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IN THE SUPREME COURT OF THE STATE OF DELAWARE

PARK EMPLOYEES' AND RETIREMENT BOARD EMPLOYEES' ANNUITY AND BENEFIT FUND OF CHICAGO, derivatively and on behalf of BioScrip, Inc., Plaintiff Below, Appellant, v. RICHARD M. SMITH, MYRON Z. HOLUBIAK, CHARLOTTE W. COLLINS, SAMUEL P. FRIEDER, DAVID R. HUBERS, STUART A. SAMUELS, GORDON H. WOODWARD, KIMBERLEE C. SEAH, HAI V. TRAN, PATRICIA BOGUSZ, KOHLBERG & CO., L.L.C., KOHLBERG MANAGEMENT V, L.L.C., KOHLBERG INVESTORS V, L.P., KOHLBERG PARTNERS V, L.P., KOHLBERG TE INVESTORS V, L.P., KOCO INVESTORS V, L.P. and JEFFERIES LLC, Defendants Below, Appellees and BIOSCRIP, INC., Nominal Defendant Below, Appellee.	No. 198, 2017 Court Below: Court of Chancery of the State of Delaware C.A. No. 11000-VCG **PUBLIC VERSION FILED JULY 11, 2017**

APPELLANT'S OPENING BRIEF

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NATURE OF PROCEEDINGS

This stockholder derivative action challenges disloyal and illegal conduct by directors and officers of BioScrip Inc. ("BioScrip" or the "Company") who engaged in a pattern and practice of intentional disregard for statutory, regulatory and compliance requirements constituting violations of fiduciary duty.[1] This disloyal and illegal conduct involved two major deceptions and a resultant pair of illegal stock offerings and insider trading resulting in windfalls to several of the Defendants. Joining BioScrip's insiders in the wrongdoing were the Company's largest stockholder, Kohlberg,[2] and the Company's investment banker, Jefferies.[3]

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[1] "Director Defendants" refers to Myron Holubiak ("Holubiak"), Charlotte W. Collins ("Collins"), Samuel P. Frieder ("Frieder"), David R. Hubers ("Hubers"), Stuart A. Samuels ("Samuels"), Richard M. Smith ("Smith"), and Gordon H. Woodward ("Woodward"). Plaintiff's Complaint inadvertently included former BioScrip director Richard L. Robbins in the caption. As a function of File & Serve Xpress Mr. Robbins appears as a party on the docket, but has been removed from the caption on appeal. No claims have ever been asserted against Mr. Robbins in this action.

"Officer Defendants" refers (collectively, with Smith) to Patricia Bogusz ("Bogusz"), Hai V. Tran ("Tran") and Kimberlee C. Seah ("Seah").

"Individual Defendants" refers to Director Defendants together with the Officer Defendants.

[2] "Kohlberg" refers to Kohlberg & Co., L.L.C., Kohlberg Management V, L.L.C., Kohlberg Investors V, L.P., Kohlberg Partners V, L.P., Kohlberg TE Investors V, L.P. and KOCO Investors V, L.P. Defendants Frieder and Woodward were Kohlberg designees on the BioScrip Board of Directors during the wrongdoing.

On August 11, 2014, Plaintiff made a books and records demand pursuant to 8 *Del. C.* §220. (A0536) That §220 investigation and the corresponding investigation of publicly available information led to Plaintiff filing its initial derivative complaint on May 7, 2015. (A0471, A0538) The initial complaint sought recovery on behalf of the Company against Defendants in six counts and alleged demand futility against the Bioscrip Board seated as of that date.

After briefing, argument and supplemental briefing, the Court of Chancery issued its May 13, 2016 Opinion ("2016 Opinion," Exhibit A). The 2016 Opinion held, contrary to Delaware law, that demand should not be evaluated against the Bioscrip Board seated as of the date of the complaint's filing (*i.e.*, the "May 7 Board").[4] (Ex. A at 25) Instead, the Court of Chancery opined that the question of demand futility should be judged against the Bioscrip Board seated as of May 11, 2015 (*i.e.*, the "May 11 Board"). (*Id.* at 25) The 2016 Opinion, however, permitted Plaintiff to seek leave to amend its complaint in light of the novel ruling. (*Id.* at 32).

On September 13, 2016, the Court of Chancery allowed Plaintiff to proceed with its Amended Complaint. (A0629, A0634) The Amended Complaint set forth identical substantive claims against the Defendants, but also presented claims for

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3 "Jefferies" refers to Jefferies LLC.

4 The seven Director Defendants constitute a majority of the ten member May 7 Board.

demand futility in the alternative against both the May 7 Board and the May 11 Board. (A0541-557) The Court issued an Opinion on April 18, 2017 (the "2017 Opinion," Exhibit B) determining that the May 11 Board was capable of considering a stockholder demand despite the conduct alleged by Plaintiff. (Ex. B at 15, 17)

The Court of Chancery has issued no decision on the merits of Plaintiff's claims on behalf of the Company or whether demand would be futile if judged against the May 7 Board.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred by holding that the May 7 Board was not the correct Board against which to determine demand futility. (Ex. A at 25-32). Delaware has adopted a bright-line test on the issue. *Braddock v. Zimmerman*, 906 A.2d 776, 786 (Del. 2006) That test makes sense from a legal, equitable and policy standpoint. Any number of intervening factors could otherwise create doubt for stockholders and corporate managers. The law balances the bright-line test by providing a later-elected Board with a wide range of options for taking control of derivative litigation should the Board so choose. *Braddock*, 906 A.2d at 785-86, *citing Harris v. Carter*, 582 A.2d 222, 230 (Del. Ch. 1990) The Court of Chancery, having requested supplemental briefing on this issue misapprehended Plaintiff's argument that the May 11 Board could, in fact, exercise plenary authority over the litigation. In addition, the Court of Chancery erroneously elected to deviate from established law, in large part relying upon a mistaken factual finding concerning the timing of BioScrip's receipt and possession of Plaintiff's claims. Moreover, the pleaded facts support Plaintiff's allegation of demand futility with respect to the May 7 Board. Given the passage of time, expensive and expansive briefing and arguments, and the record developed, this Court should not only reverse but also rule in favor of Plaintiff's futility argument as to the May 7 Board.

