allegations?

This Court and numerous others have already addressed this policy question. As this Court noted recently in *King II*, "it is wasteful of the court's and the litigants' resources to have a regime that could require a corporation to litigate repeatedly the issue of demand futility." 12 A.3d at 1150–51. Indeed, the Court of Chancery recognized this identical principle earlier in this very case. *See supra* p. 6. Many other cases have recognized that, absent application of collateral estoppel in these circumstances, defendants could be required to defend the same claims over and over again. *E.g.*, *Sonus Networks*, 499 F.3d at 64; *Henik*, 433 F. Supp. 2d at 372. There is no contrary authority.

Under the Court of Chancery's reasoning, a Rule 23.1 dismissal can <u>never</u> bind other shareholders, and the dismissing court's analysis and conclusions are entitled only to the weight a subsequent court elects to give them—*i.e.*, as the Court of Chancery would have it, they are at most "persuasive authority" or "*stare decisis*." Op. 36. But as this case shows, under the Court of Chancery's reasoning, a successive court is free to render a contrary decision simply because it disagrees with the first court. That is directly contrary to all of the ancient policy foundations of collateral estoppel, under which the first judgment must be respected <u>regardless</u> of whether the second court agrees with the first. *E.g.*, *Kent Cnty. v. Shepherd*, 713 A.2d 290, 303 (Del. 1998) (There is no "roving 'public policy exception' to the full faith and credit due judgments") (citations omitted); *Thompson*, 320 A.2d at 734 ("a judgment, order or decree rendered by a court having jurisdiction of the parties and the subject matter, unless reversed or annulled in some proper proceeding, is not open to collateral attack in any other proceeding").

The Court of Chancery denied that its privity ruling would permit relitigation *ad infinitum*. A657–60 (Tr.). First, the court stated, the second court might find the first decision persuasive. But that point has nothing to do with whether the issue will be relitigated—the company will still be put to the expense

(at a minimum) of moving to dismiss another complaint. Second, the court contended that companies would have to relitigate at most "twice": "Once against the fast-filer who sued without books and records, and once against the stockholder who got them." A659 (Tr.). But that is simply incorrect. There can be multiple "fast-filers" (or, for that matter, multiple slow-filers) in multiple forums. If shareholders are not in privity with one another unless and until one survives a Rule 23.1 motion, the corporation will be obligated to litigate against each stockholder, whether there are two or ten.

There are deeper policy considerations. Under the court's privity reasoning, a Delaware corporation cannot achieve finality against meritless shareholder derivative claims unless it settles; simply winning a Rule 23.1 dismissal against a single shareholder will not give finality. But settlement will. *See* Op. 29 (when "a court has approved a derivative action settlement and made the determinations required by Rule 23.1," then the judgment of settlement will preclude other shareholders). This will create intense pressure on corporations to settle even meritless derivative claims rather than try to dismiss multiple successive suits on Rule 23.1 grounds. Fully briefing any given Rule 23.1 motion, or even prevailing in the first jurisdiction, would be as useful as cutting a single head off the Hydra. Settlement with the first filer before even moving to dismiss could be the rational decision, even if the allegations are meritless.

The Court of Chancery's rule also puts Delaware at odds with every court in every jurisdiction that has adjudicated the collateral estoppel issue. *See supra* p. 14. Not only is such a split of authorities unwise as a general matter, the doctrine proposed here would reduce the incentive for corporations to incorporate (or remain incorporated) in Delaware. The point is not that Delaware should try to "ritualistically favor[] defendants." *Cf.* Op. 58. Rather, Delaware should not subject its corporations to expensive successive litigation that entities incorporated elsewhere do not face. This is especially true in the modern era, in which directors face a derivative suit after virtually any corporate trauma.

Nothing in the Court of Chancery's opinion undermines these conclusions. The thrust of the court's reasoning, which it reiterated several times, was the principle that a shareholder does not speak for the corporation or other shareholders until it survives a Rule 23.1 motion. Op. 23–27, 31–32, 34, 36. But as discussed above, the cases explaining the two-fold nature of a derivative action (such as *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993), and *Cantor v. Sachs*, 162 A. 73, 76 (Del. Ch. 1932)), do not require or even suggest that a second shareholder can make the same demand futility allegations that another court has already rejected. And the prior precedents did not "miss" the two-fold nature of derivative litigation. Rather (unlike the Court of Chancery),

they have uniformly held that this point does not control the question of whether there is privity between stockholders for purposes of collateral estoppel. *See supra* pp. 14–16.

The Court of Chancery's holding is based on the overly formalistic definition of the word "privity" that the Restatement discourages. The "privity" question here (as always) is whether the two different parties' interests are so closely aligned that it is fair to bind the second plaintiff to the judgment against the first. Where, as here, both sets of plaintiffs have access to the same books and records and use the same legal theories, it is fair to bind them (and it would be unfair to the corporation for them not to be bound). The Court of Chancery also suggested that a finding of privity would mean that a grant of a Rule 23.1 motion in the first action would extinguish any of the corporation's claims under *res judicata* principles. A631 (Tr.). But that is incorrect because a finding of privity among shareholders says nothing about privity between a shareholder and the corporation itself; and further, the issue of demand futility is irrelevant to the corporation if it chooses to pursue a claim on its own.