2. The Court of Chancery erred in its determination that the May 11 Board was capable of considering a demand. (Ex. B. at 15, 17) By its actions and conduct, the May 11 Board, with knowledge of the wrongdoing by the Individual Defendants, ignored its powers under 8 *Del. C.* §141 and took positions that aligned it and the Company with the individuals and entities accused of harming the Company. It did so by seeking dismissal of the action on the merits on behalf of BioScrip, by engaging the same counsel as the Individual Defendants, and prejudging, without rationale, the valuable claims raised on the Company's behalf. For these reasons, the May 11 Board is disabled. *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1983); *Grimes v. Donald*, 673 A.2d 1207, 1217 (Del. 1996). Neither policy nor equity supports deference to the irrational actions of the May 11 Board.

STATEMENT OF FACTS

A. Plaintiff Set Forth Detailed Allegations That Establish Liability and Undermine the May 7 Board's Ability to Assess Demand

From at least 2007 through 2013, BioScrip, through its directors and officers, engaged in a pattern and practice of intentional disregard for regulatory and compliance requirements as well as violations of fiduciary duty. This disloyal and illegal conduct involved two major deceptions and a resultant pair of illegal stock offerings and insider trading.

1. The First Deception: The Exjade Kickback Scheme

The first deception involved a kickback scheme concerning a dangerous Novartis Pharmaceuticals Corporation ("Novartis") product called Exjade (the "Exjade Kickback Scheme"). (A0466, A0492-499) The scheme spanned from early 2007 until May 2012 when the BioScrip unit involved with the scheme was sold. (A0494-498) This scheme resulted in over 40,000 false claims, and tens of millions of dollars paid to the Company by Medicare and Medicaid that should not have been paid. (A0466)

Most of the Individual Defendants knew or at very least should have known about the Exjade Kickback Scheme well before 2012 but did nothing to halt the illegal activity. (A0489-492, A0498-499, A0501-503) They, at best, ignored red flags and, in the case of CEO Smith, actively promoted the deception. (A0466, A0498-499, A0501-505, A0545-546) And, no one disputes that all Individual

Defendants knew about the scheme and the Government investigation by no later than September 2012 when the Company was served with a civil investigative demand ("CID") by the Government. (A0499-501, A0543) The Individual Defendants failed to disclose the Government's investigation and, in fact, covered up the investigation into the violations of the Anti-Kickback Statute and False Claims Act by BioScrip's specialty pharmacy division and the receipt of the CID for at least a year. (A0501-505)

The Individual Defendants signed several public filings to advance the core deceptions. (A0467, A0501, A0508-510) Each Director Defendant signed the Form 10-K for the year ending December 2012. (A0467, A0490, A0505, A0516, A0562-563) This 2012 Form 10-K was one of the critical documents perpetuating the cover up of the Exjade Kickback Scheme and each Director Defendant also signed other documents such as the Form S-3 for the shelf-registration leading to the two public offerings at issue incorporating the Form 2012 10-K. (A0467, A0508-509, A0514, A0519, A0543, A0562) All Director Defendants also signed the Amendment to Form S-3. (A0467, A0519, A0562-563) In addition, Defendant Smith, a director and Officer Defendant, signed various other documents covering up the deceptions including the Q3 2012 Form 10-Q (as

CEO), 1Q 2013 Form 10-Q (as CEO), and 2Q 2013 Form 10-Q (as CEO).[5] (A0467, A0490, A0514, A0516, A0519, A0545, A0562-563)

As a direct and proximate result of the Individual Defendants' breaches of their duties of loyalty and care, BioScrip was caused to violate its disclosure obligations under the Securities Act of 1933 and the Securities Exchange Act of 1934.

There can be no dispute that BioScrip failed to disclose the government investigation and the receipt of the 2012 CID until a year later in September 2013. (A0467-468, A0514-515, A0522, A0525, A0528-529) That disclosure came only after a second CID was served and only after the government informed BioScrip that it was filing suit imminently. (A0467-468, A0526) The second CID demanded more documents, as well as testimony from employees identified by the Department of Justice after the 2012 CID. (A0526, A0528) The deliberately belated disclosure by way of a Form 8-K unleashed, among other harms, a compelling and meritorious federal securities action, which has since settled, and a suit filed by the United States Attorney General. (A0467-468, A0535-536)

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[5] In addition, Officer Defendants Tran, Bogusz and Seah signed multiple false public statements. (A0467, A0490, A0505, A0514, A0516, A0519, A0562-563)

2. The Second Deception: The PBM Cover-Up

The second major deception concerned BioScrip's pharmacy benefit management ("PBM") business, one of the three main segments of the Company. The Individual Defendants covered up the fact that one of BioScrip's formerly most profitable business segments - PBM - was in the process of collapse.

As with the Exjade Kickback Scheme, the 2012 Form 10-K, signed by all Director Defendants, did not disclose the impending loss of a major contract for PBM, accounting for 33% of the segment's quarterly revenues. (A0468, A0508-509, A0517, A0543, A0562-563) It also did not disclose the scaling back by a chief promotor of discount card services - facts known to the Individual Defendants, Defendants Kohlberg (the largest stockholder of BioScrip) and Jefferies, the longtime advisor to BioScrip that was tasked first with unloading the PBM Services segment and later with selling the entire Company, both without success. (A0468, A0505-508, A0517, A0523) In addition, all Director Defendants signed the Form S-3, which failed to disclose the truth regarding the decline of the PBM segment. (A0519, A0562-563) Also, Defendant Smith signed various Form 10-Q's that hid the truth regarding PBM. (A0467, A0490, A0514, A0545, A0562-563)

Instead of disclosing the PBM business problems, the Individual Defendants tried to sell the segment. (A0468-469, A0507-513) When no interested buyer

emerged, the Individual Defendants sought to avoid disclosing the PBM business's free-fall by cutting costs in an amount equal to the losses in revenue to give the false impression that the segment was flat when it was actually collapsing. (A0468-469, A0509) The Individual Defendants again intentionally violated federal disclosure obligations and, thus, their fiduciary duties. (A0508-510, A0562-563)

By late 2012, the Director Defendants discussed various strategies, including the sale of the collapsing PBM segment, the retention of Jefferies to seek a buyer for the PBM segment, and, after the segment sale effort failed, the retention of Jefferies to sell the entire Company. (A0469, A0510-512) In the end, there were no buyers for the Company. (A0512) Long afterward, in August 2015, the PBM segment was sold. (A0469, A0488)

3. The Deceptions Led to Insider Trading

When neither a sale of PBM nor the Company as a whole could be achieved, Jefferies became intimately involved in advising and assisting BioScrip in other efforts to raise capital through a shelf-registration. (A0469-471, A0518) The shelf-registration leading to both the April and August 2013 Offerings was prepared and designed by Jefferies and the first Offering in April 2013 was recommended, structured and timed by Jefferies. (A0469, A0518, A0520) Jefferies also advised the Pricing Committee for the April 2013 Offering and was

later retained as an underwriter for the April Offering. (A0469-470, A0476-477, A0520-521) Jefferies attended meetings concerning the April 2013 Offering and specifically advised on the April 2013 Offering's size and price. (A0518-521) Jefferies also acted as an underwriter on the April 2013 Offering and in its capacity as an adviser and underwriter promoted and participated in the preparation of the April 2013 Offering documents - documents that also concealed the truth. (A0469-470, A0476-477, A0512, A0520)

The Company capitalized (albeit on the back of the Individual Defendants' disloyal conduct) on its inflated, historically high, stock prices through a public offering of BioScrip common stock in April 2013. (A0470, A0520-521) Also capitalizing on BioScrip's inflated stock was 26.2% stockholder Kohlberg. (A0470, A0519-522) Kohlberg participated with inside, material information in the two challenged offerings, one in April 2013 alongside the Company and one solely for Kohlberg's benefit in August 2013. (A0470, A0522, A0527-528)

Additionally, four directors (Hubers, Holubiak, Friedman and Woodward) including the two Kohlberg designees and one officer, Defendant Bogusz, traded with inside knowledge of the government investigation and the collapsing PBM Services segment. (A0470, A0531-535) All of the knowledge was based on internal material information departing from what the market knew. (A0470, A0531-532) The insider trading amounted to damages recoverable by the

Company under *Brophy v. Cities Service Co.*, 31 Del. Ch. 241 (Del. Ch. 1949) of approximately $131 million.[6] (A0532-534)

By their conduct, the Individual Defendants breached their fiduciary duties of care and loyalty and certain of them engaged in insider trading with material assistance from Kohlberg[7] and Jefferies. As such, demand against the members of the May 7 Board, a majority of whom were specifically implicated in the deceptions and insider trading, would have been and remains futile.

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[6] Because of the nature of the insider trading involved, a derivative *Brophy* claim is the Company's only avenue to recover these damages (A0695-696, A0875-876)

[7] Plaintiff also alleged that Kohlberg acted as a controlling stockholder in connection with the shelf-registration and subsequent stock offerings and, as such, breached its fiduciary duty. (A0469-471, A0486-487)

4. The Deceptions Resulted in Meritorious Litigation Against the Company

On or around January 8, 2014, BioScrip settled a Government investigation which resulted in the unsealing of a related whistleblower action regarding the Exjade Kickback Scheme, agreeing to pay $15 million ($11.7 million to settle the *qui tam* case brought on behalf of the federal government and $3.3 million to settle the certain states' claims). (A0470, A0535)

Predictably, once the true state of BioScrip's condition emerged the news prompted the filing of federal securities actions, consolidated as the "Federal Action." (A0467-486, A0536) The Federal Action alleged, among other things, that BioScrip made false and misleading statements regarding the Exjade Kickback Scheme, PBM business and stock offerings. (A0536) The Complaint in the Federal Action was sustained on March 31, 2015 with that Court finding scienter with respect to BioScrip's failure to disclose the CID when it made legal compliance statements and its affirmative misstatements concerning the existence of the CID. (A0536, A0543-544) Each member of the May 7 and May 11 Board had knowledge regarding the federal decision, the Company's public filings, the Company's internal documents revealing the date the CID was received (and its nature and scope), the sequence of events regarding the collapse of the PBM Segment and the internal record of various government investigations and

whistleblower suits. (A0467, A0491-492, A0499-501, A0507-508, A0513-517, A0543, A0552-555)

B. Demand Is Excused as to the May 7 Board

The Court below needed only to look to Count II of the Complaint to find that seven members of the May 7 Board (constituting a majority of the May 7 Board) were interested under either a *Rales* or *Aronson* analysis. (A0183-202, A0327-334, A0541-544, A0594, A0680-684)

Count II as asserted against the Director Defendants, alleges that each of the Director Defendants violated his duty of loyalty by concealing the Government's investigation into BioScrip's participation in the Exjade Scheme, the receipt of the CID and information concerning the failing PBM Service's Segment. (A0561-563)

The Complaint details each omission of material fact, rendering a disclosure misleading, and each misstatement of material fact by each of the Director Defendants. (A0501, A0505, A0508-510, A0513-517, A0519, A0522-526, A0562-563)

Notably, the 2012 Form 10-K, concealed the truth about the Government investigation and receipt of the first CID and the collapsing PBM Segment. (A0468, A0505, A0508-509, A0516-517) Each Director Defendant knew about both problems at the time they signed the 2012 Form 10-K, which was filed in

March 2013. (A0501-505, A0508-509, A0543, A0562-563) Each Director Defendant had knowledge of the Government investigation and its nature and scope, from at least September 2012, and knowledge of the problems at PBM Segment since at least late 2012.[8] (A0500, A0507-509)

No conceivable definition of candor can sanction the blatant omissions of material fact and the misrepresentations of material fact concerning the government investigation, the receipt of the CID and the collapsing PBM Services Segment.