The Court of Chancery also suggested that it would be "inequit[able]" for defendants who prevail under Rule 23.1 in one action because the first plaintiff lacks authority to represent the company to seek to avoid a successive complaint making the same futility allegations. Op. 27. But Allergan has already shown, on these same allegations, that demand would not have been futile, and therefore it should not be forced to relitigate the identical issue. *See King II*, 12 A.3d at 1150; *Sonus Networks*, 499 F.3d at 64. There is nothing inequitable about a litigant asking one court to give the judgment of another court full faith and credit. A board of directors that is presumed to control corporate litigation under 8 *Del. C.* § 141(a), and has obtained a final judgment showing that it remains in control regarding a specific corporate event, has every right to rely on that judgment to exert and exercise the control vested in it by Delaware law and confirmed by a court of competent jurisdiction. If there is any inequity here, it is in allowing a collateral attack on the federal judgment and the Board's right to govern the Company.

That is especially true here, where the Court of Chancery itself specifically recognized that "it is simply not efficient from the perspective of judicial resources or, frankly, corporate resources to do things twice, to rule on the motion to dismiss twice," and that there should not be "multiple decisions on the same issues, whether those be seriatim in one proceeding or whether those be parallel and seriatim in different courts." A655–66. Based on the court's remarks, both plaintiffs and defendants in this very case had every reasonable expectation that the first court to reach final judgment would resolve the issue

once and for all. In fact, UFCW expressly premised its motion to intervene in this case on its recognition that once a court ruled on demand futility, other stockholders would be collaterally estopped from relitigation of the issue. A81. There is nothing inequitable in Defendants' maintaining the position that every party and the court previously took in this very case.

The Court of Chancery also stated that its privity holding was "squarely" supported by *Kohls v. Kenetech Corp.*, 791 A.2d 763 (Del. Ch. 2000). Op. 29–32. That is incorrect. *Kohls* involved direct, not derivative, claims. In the first case, individual shareholders (who never sought to certify a class) sued the corporation, which prevailed after trial. 791 A.2d at 768 n.18. The company was then sued again by different plaintiffs, who like the first plaintiff asserted direct claims against the corporation. The *Kohls* court held that the first plaintiffs never represented the second plaintiffs (nor did they ever seek to), and "[b]eing fellow stockholders is plainly not the type of legal relationship" that can support privity for collateral estoppel. *Id.* at 769. It is entirely uncontroversial that a shareholder bringing a direct claim in an individual capacity speaks only for itself. But that situation has nothing to do with derivative actions like the present case, brought on behalf of the Company rather than against it, in which the only relevant question is whether the board is independent and disinterested. The Court of Chancery's reliance on *Kohls* was thus misplaced.

The Court of Chancery also thought this Court's decision in *Grimes*, 673 A.2d at 1218–19, supported the Court of Chancery's new privity doctrine. Op. 33. This, too, is incorrect. *Grimes* prevented a shareholder who had previously made a pre-suit demand upon the board from later arguing, with regard to the same allegations, that demand would have been futile. 673 A.2d at 1218–19. The Court of Chancery here believed that because this Court had "rendered its decision [in *Grimes*] without mentioning collateral estoppel or *res judicata* suggests that the high court did not envision an expansive (if any) role for preclusion doctrine in the Rule 23.1 context." Op. 33. That is incorrect on its face because *Grimes* did refer to *res judicata*: "The Court of Chancery implicitly applied a test analogous to *res judicata* to determine whether Grimes' demand letter conceded that demand was required for all legal theories arising out of the set of facts described in the demand letter. We believe this to be a correct approach." 673 A.2d at 1219. This Court went on to cite the Restatement for the principle that "fairness to the defendant, and sound judicial administration, require that at some point litigation over the particular controversy come to an end." *Id*. (citing Restatement (Second) of Judgments § 19 cmt. a). Those principles militate in favor of collateral estoppel here.

In sum, the Court of Chancery's privity rule, under which a Rule 23.1 dismissal does not preclude another shareholder plaintiff from bringing a successive action, is unsupported by Delaware precedents. It is based on unjustified extensions of this Court's cases defining derivative actions and an improperly formalistic understanding of "privity." It undermines the practical and constitutional foundations of the full faith and credit requirement. And it is bad policy because it invites serial relitigation against Delaware corporations of identical claims in multiple forums, and would create perverse unintended consequences, including pressure to settle meritless claims and an incentive to incorporate elsewhere.

3. The Court of Chancery also erred by applying a "fast-filer presumption" in its adequacy of representation analysis.

Independent of its privity analysis, the Court of Chancery held that the California federal case could not preclude UFCW and LAMPERS here because the plaintiffs in federal court had provided inadequate representation under its newly announced "fast-filer presumption." As noted above, it was incorrect to apply Delaware law to this element of the collateral estoppel analysis. But in any event, the "fast filer presumption" has no basis in Delaware law.