When a Delaware corporation communicates with shareholders, even in the absence of a request for action, shareholders are entitled to honest communications from directors, given with complete candor and good faith. *In re InfoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 990-991 (Del. Ch. 2007). Communications that depart from this expectation, particularly where it can be shown that the directors involved issued their communications with knowledge that it was deceptive or incomplete, violate fiduciary duties that protect shareholders. *Id.* Such violations are sufficient to subject directors to liability in a derivative action. *Id.*

The Court of Chancery could have reasonably inferred, based upon the allegations here, that the Director Defendants, constituting a majority of the May 7

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[8] Several other SEC filings also were false when signed by one or more director. (A0467, A0501, A0514-517, A0519, A0562-563)

Board, signed the 2012 Form 10-K and corresponding Form 10-Q's and the Form S-3's knowing that the information therein fell far below the standard of conduct expected from them. Thus, the Director Defendants face a significant likelihood of personal liability arising from this lawsuit and should be considered interested for purposes of demand.

Moreover, in addition to having made knowingly false disclosures, Defendant Smith, as CEO, was an active participant in the underlying wrongdoing. (A0466, A0489-499, A0501-508, A0521, A0545-546) Also, Defendants Hubers, Holobiak, Frieder and Woodward all engaged in illegal insider trading. (A0470, A0531-535) These actions by half of the May 7 Board provides an additional basis to excuse demand.

C. With Knowledge of the Wrongdoing, the May 11 Board Recklessly and in Bad Faith Adopted the Individual Defendants' Position in Lock-Step Rendering Demand Futile

On May 11, 2015 ten directors were elected to BioScrip's Board. (A0552) Three of those directors resigned that same day from the Board, leaving the BioScrip Board with seven members including Defendants Holubiak and Smith. (A0552)

Although ignored by the Court of Chancery, the May 11 Board would have had plenary authority over the litigation that was filed on May 7, 2015 if it had so chosen. Nevertheless, the May 11 Board affirmatively chose to endorse

Defendants' actions and fought against BioScrip's interests and as such is not capable of considering demand. (A0552-555)

In addition to having notice and possession of the detailed claims in this action regarding the Exjade Kickback Scheme and PBM Segment deceptions, the Company and its Board -- at any relevant time -- were aware of and in full possession of the material facts concerning and supporting Plaintiff's claims. (A0536-541, A0552-555, A0595, A0598-599, A0811-812) As part of these allegations, Plaintiff set forth the multiple false statements made by the Company, by and through its directors and officers and alleged facts regarding massive insider trading. (A0072, A0085) Plaintiff's allegations were corroborated by its books and records investigation, the settlement of the Government investigation and related whistleblower action and the findings of the Federal Court, including regarding the disclosures. (A0034-035, A0060-066, A0092-093, A0095) Thus, the May 11 Board had to be aware that Plaintiff's claims were based on objectively meritorious allegations and were valuable to the Company.

1. BioScrip, and Later the May 11 Board were in Possession of Plaintiff's Claims Immediately Upon Filing

Contrary to the Court below's finding, Plaintiff did not waste a moment after filing to provide BioScrip and its counsel with the Complaint.

On May 7, 2015 Plaintiff filed its Complaint. (A001, A0028-118) Pursuant to the requirements of the Confidentiality Agreement entered in connection with

the books and records demand and Court of Chancery Rule 5.1(e) Plaintiff filed the Complaint under seal. (A0538)

Twenty-two (22) minutes after filing the Complaint, Plaintiff's counsel provided the Complaint to counsel at Kirkland & Ellis LLP that represented the Company in the §220 proceedings ("Known Counsel"). (A0538-539) By e-mail, Plaintiff's counsel also, on May 7, 2015, provided Known Counsel written notice as required by Court of Chancery Rule 5.1(e), a copy of Rule 5.1 and proposed redactions to the Complaint. (A0229-230, A0538-539) Pursuant to Rule 5.1(e) Plaintiff alerted Known Counsel that Plaintiff would file the public version of the Complaint at 3:00 p.m. on May 12, 2015 unless, prior to that time, the Company designated portions of the Complaint for confidential treatment. (A0538-539)

Also on May 7, 2015, immediately upon filing the Complaint, Plaintiff's counsel delivered, by hand, a copy of the Complaint, written notice as provided by Court of Chancery Rule 5.1(e), a copy of Rule 5.1 and proposed redactions to the Complaint to BioScrip's registered agent in Delaware. (A0539)

Thus, within an hour of filing the Complaint, Plaintiff made every reasonable effort to provide the Complaint to the Company (and therefore the May 7 Board) through its Registered Agent and its Known Counsel as permitted by agreement and Court Rules.

At that time, Plaintiff was prohibited from further disseminating the Complaint. (A0539) Therefore, on May 7, 2015, the Nominal Defendant was on notice of and in possession of the claims and allegations made by Plaintiff. (A0538-539) The May 7 Board was in full possession of its 8 *Del. C.* §141 corporate management rights as described in *Braddock v. Zimmerman* to assert its control over derivative litigation. Likewise, when the membership of the Board changed and the May 11 Board was seated, those directors were also on notice of and in possession of the claims and allegations and could have exerted power over the litigation in a number of ways. (A0536-541, A0552-555, A0593, A0598-599, A0811-812) That the board membership changed after filing the Complaint did not alter those powers.

On May 12, 2015 at 1:14 p.m., less than two hours before Plaintiff was required to file the public version of the Complaint pursuant to Rule 5.1(e), Known Counsel responded via e-mail with proposed redactions to the Complaint. (A0232, A0539-540) Plaintiff filed the public version of the Complaint at 3:01 p.m. on May 12, 2015 incorporating all of the redactions proposed by the Company's Known Counsel. (A0001, A0540)

Because Plaintiff dutifully followed the process required by Rule 5.1(e) and the Confidentiality Agreement the Complaint could not have been formally served. (A0540) However, the Complaint was in possession of BioScrip (and the May 7

Board) in unredacted form on May 7, 2015, and therefore shortly thereafter in the possession of the May 11 Board. (A0538-539)

On May 22, 2015 Plaintiff provided the public version of the Complaint to all Defendants. (A0540)

On May 26, 2015, Richards Layton & Finger, P.A., advised it represented BioScrip and all Individual Defendants and confirmed BioScrip did not object to Plaintiff providing an unredacted copy of the Complaint to all Defendants. (A0541)

Having obtained the Company's permission to do so, on May 27, 2015 Plaintiff served the unredacted version of the Complaint on the non-BioScrip Defendants. (A0541)

2. Since its Installation, the May 11 Board, With Knowledge of the Wrongdoing, Has Sought Dismissal of the Claims on the Merits

Throughout the litigation of this case, BioScrip (and thus the May 11 Board) has been represented by the same legal counsel as the Individual Defendants, including the Director Defendants. (A0122-129, A0233-238, A0577-A0580, A0635-642, A0784-792, A0811-812)

The May 11 Board, represented by counsel and with knowledge of its options, made a swift, affirmative and repeated decision to oppose the litigation under both Rules 23.1 and Rule 12(b)(6), endorsing the Defendants' conduct and

eschewing BioScrip's best interests. *Id.* As such, if the May 11 Board is determined to be relevant to the demand futility analysis, it has already proven, in deed and fact, its inability to consider demand.

On June 16, 2015, less than six weeks after the filing of the Complaint and with knowledge of the Federal Action decision, and full access to the internal sequence of events concerning the cover-ups, the Individual Defendants, Jefferies, Kohlberg and Nominal Defendant BioScrip, by and through the May 11 Board, moved to dismiss the Complaint in this action pursuant to Chancery Court Rules 23.1 for lack of demand futility and 12(b)(6) for substantive failure to state a claim. (A0002, A0119-129) The Company, by and through the May 11 Board, aligned itself and chose joint representation with the Defendants. *Id.* The May 11 Board quickly made an affirmative choice to seek dismissal, on the merits, of claims brought by Plaintiff. (*Id.*, A0552-555, A0593, A0598-599, A0811-812) That position is in direct opposition of the interests of BioScrip. (A0552-555)

In making this decision, the May 11 Board determined, purportedly on behalf of the Company, that the substance of the claims against disloyal, self-dealing fiduciaries lacked merit. (A0552-558, A0598-599, A0811-812) However, any independent-minded board, armed with knowledge of the cover-ups, the investigation and the decision in the Federal Action, considering the allegations in

the Complaint would not and could not have made such a judgment and, further, would go to the mat to fight those claims.

On August 17, 2015, BioScrip, again acting through the May 11 Board, filed its Opening Brief in Support of the BioScrip Defendants' Motion to Stay or Dismiss the Complaint, pursuant to Rules 12(b)(6) and 23.1. (A0122-129)

On November 30, 2015, the Company, acting through the May 11 Board, filed the BioScrip Defendants' Reply Brief in Support of their Motion to Dismiss or Stay the Complaint pursuant to Rule 12(b)(6) and 23.1. (A0233-238)

At argument on January 12, 2016, counsel for BioScrip argued that the Complaint should be dismissed pursuant to both Court of Chancery Rules 23.1 and 12(b)(6). (A0245-265)

BioScrip, by and through the May 11 Board, continued its irrational hostility toward the claims on its behalf after the 2016 Opinion in supplemental briefing ordered by the Court of Chancery filed February 2, 2016 and February 12, 2016. In each supplemental brief, the Nominal Defendant, by and through the May 11 Board continued to seek dismissal of the claims under 12(b)(6). (A0014, A0016)

On August 12, 2016, BioScrip, the Nominal Defendant, unsuccessfully opposed the filing of the Amended Complaint. (A0577-580) Undeterred, the Company, directed by the supposedly independent May 11 Board and counsel, again moved to dismiss the claims on the merits on October 10, 2016 (by motion

and supporting brief). (A0635-637) The Company filed a reply brief in support of merits dismissal on November 21, 2016. (A0784-792)

The May 11 Board has taken no steps to address or remedy the wrongs alleged in Plaintiff's Complaint despite being aware of the allegations since its election. The May 11 Board, with knowledge of the wrongs, has fought tooth-and-nail against the Company's interest in obtaining redress against Defendants. Having affirmatively chosen to adopt the position of the faithless directors and officers and their alleged aiders and abettors, the May 11 Board cannot now argue that it can impartially consider demand.