The Court of Chancery's fast-filer presumption was an attempt to improve the current system of shareholder derivative litigation. As the court explained it, "specialized plaintiffs' firms" currently act as corporate monitors, driven by attorneys' fees." Op. 39–40. Since many courts award control of a case, and ultimately attorneys' fees, to the first-filed case among identical actions, "plaintiffs' firms rationally eschew conducting investigations and making books and records demands, fearing that any delay would enable competitors to gain control of the litigation and freeze-out the diligent lawyer." Op. 41–42. The Court of Chancery explained that the current system may harm shareholders who would prefer not to waste corporate resources defending against meritless claims (that would have been exposed as meritless through further investigation), but also would prefer for claims with merit to be filed only after a thorough investigation, at which point they have a greater chance of surviving a Rule 23.1 motion. Op. 53–56. Thus, according to the court, the "first-to-file regime disserves stockholder interests across multiple dimensions." Op. 58.

The court then recited several areas in which the Court of Chancery has attempted to "shape the legal incentives of specialized plaintiffs' firms" to "mitigate[] the first-to-file problem." Op. 59. These included cases addressing

the propriety of a stay in favor of other litigation, as well as the Court of Chancery's adoption of Chancery Rule 15(aaa). Op. 60. The court also noted that this Court had "rejected two other attempts by [the Court of Chancery] to address the first-to-file problem." Op. 61–63 (citing *King II*, *rev'g King v. VeriFone Holdings*, 994 A.2d 354 (Del. Ch. 2010) ("*King I*"), and *White v. Panic* 783 A.2d 543 (Del. 2001) ("*White II*"), *affirming on other grounds* 793 A.2d 356 (Del. Ch. 2000) ("*White I*")). Rather than construing these decisions as precluding further attempts to regulate fast-filers through judicial innovation, the Court of Chancery was of the view that this Court had "expressed support for the effort." Op. 61.

The Court of Chancery then "adopt[ed] and appl[ied] the fast-filer presumption in this case." Op. 38. "By leaping to litigate without first conducting a meaningful investigation, the California plaintiffs' firms failed to fulfill the fiduciary duties they voluntarily assumed as derivative action plaintiffs. . . . In doing so, the fast-filing plaintiffs failed to provide adequate representation." Op. 64. Furthermore, "[s]ubsequent events"—such as the receipt of the full books and records production and amendment of the federal complaint in accordance with them—"did not transform the fast-filing plaintiffs into adequate representatives" because they "already had shown where their true loyalties lay." Op. 64–65.

Although the Court of Chancery has since insisted that the presumption is "rebuttable," it nowhere explained how or when it might be rebutted (or who is empowered to rebut it). *See* A559, A663 (Tr.). Certainly no party (or non-party) in this case was ever given an opportunity to offer a rebuttal because the court announced the presumption on page 38 of its Opinion and applied it on page 64. Thus, in this case, the presumption was both conclusive and dispositive. A644 (Tr.) (explaining that the fast filer is inadequate, "Period. Stop.").

The fast-filer presumption conflicts with *King II* and *White II*, both of which <u>rejected</u> attempts to alter substantive law to shape the course of derivative litigation. In *White II*, this Court blocked a Chancery attempt to modify the Rule 23.1 pleading standards to punish fast-filing plaintiffs. 783 A.2d at 549–50. More recently in *King II*, this Court blocked a Chancery attempt to punish fast-filing plaintiffs by presuming that they lack a proper purpose in seeking books and records after they have already filed a derivative action. 12 A.3d at 1151. This Court stated that "[u]ndoubtedly the . . . rule adopted by the Court of Chancery was intended as a needed prophylactic cure," but was nevertheless "overbroad and unsupported by the text of, and the policy underlying, Section 220." *Id*. at 1150-51. A change in law of that magnitude needed to be "imposed expressly by the General Assembly, not decreed by judicial common law

decision-making." *Id*. at 1151. In fact, *King II* implicitly rejects the fast-filer presumption: if the plaintiff in that case were a presumptively inadequate representative, there would be no reason to allow him access to books and records to evaluate filing a lawsuit, since he would (presumably) be unable to prosecute that suit. And because *King II* rejected punishing plaintiffs for their own flawed investigations, it implicitly rejected punishing the corporation and its directors for plaintiffs' hasty filing decisions as well.

The fast-filer presumption also creates radical changes in the system of derivative litigation even greater than those attempted in *King I*—which this Court expressly said should be reserved for the General Assembly. Although the Court of Chancery openly disagreed with that facet of *King II* (A668–69 (Tr.)), similar changes regarding lead plaintiffs in federal securities cases were made by legislation rather than judicial action. *See* 15 U.S.C. § 78u-4(a)(3) (lead plaintiff provisions of the Private Securities Litigation Reform Act of 1995 ("PSLRA")). As one example of the radical changes implied by the Court of Chancery's new rule, the court intended to create a new basis for dismissing or staying a fast-filed case, asserting that defendants "should win most of the stay or dismissal motions on inadequacy." A660 (Tr.). A motion to dismiss founded on the inadequacy of an investigation would seem to require pre-motion-to-dismiss discovery into the plaintiff's investigatory methods and an opportunity (never given here) for the first plaintiff to defend its investigatory decisions—novel concepts. Another example of the radical changes implied by the presumption is that applying it in a successive suit would appear to call for discovery into the investigatory methods of the plaintiff in the prior case, who would not even be present before the court.