ARGUMENT

I. The Court of Chancery's Determination that the May 7 Board was not Correct for a Demand Futility Analysis Constitutes Reversible Error

A. Question Presented

Did the Court of Chancery commit reversible error by concluding that the May 11 Board, and not the May 7 Board, was proper for considering demand futility? Appellant preserved this issue below. (A0179-183, A0334-342, A0397-401, A0542, A0594)

B. Scope of Review

This Court's review of dismissals for failure to plead demand futility under Court of Chancery Rule 23.1 is *de novo*. *Delaware County Employees Retirement Fund v. Sanchez*, 124 A.3d 1017, 1021 (Del. 2015); *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008). The Court must accept all well pleaded allegations as true and draw all reasonable inferences in Plaintiff's favor. *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

C. Merits of the Argument

1. The Question of Demand Futility is Properly Measured Against the May 7 Board

Delaware law establishes a firm rule that demand is measured as of the date the complaint is filed, *i.e.*, against the May 7 Board. *Braddock*, 906 A.2d at 784-786. Policy and equity favor measuring demand as to the May 7 Board, and not as

to the May 11 Board so as to avoid the slippery-slope of a standard susceptible to manipulation or gamesmanship by either plaintiffs or defendants and to avoid arbitrary analyses of various factors such as the number of days before a change in the board, the number of days of notice of a change in the board and adjournment of a meeting to elect the board and so forth.

The rule is that whether the board is capable of considering a demand is to be determined as of the time of the filing of the complaint. *See, e.g., Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993); *In re Fuqua Indus. S'holder litig.*, 1997 Del. Ch. LEXIS 72, *53-*55 (May 13, 1997). That there is a change in the board composition after suit has been properly instituted does not require that the plaintiff present a demand to the new board or allege new facts that would excuse demand upon the new board in order to continue to prosecute the litigation. *In re China Agritech, Inc.*, 2013 Del. Ch. LEXIS 132, *35 (Del. Ch. May 21, 2013); *see also Needham v. Cruver*, 1993 Del. Ch. LEXIS 76, *11 (May 12, 1993); *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 985-986 (Del. Ch. 2007) ("First and foremost, it is important to remember that demand is made against the board of directors at the time of filing of the complaint. It is that board, and no other, that has the right and responsibility to consider a demand by a shareholder to initiate a lawsuit to redress his grievances."). In such a case, "some tribute must be paid to the fact that the lawsuit was properly initiated." *Zapata Corp. v. Maldonado*, 430

A.2d 779, 787 (Del. 1981). Here, Plaintiff did not circumvent the demand requirement. Plaintiff heeded Delaware law in assessing demand as to the board in place at the time that Plaintiff brought suit.

Assessing demand as to the May 7 Board is supported by policy considerations. Bright-line tests are favored in appropriate circumstances because of their ability to promote uniformity and predictability and to avoid gamesmanship. *See Hertz Corp. v. Friend*, 559 U.S. 77, 94 (U.S. 2010) (upholding a bright-line rule that "promote[d] greater predictability" which "is valuable to corporations making business and investment decisions" and "to plaintiffs deciding whether to file suit" and stating "complex tests produce appeals and reversals, encourage gamesmanship, and, again, diminish the likelihood that results and settlements will reflect a claim's legal and factual merits."); *LeVan v. Independence Mall, Inc.*, 940 A.2d 929, 934 (Del. 2007) (upholding a date-related bright-line rule as "appropriate ... so that all parties can operate with some predictability.") (internal citation and quotation omitted); *Quadrant Structured Prods. Co., LTD . v. Vertin*, 115 A.3d 535, 553-554 (Del. Ch. 2015) (upholding bright-line rule allowing creditors to bring derivative suits based only on a company's financial

state as of the date of filing and without consideration of subsequent events because "there is considerable value in the predictability of bright-line rules").[9]

Measuring demand as to the May 11 Board goes against the bright-line rule of law that is established in Delaware and leaves parties in a position of uncertainty. The Court of Chancery's ruling below incentivizes gamesmanship: Plaintiffs will rush to the courthouse to bring suit against a conflicted board, while defendants will delay pre-litigation proceedings such as §220 actions in an attempt to put a new board in place. Neither of these tactics advances meritorious litigation or quality corporate governance. Moreover, the Court would be placed in the unenviable position of parsing through a number of questions, on an ongoing basis, regarding board composition for demand futility. For example, the Court would need to determine, among other possible issues, whether there was a possibility of a board change on the horizon, who had notice of that possibility, when they had notice, and whether other corporate events invoked renewed demand assessment against a later board. These considerations add greater weight to the policy in favor of a bright-line rule. *See Gibson v. Clean Harbors Envtl. Servs.*, 840 F.3d 515, 521 (8th Cir. 2016) (bright-line approach "allows courts to avoid unnecessary

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[9] *See also Graiser v. Visionworks of Am., Inc.*, 819 F.3d 277, 286 (6th Cir. 2016) ("the bright-line approach provides both sides with tools to prevent "gamesmanship"); *NLRB v. Maryland Ambulance Servs.*, 192 F.3d 430, 434 (4th Cir. 1999) ("While bright-line rules ... may run the risk of being over- or under-inclusive in their coverage, it is generally recognized that the certainty and stability such a rule affords outweighs any harm done when the rule is applied evenly.").

and time-consuming inquiries into determining what a [party] should have known or should have been able to ascertain [and] when."); *Harris v. Bankers Life & Cas. Co.*, 425 F.3d 689, 697 (9th Cir. 2005) (citing with approval a "bright-line approach" meant to bring "certainty and predictability to the process," "avoid[] gamesmanship in pleading," and avoid "the spectre of inevitable collateral litigation"); *Swope v. Columbian Chems. Co.*, 281 F.3d 185, 194 (5th Cir. 2002) (rejecting the "practice of combing the record for manipulative intent" since it "wastes resources better spent on the merits"); *Jaske v. Commissioner*, 823 F.2d 174, 176 (7th Cir. 1987) ("bright line, mechanical tests are designed to achieve simplicity, to provide predictability, and to obviate the need for case-by-case inquiry.").