The decision below also conflicts with the previous decision of the Court of Chancery in *Career Education.* There, as here, the federal plaintiff who failed to survive a Rule 23.1 motion did not initially seek 220 materials, but later amended his complaint to refer to certain such materials that he obtained following the Delaware plaintiffs' Section 220 demand. *Career Education* held that any risk that recognizing preclusion would undermine the "'efficacy' of the Section 220 device" was cured by the fact that the federal plaintiff later amended his complaint to include the Section 220 materials acquired by the Delaware plaintiffs. 2007 WL 2875203, at *10 n.58. In contrast, the Court of Chancery here held that "receiving the benefit of another lawyer's work d[oes] not rehabilitate" a fast-filer because that would "undercut" the "policy goal of encouraging plaintiffs to use Section 220." Op. 65.

The court's fast-filer presumption also conflicts with other decisions of the Court of Chancery, including a prior decision in this very case, holding that filing a complaint before obtaining books and records does <u>not</u> make a

shareholder presumptively inadequate. When UFCW sought to intervene in the Court of Chancery, it expressly argued that because LAMPERS failed to utilize Section 220 before filing suit, LAMPERS was an inadequate derivative representative. A79–83; A90. The Court of Chancery rejected this argument, stating that nothing in its intervention ruling should be "construed as any criticism" of LAMPERS or its counsel (A144–45), and suggesting that UFCW and LAMPERS file a joint complaint (A142), which they subsequently did. *Accord Norfolk Cnty. Ret. Sys. v. Jos. A. Bank Clothiers, Inc.*, 2009 WL 353746, at *8 (Del. Ch. Feb. 12, 2009) ("Although the prior plaintiff's failure to make a books and records request before filing a derivative lawsuit does not comport with the approach suggested by Delaware courts, <u>that alone does not indicate</u> that he was an inadequate representative") (emphasis added); *In re Fuqua Indus., Inc. S'holder Deriv. Litig.*, 752 A.2d 126, 129–30 (Del. Ch. 1999) (listing "eight factors to be considered in evaluating the adequacy of a representative plaintiff"); *Youngman v. Tahmoush*, 457 A.2d 376, 379–80 (Del. Ch. 1983) ("a Court can and should examine any extrinsic factors," listing eight traditional factors).

Federal Rule of Civil Procedure 23.1(a) already states that a shareholder plaintiff must "fairly and adequately represent the interests of shareholders or members who are similarly situated," and no case has ever held or suggested that this federal standard—which indisputably governed the federal action in this case—requires an analysis into the plaintiff's investigation. (Nor does *Kamen* or any other case hold or suggest that federal Rule 23.1(a) incorporates a substantive state law standard, in contrast to Rule 23.1(b)(3)(B)'s reliance on the substantive law of the state of incorporation for demand futility.)

The leading case from the federal courts on this topic, *Sonus Networks*, adopted the Restatement's standard: the first plaintiff is an inadequate representative only if the allegations in its complaint are "so grossly deficient as to be apparent to the opposing party." 499 F.3d at 66. Neither the Court of Chancery nor Plaintiffs in this case alleged that the federal court plaintiffs failed to meet these federal standards for adequate representation. *Cf. Hansberry v. Lee*, 311 U.S. 32, 44 (1940). It would be unwise, if not an outright violation of the full faith and credit and due process clauses, for Delaware to adjudge a federal plaintiff "inadequate" when a federal court would not do the same. *See* A548, A550.

The fast-filer presumption does not even work on its own terms. It creates no disincentive for a "fast-filing" firm to bring a hasty complaint in any jurisdiction outside of Delaware. There is always a chance that the foreign court will find that demand is excused; and in that event, it will be irrelevant to the fast-filer that other plaintiffs' firms are conducting a slower investigation using

Section 220. The presumption does not even prevent the very same law firm from recruiting one plaintiff for a fast-filing case and a different plaintiff for a fallback books-and-records investigation. The only entities truly affected by the presumption are the corporations themselves, who will be forced to litigate multiple times against different plaintiffs, each of which will contend that the plaintiffs who came before did not conduct an adequate investigation.