The Court of Chancery requested supplemental briefing regarding the policy and equity reasons for considering demand as to the May 7 Board versus the May 11 Board and at argument expressed concern that measuring demand against the May 7 Board would deprive the May 11 Board of managing the Company's assets – including litigation. (A0383-387) Plaintiff addressed these issues in the requested supplemental briefing. (A0402-405, A0400-453) However, the 2016 Opinion misperceived and rejected the argument made in Plaintiff's supplemental briefing in February 2016 that *Braddock v. Zimmerman* provides a balanced remedy for a later seated board to assert plenary authority over a derivative action

filed before it took office. (*See* Ex. A at 31-32) *Braddock* provides an ideal foil against the equitable concerns regarding bright-line rules because of the broad set of options (*e.g.*, realignment; dismissal as not in the best interest; permitting the representative plaintiff to move forward; or establish a special litigation committee) available to a later-seated board that acts loyally and in good faith. In rejecting Plaintiff's argument, the Court of Chancery ignored these options, conflating control over the derivative action with only one option -- moving to dismiss under Rule 12(b)(6), which it determined was not tantamount to taking control of an asset. (Ex. A at 31-32)

Further, the 2016 Opinion holding that, in this case, a deviation from the well-established rule was equitable appears to be rooted in an erroneous factual finding regarding the Company's access to the Complaint. The Court of Chancery repeatedly refers to the Complaint as not being formally served until weeks after filing, thus not enabling the May 7 Board to be in a position to consider a demand. (Ex. A at 19, 24-25, 29) That finding ignores, however, that Plaintiff's ability to perfect formal service was stunted by the §220 confidentially agreement between the Company and Plaintiff and Court of Chancery Rule 5.1, as discussed above and in briefing below. Nevertheless, Plaintiff provided Company counsel with the Complaint with minutes of its filing. (A0538-539) The Court of Chancery's equitable rationale is flawed. The fact that formal individual service on the

Company, and hence its board, and successor boards, was not permitted to be completed at the time of filing, does not change the fact that the Company, and, therefore, Director Defendants had access to the Complaint as of May 7, 2015.

For further support of its ruling, the Court of Chancery looked to the bench ruling in *In re Puda Coal, Inc. Stockholders Litigation,* C.A. No. 6476-CS (Feb. 6, 2013) (TRANSCRIPT), cited by Defendants at argument for the first time. (A0248-249, A0379-380, A0408-441) The Court of Chancery read *Puda Coal* to hold that, by looking at events after the filing of the action, the Court could assess demand against the board in place after the filing of the action. (Ex. A at 29) This is wrong. Instead, in *Puda Coal*, the Court of Chancery, looked only at the board in place at the time of the filing of the complaint, and refused to dismiss a breach of fiduciary duty claim against the independent directors of Puda Coal, Inc. (A0428-430)

Plaintiffs in *Puda Coal* alleged that the independent directors had failed to detect the unauthorized sale of the company's assets by its chairman. When the plaintiffs filed the complaint, the board consisted of five members, three of whom were nominally independent. (A0416-A0420) After the complaint was filed, the independent members quit and walked away from the board and their duties. (A0420-421) Defendants in *Puda Coal* argued that demand should not be excused

because three of the five board members in place on the day the complaint was filed were independent. (*Id.*)

The Court analyzed the independence of the members of the board in place on the day the complaint was filed (all five members) and found that demand was not excused. The Court noted that in assessing the independence of these five members, it could not turn a blind eye to the actions of the independent directors in simply quitting and leaving the company under the sole dominion of a person who they knew had pervasively breached his fiduciary duty of loyalty. (A0422-423) The Court reasoned that "to use doctrinal law in some sort of gotcha way," which "could have fairly catastrophic consequences on the ability of the derivative plaintiffs to go after persons that they claim to be essentially thieves," "is just not appropriate." (A0427-428) As such, the Court determined that those members could not be considered independent for demand futility purposes given their conduct. (A0429-430) *Puda Coal* does not apply here. The conduct of the May 7 Board members subsequent to filing is not relevant to assessing demand. Looking to post-filing conduct by board members to assess demand futility is a far cry from altering Delaware law regarding the correct board to consider a demand. If anything, *Puda Coal* enhances Plaintiff's argument that not only is the May 7 Board correct but that demand with respect to the May 11 Board is also futile, as discussed below.

2. The Supreme Court Should Remand and Also Hold Demand to be Excused Under Rule 23.1 with Respect to the May 7 Board

Plaintiff initiated this action on May 7, 2015 after a contentious7923 §220 process. Since then, there have been two arguments, two opinions and countless briefs. One thing has not changed: demand against the May 7 Board is futile. This Court has, within its jurisdiction, the authority to "rule on an issue fairly presented to the trial court, even if it was not addressed by the trial court." *Unitrin Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1390 (Del. 1995). Plaintiff respectfully requests this Court reverse the 2016 Opinion and further find demand excused with respect to the May 7 Board.

II. The Court of Chancery's Determination That the May 11 Board was Capable of Considering Demand Constitutes Reversible Error

A. Question Presented

Did the Court commit reversible error by determining that the May 11 Board was capable of considering demand? Appellant preserved this issue below. (A0402-405, A0448-450, A0454-456, A0593-602, A0653, A0810-825)

B. Scope of Review

This Court's review of dismissals for failure to plead demand futility under Court of Chancery Rule 23.1 is *de novo*. *Delaware County*, 124 A.3d at 1021; *Wood*, 953 A.2d at 140. The Court must accept all well pleaded allegations as true and draw all reasonable inferences in Plaintiff's favor. *Beam*, 845 A.2d at 1048.

C. Merits of the Argument

The May 11 Board, with knowledge of the wrongdoing, has, without fail, taken knowing, affirmative positions hostile to Plaintiff's claims and, thus, BioScrip. By making the decision to harm the corporation's interest in the face of objectively meritorious claims against Defendants, the May 11 Board cannot hide behind the business judgment rule or purported independence and disinterest. The May 11 Board has sought substantive exoneration of all Defendants for all claims despite its simultaneous claim of being an independent decision–making body. Its members' determination to protect Defendants is indefensible in these circumstances and excuses demand against the May 11 Board as to all counts.