Finally, even if the Court were inclined to adopt some form of a fast-filer penalty, this would not be an appropriate case in which to do so for a variety of reasons. Defendants did the right thing (from the Court of Chancery's perspective) by seeking to stay the federal action in favor of the Delaware action. But the California federal court felt itself obligated to deny a stay under Ninth Circuit law because of the existence of securities claims in the federal case, something Defendants had no control over. Also, there were extensive publicly available documents, including 150 pages of False Claims Act complaints, a 45-page government sentencing memorandum and numerous other documents, which permitted shareholders to file particularized complaints even without books and records. Indeed, the Board documents that were the primary grounds for the Court of Chancery's demand futility finding (*see infra* Argument II) were available to both LAMPERS and the original federal plaintiffs <u>before</u> the books and records request. *E.g.*, A43 ¶ 39. Next, the Complaints in the federal and Delaware cases are materially identical, so any difference in investigation was irrelevant from the point of view of a public stockholder. LAMPERS itself was a fast-filer (actually the first-filer (Op. 64)), and was only saved because it reached an agreement with UFCW). Furthermore, the fast-filer presumption was unbriefed (as the court acknowledged, A676–77 (Tr.)) because it is a new doctrine; by failing to argue against the adequacy of the California plaintiffs, LAMPERS and UFCW have waived this issue and the court should not have reached it. Moreover, no court has yet heard the other plaintiffs' defense of their investigation. Finally, applying the presumption to the detriment of Defendants here would be impermissibly retroactive because of Defendants' justifiable reliance on settled law. *See Stoltz Mgmt. Co. v. Consumer Affairs Bd.*, 616 A.2d 1205, 1210–11 (Del. 1992).

None of this is to say that there are not real concerns with "fast filers," as the Court of Chancery has stated on several occasions. Rather, it points up that such concerns should be addressed, <u>prospectively</u>, by amendments to the statutes or rules governing derivative cases, *King II*, 12 A.3d at 1151, not by *ad hoc* judicial decisions. *See, e.g.*, *United States v. Fla. E. Coast Ry. Co.*, 410 U.S. 224, 245 (1973) (rulemaking, as distinct from adjudication, involves "promulgating policy-type rules or standards").

II. THE COURT OF CHANCERY ERRED IN FINDING THAT DEMAND WAS FUTILE.

A. Question Presented.

Was it unreasonable to infer from the documents relied upon by the Court of Chancery that every one of the Company's directors consciously intended the Company to break federal food and drug law? *See* Nom. Def. Allergan, Inc.'s Op. Br. in Supp. of Its Mot. to Dismiss the Verif. Sec. Am. Compl. (D.I. 61) at 1–2, 6–7, 9, 14–19; *see also* A545.

B. Scope of Review.

This Court reviews the denial of a Rule 23.1 motion to dismiss on demand futility grounds *de novo*. *Brehm v. Eisner*, 746 A.2d 244, 253–54 (Del. 2000).

C. Merits of Argument.

Delaware directors are entitled to a presumption of good faith in their actions, and plaintiffs bear the burden of rebutting that presumption. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993). This Court "need not blindly accept as true all allegations, nor must [it] draw all inferences from them unless they are reasonable inferences." *White II*, 783 A.2d at 549 (quoting *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988)) (emphasis added). Plaintiffs in this case argued that demand would be futile under *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984), in that each of Allergan's directors supposedly faces a substantial risk of personal liability if this case goes forward, because each director is alleged to have consciously intended the Company to break the law.

As the Court of Chancery explained, the FDCA permits physicians to prescribe (and accordingly for drug companies to sell) drugs for uses that do not yet have regulatory approval. Op. 3. Accordingly, there is nothing unlawful, or even suspect, in the Company's knowledge that physicians use its drugs for off-label purposes.

The Court of Chancery interpreted the demand futility allegations in this case to involve "Allergan's failed efforts (demonstrated by the guilty plea and government settlement) to walk the fine line between off-label sales and off-label marketing." Op. 4. But there is not a single fact alleged (as opposed to unsupported conclusions) demonstrating that Defendants tried to walk any "fine line." The Court of Chancery purported to find these facts by taking isolated

snippets out of two documents, while ignoring what the same documents actually said.

The documents that the Court of Chancery relied on were a strategic plan for 1997-2001 that the Board adopted in 1997 (and accompanying slides), and a 2006 e-mail discussing the Company's response to the "Schim incident." The court inferred from these documents that "the Board knowingly approved and subsequently oversaw a business plan that required illegal off-label marketing and support initiatives for Botox." Op. 77.

The court's inference was erroneous because the only possible reading of the documents is that Allergan's directors intended the Company to comply with the law. The court reached its erroneous conclusion only by relying on out-of-context snippets extracted from the documents, while ignoring the express content of the documents themselves.[3]

The strategic plan projected large increases in future sales of BOTOX® for various uses, from which the Court of Chancery inferred illegal intent because the uses were unapproved at the time the plan was adopted. The court simply ignored that the plan also contemplated regulatory approvals for the new uses, with both the approvals and increased sales occurring in the same future years. There is nothing unlawful about projecting increased sales coupled with new approved uses—which is in fact what happened.

The court premised its inference of unlawful intent based on a handful of excerpts from the Plan Slides and Written Plan, which forecasted increasing sales for uses of BOTOX® therapeutic that were not yet approved: (a) a corporate priority to "Maximize new sales for spasticity and new indications such as migraine" (Op. 70–71 (citing Written Plan 14 (A299) & Plan Slides 5, 10 (A268–69))); (b) corporate plans to "Invest to grow new indications & develop follow-on" drugs like BOTOX® therapeutic for "Spasticity," "Back pain," and "Head ache," which gave specific sales projections up to six years in the future (Op. 70–73 (citing Written Plan 3, 5, 22 (A288, A290, A311) & Plan Slide 5 (A268))); (c) statements that BOTOX® therapeutic represented "immediate growth" opportunity and a potential to "maximize [sales] now" (Op. 70 (citing Plan Slide 11 (A269))); (d) statements that a significant part of Allergan's planned growth

[3] The Written Plan and Plan Slides were incorporated by reference into the Complaint. At least one copy of the documents submitted to the Court of Chancery was largely illegible. Defendants' Appendix includes a better copy (at A267–414) to allow this Court to perform the requisite in-context *de novo* review.

would come from "new indications for *Botox*" (Op. 72–73 (citing Written Plan 10 (A295))); and (e) a statement that physicians currently use BOTOX® therapeutic in part because of "U.S.-Reimbursement assistance" (Op. 73 (citing Written Plan 59 (A363))). The Court of Chancery found highly significant the fact that many of the planned expansion areas were "off-label applications" in the sense that they were not "FDA-approved uses" at the time the plan was adopted in 1997. Op. 70–72.

Based on these excerpts, the court found it reasonable to infer that "[s]o significant was the scope of the expansion that it necessarily contemplated" illegal activity and that it could "reasonably infer that the Board knowingly approved and monitored a business plan that contemplated illegality." Op. 69 (emphasis added). Apparently assuming that Allergan could not legally communicate data about unapproved uses of BOTOX® therapeutic with the medical community in any manner without violating the FDCA (which is not true, *see, e.g.*, *Sorrell v. IMS Health Inc.*, 131 S. Ct. 2653, 2667–68 (2011)), the court further stated that it could "reasonably infer at the pleadings stage that the Board knew physicians were not harmonically converging on off-label uses in the same areas that Allergan happened to be targeting aggressively for sales growth." Op. 73.

The Court of Chancery's inferences are directly contradicted by the bulk of the other statements in the Plan Slides and Written Plan. The court's fundamental error was its failure to recognize that these documents outlined a plan that was to be executed over a five-year period, which was based on further projections extending ten years out. And the five- and ten-year windows expressly called for increased research and development and further regulatory approvals to drive expanded sales over the same time period.

The Strategic Plan and Plan Slides expressly and repeatedly discussed research and development leading to "U.S. Approval[s]" for the new uses of BOTOX®, including for juvenile cerebral palsy, adult spasticity, back pain, and headaches. A270 (Plan Slide 17), A362 (Written Plan 58) ("data and approvals to support" new "indications"). As the plan noted, at the time of its adoption, several of these new indications were already deep into clinical testing, with back pain and headache indications in Phase II trials and spasticity indications about to begin Phase III trials. A362 (Written Plan 58).

Critically, it was these new indications that were expected to drive the Company's future growth. The Written Plan and Plan Slides advised the Board that the future growth was expected to come after FDA approvals of the new uses. A table near the front of the Written Plan titled "How Will We Grow the

Business," reproduced in part below, linked new products with future approvals and future sales:

New Product	Est. Launch Year	Est. Peak Year Sales
Juvenile Cerebral Palsy	2001	$75 million
Migraine Headache	2001	$596 million
Back Pain	2002	$666 million

A290 (Written Plan 5). The fact that "Launch Year" coincided with the year of "U.S. Approval" is confirmed by Slide 17, which provides the identical timetable to "Invest/Grow via New Indications," and expressly notes that the timetable listed is based upon "U.S. Approval Dates." A270. The fact that the projected "Launch Year[s]" were the same as the "U.S. Approval" dates shows conclusively that the Board was approving a plan under which future sales would be driven by future FDA approvals. This is confirmed by a summary of the Company's "strategic positioning" for the "Future" includes as its first item: "Data and approvals demonstrating the safety and efficacy of *Botox* for nonapproved indications." A363 (Written Plan 59).

The linkage between future research, future approvals, and future sales is discussed throughout the Written Plan and Plan Slides. To give only a few examples: the executive summary stated that the overall BOTOX® strategy was to "fund opportunities with new indications and uses" (A288 (Written Plan 3)); the strategy for increasing shareholder value was to create "high margin new products" (A291 (Written Plan 6)); the Company had significant opportunities because it was "at the beginning of major new product launches [including] new indications for BOTOX®" (A294 (Written Plan 9)); and the strategic rationale for "invest[ing] to develop" new BOTOX® uses was that "investments in new indications represent two of the top three future growth opportunities" in the Company's profile (A311 (Written Plan 22)). These points are summarized on Plan Slide 79, which states that, for these new uses expected to launch in 2001 and 2002, "Approval will lead to market expansion." A281.

Thus, the Strategic Plan does <u>not</u> show sales growth being driven by increased off-label sales, as the Court of Chancery believed it "necessarily" implied. Op. 69. Instead, the plan was explicitly premised on gaining further FDA approvals for new uses, and using those new approvals to drive future growth. Whatever it means for an inference to be "reasonable," it cannot permit Plaintiffs or the court to take snippets from a document while ignoring the bulk of the same document that directly refutes the proposed inference. *Cf. Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323–24 (2007).

The Court of Chancery also relied on the 2006 e-mail from the general counsel to the Board discussing the Schim incident. A417–18. The e-mail explained, by way of background, that "Allergan conducts a physician speaker program" at which physician speakers explain to other physicians clinical data and benefits of the Company's FDA-approved drugs. A417. Presentations are first approved by the Company's Regulatory Affairs department to confirm that only information consistent with FDA-approved labeling is used. Presentations are then submitted to the FDA before they can be delivered. *Id.*

The "incident" involved the Company's discovery that one of its sponsored physician speakers, Dr. Schim, had supplemented his approved slides on the use of BOTOX® therapeutic to treat cervical dystonia (which was an approved use by 2006) with additional unapproved slides on headache treatment (which was not yet approved). Discussing unapproved uses in that manner violated corporate policy and (unless prompted by audience questions) likely violated FDA regulations. The general counsel's e-mail stated that "[t]he sales representatives and sales manager knew or should have known that [unapproved] slides were being used but apparently did not believe it was their responsibility to ensure that only [approved] slides were being used." A418.

Based on these excerpts, the Court of Chancery inferred that "the Board nevertheless decided to continue Allergan's existing business practices in pursuit of greater sales." Op. 74. Moreover, the court stated that the 2006 e-mail showed that the directors were "fully conscious of the role of off-label marketing in Allergan's success." *Id.* According to the court, the incident "further illuminated the serious legal risks posed by Allergan's various programs for supporting off-label use," and was a "red-flag" demonstrating "a culture of non-compliance at the company." Op. 80.

The court's analysis ignores numerous other statements in the very same e-mail that completely refute the notion of a "culture of non-compliance." First, the e-mail carefully laid out the governing legal regime, including submission of slides to the FDA (using FDA "Form 2253"). A417. The e-mail explicitly discussed the difference between the approved use of BOTOX® therapeutic (cervical dystonia) and the unapproved use (headache). The e-mail explicitly stated that "[i]t is not appropriate to proactively discuss off-label indications in promotional dinner meetings hosted and controlled by the Company." *Id.* Thus, the Board was being educated about the law, not being asked to ignore it.

Second, the e-mail explained the results of the "internal investigation" that sought to discover how unapproved slides had been used at eight meetings over the course of a year. A417. The e-mail explained the process flow—how

presentations were created and approved—and concluded that no one had been assigned to ensure that the actual slides used at any given dinner presentation matched the ones that had been approved and submitted to the FDA. *Id.*

Third, the e-mail discussed in detail the severe punishments imposed on all personnel involved in the incident. "Each of the involved employees . . . will receive a written reprimand indicating that he or she has committed serious misconduct and that the reprimand is not capable of being expunged from their personnel file." A418. One of the regional managers who was being considered for a promotion had his promotion revoked and was "relieved of his current position and moved out of the Botox sales and marketing organization and into a less sensitive role in the organization." *Id*.

Fourth, the e-mail discussed improvements to internal controls designed to prevent such incidents in the future. The Company's President of North America operations sent "a message to the entire sales force making explicitly clear to each of them that anyone involved in the presentation of a dinner meeting is personally responsible for ensuring that all of the policies, including the policy limiting physicians to use only [approved] slides, are followed at such dinner meetings." A418. All doctors participating in the program, and all sales and marketing employees, were to receive additional training. *Id*. Finally, all doctors giving presentations would be required to certify that they would use only approved slides. *Id*.

As these statements show, it is entirely unreasonable to read this two-page e-mail as supporting an inference of a "culture of non-compliance," as the Court of Chancery did. A fair reading of the e-mail instead shows a corporate culture that detected a problem, investigated it, corrected the underlying causes, and imposed severe consequences on those responsible.

The Court of Chancery found it reasonable to infer that Allergan's directors "saw the distinction between off-label selling and off-label marketing as a source of legal risk to be managed, rather than a boundary to be avoided." Op. 75. This supposition was based not on anything in the record, but instead on a handful of law review articles. Op. 75–76 nn.33 & 34. Having drawn this hypothesis from nothing in the record, the court then credited an inference that Allergan might in fact be one of those bad companies, rejecting the competing inference that the Board actually "approved a business plan and management initiatives in the good faith belief that Allergan was remaining within the bounds of the law." Op. 76. The court's speculation, besides being contrary to the actual documents before it, is utterly inconsistent with the presumption of good faith to which directors are entitled. *Cede*, 634 A.2d at 361.

The court's general approach of crediting selective portions of documents while ignoring other parts of the same documents has terrible policy implications. Many board documents from any corporation in any industry could be similarly excerpted to paint a picture of unlawful intent. It is particularly unsound to evaluate the legality of plans extending years into the future against the state of affairs when the plan is written rather than the projected state of affairs in the future. This is why courts should analyze documents cited in the complaint in their full context rather than focusing only on misleading excerpts quoted by plaintiffs. *See Tellabs*, 551 U.S. at 323–24.

The flaws in the Court of Chancery's approach stand in contrast to the thorough analysis of the federal court that was based on the same documents and theories as in this case. A422–26; A529–31. As the federal court recognized, the Written Plan and Plan Slides "make[] no mention of off-label marketing." A425; A531. And regarding the theory (credited by the Court of Chancery) that future sales growth of then-unapproved uses must have been predicated on *sub silentio* plans to engage in illegal promotion, the federal court correctly explained that "[g]iven that the Plan specifically contemplated data collection and approval of new uses, the fact that the Plan sought to maximize sales for new indications in the future is hardly suspect." A425. Similarly, the federal court correctly stated that the Schim incident "actually proves the opposite of Plaintiffs'" theories of unlawful intent because "the Directors were not aware of the problematic slides before the presentation and took appropriate remedial action after learning of Dr. Schim's impermissible presentation." A425–26. Thus, there was "no evidence that [the Board] supported or knew about violations of the law." A426.

In the face of this well-reasoned analysis that was based on a careful review of the documents, the Court of Chancery simply stated that it found the federal court's detailed opinions "unpersuasive." Op. 77. Thus, despite stating that a prior Rule 23.1 dismissal "could operate as *stare decisis*" even if it does not have collateral estoppel effect, the Court of Chancery refused to give any weight at all to the judgment of the federal court. Op. 36. Preclusion doctrines are designed to prevent precisely this kind of inter-jurisdictional judicial inconsistency. *Supra* Part I. But in any event, the judgment of the federal court was thorough, well-reasoned, and correct. Allergan's Board intended to expand sales while complying with the law, and that is the only possible inference to draw from the cited documents. The Court of Chancery erred when it concluded otherwise.

III. THE COURT OF CHANCERY ERRED IN HOLDING THAT EVERY COUNT IN THE COMPLAINT STATES A CLAIM FOR RELIEF.

A. Question Presented.

Are there legal differences between the standards for showing demand futility and those for stating claims upon which relief can be granted, such that the denial of a Rule 23.1 motion does not automatically mean that the complaint has stated a claim against every defendant on every count under Rule 12(b)(6)? *See* Dir. Defs.' Op. Br. in Supp. of their Mot. to Dismiss Pltfs.' Sec. Am. Compl. (D.I. 62) at 1–3, 12, 14–15, 28, 30; *see also* A545.

B. Scope of Review.

This Court reviews the denial of a Rule 12(b)(6) motion *de novo*. *Gadow v. Parker*, 865 A.2d 515, 518 (Del. 2005).

C. Merits of Argument.

The Complaint asserts two counts for relief: (I) fiduciary breach, and (II) corporate waste. A244–46 (¶¶ 231–241). The director defendants moved to dismiss both counts under Rule 12(b)(6) for failure to state a claim upon which relief could be granted. A159–60. The Court of Chancery denied the motion because "[a] complaint that pleads a substantial threat of liability for purposes of Rule 23.1 will also survive a 12(b)(6) motion to dismiss." Op. 81 (citing *McPadden v. Sidhu*, 964 A.2d 1262, 1270 (Del. Ch. 2008)). But a decision on Rule 23.1 determines only whether a majority of the board could consider a demand disinterestedly and independently. A Rule 12(b)(6) motion, by contrast, requires the court to determine whether the complaint states a claim on every count with respect to every defendant. *McPadden*, 964 A.2d at 1273.

The Court of Chancery's Rule 23.1 analysis does not reach the culpability, if any, of directors Deborah Dunsire and Dawn Hudson (Op. 74–75), yet it extended its Rule 12(b)(6) decision to all directors equally. At a minimum, all counts should be dismissed as to directors Dunsire and Hudson.

Furthermore, the complaint does not state a claim for waste. Such a claim requires a plaintiff to allege a corporate transaction that was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration"—that it either "serve[s] no corporate purpose or [is] . . . completely bereft of consideration." *In re 3COM Corp.*, 1999 WL 1009210, at *4 (Del. Ch. Oct. 25 1999). The Complaint here fails to allege any such transaction. Therefore, Count II should be dismissed.

CONCLUSION

The Court of Chancery committed reversible error in ruling on each of the three bases for Defendants' motion to dismiss. First, the court erred by refusing to give full faith and credit to the prior federal court judgment, holding instead that (1) the elements of the preclusive effect of a California federal judgment should be resolved, via the internal affairs doctrine, by reference to Delaware law; (2) as a matter of Delaware law, derivative plaintiffs are not in privity with one another unless and until one of them survives a Rule 23.1 motion to dismiss; and (3) a shareholder is an inadequate representative of other shareholders and the corporation unless it seeks corporate books and records before filing a complaint. Second, the court erred by inferring from certain allegations and documents referenced in the Complaint that each of Allergan's directors intended the Company to break the law. Third, the court erred by holding that the Complaint states a claim upon which relief can be granted. For any or all of these reasons, the Opinion below should be reversed and the case remanded with instructions to dismiss the Complaint with prejudice.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on August 21, 2012, she caused to be served by LexisNexis File & Serve a copy of the foregoing APPELLANTS' CORRECTED OPENING BRIEF IN SUPPORT OF INTERLOCUTORY APPEAL upon the following counsel of record:

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