Under *Aronson*, demand is excused when there is reasonable doubt as to whether the directors are disinterested and independent or whether the challenged transaction is not the "product of a valid business judgment." *Aronson*, 473 A.2d at 814. The "reasonable doubt" standard means, simply, there is "reason to doubt" and is a "concept that is sufficiently flexible and workable to provide the stockholder with 'the keys to the courthouse' in an appropriate case where the claim is not based on mere suspicions or stated solely in conclusory terms." *Grimes*, 673 A.2d at 1217.

Because of the unusual procedural posture of this action, the affirmative actions taken by the May 11 Board as set forth in the Amended Complaint should be analyzed under *Aronson*.[10] Judged under either "prong" of the *Aronson* test, the conduct of the May 11 Board, at a minimum, raises a reasonable doubt that it is capable of considering a demand under Rule 23.1.

The very concept of allowing a stockholder to prosecute a derivative action exists "for the purpose of preventing injustice where it is apparent that material corporate rights would not otherwise be protected." *Zapata*, 430 A.2d at 784, *quoting Sohland v. Baker*, 141 A. 277, 282 (Del. 1927). "The nature of the [derivative] action is two-fold. First, it is the equivalent of a suit by the

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[10] Likewise, because the May 11 Board's conduct fails under the first prong of *Aronson*, a *Rales* analysis of the prejudgment of Plaintiff's claims also results in a conclusion that demand is futile. *Rales*, 634 A.2d at 936.

shareholders to compel the corporation to sue. Second, it is a suit by the shareholders on its behalf, against those liable to it." *Aronson*, 473 A.2d at 811. The concept of demand futility is "bound to issues of business judgment" and the inherent presumption that directors will have "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Id.* at 812. Equity here demands that BioScrip's rights and interests be protected through stockholder litigation given the May 11 Board's failure to act rationally and in good faith.

The May 11 Board has taken an affirmative legal position hostile to BioScrip's interests, so it cannot now argue against demand futility. The May 11 Board had an opportunity to take a position on Plaintiff's claims but it did so in a faithless manner. That irrational, disloyal conduct cannot be sanctioned by this Court. Such a holding creates a circumstance analogous to the "gotcha" situation described in *Puda Coal*. Plaintiff finds itself having pleaded demand futility against the correct board, but a later-seated board can apparently simply ignore valuable, meritorious claims without rationale while being represented by the same counsel as those individuals that have harmed the Company. That is not equitable.

Plaintiff does not rely on a *res ipsa loquitur* theory – as the Court of Chancery suggests – that any time a board moves on behalf of a corporation to dismiss on merits, such a motion will automatically disqualify that board from

considering demand. Rather, Plaintiff argues that the conduct of the May 11 Board, *e.g.*, moving to dismiss on the merits and doing so in the face of specific, detailed allegations on behalf of the Company and knowledge of the wrongdoing from various public and internal sources disqualifies the May 11 Board. The May 11 Board ignored claims that could mitigate losses in the known meritorious Government and Federal Action and create a recovery for damages including insider trading . The May 11 Board's conduct was inconsistent with the rational exercise of business judgment and therefore, excuses demand.

At the same time, Delaware law fully protects the §141 rights, powers and duties of a board faced with pre-existing litigation. When a board is comprised of new directors who are under no personal conflict with respect to prosecution of a pending derivative claim, the new board has the power to cause the corporation to act in a number of ways with respect to that litigation. *Braddock*, 906 A.2d at 785-786, *citing Harris*, 582 A.2d at 230. In *Braddock*, the Court set forth the various options available to a new board that is faced with a preexisting suit, which include that the new board:

- May take control of the litigation by asking the Court to realign it as a party plaintiff;
- May move to dismiss the case as not in the best interests of the corporation;
- May simply decide not to act at all, allowing the derivative plaintiff to proceed with the litigation; or

- May appoint a special litigation committee to determine the action to take.

Id. at 786.

Thus, when during the pendency of a derivative litigation there occurs a change in the composition of a board (whether that be five days or five months) that was disabled by conflict, and the new board is capable of validly exercising judgment concerning that corporate claim, it has sufficient options available to meet its Section 141(a) managerial responsibilities. *Id.*

Here, the May 11 Board possessed all the options presented in *Braddock* and *Harris* to act within the May 11 Board's §141 rights and duties with respect to the Plaintiff's derivative claims. It chose none of them. Rather, the May 11 Board, represented by counsel and with knowledge of its options, made an affirmative decision not to evaluate the claims and to oppose the litigation under both Rule 23.1 and Rule 12(b)(6). The Court of Chancery improperly rejected Plaintiff's argument seemingly by conflating Plaintiff's position regarding demand excusal with respect to the May 11 Board with the situation where a demand was made and wrongfully refused. (Ex. B at 14) This is not the standard. As the Court of Chancery correctly recognized in its 2016 Opinion, jurisprudence regarding the effect of a demand made and the availability of derivative litigation where demand

is wrongfully refused is beyond the scope of the issues in this case. (Ex. A at 3 n.2)

In fact, on no fewer than ten occasions (*see* 20 -23, *supra.*) between June 16, 2015 and January 19, 2017, the Company, acting by and through the May 11 Board took positions aligned with Defendants and against the interests of BioScrip. It did so irrationally, disloyally and in bad faith.

Having affirmatively chosen to adopt the position of the faithless directors and officers and their alleged aiders and abettors, the May 11 Board cannot now argue that it can impartially consider demand even if it were permitted to do so. *See Conrad v. Blank*, 940 A.2d 28, 37 (Del. Ch. 2007) (finding the company joining the individual defendants in moving to dismiss for failure to make a demand to be one of the "troubling aspects' that undermined 'the court's confidence in the ability of the board to properly consider a demand."); *see also Young v. Klaassan*, 948 A.2d 1152, at 1155 n. 5 (Del. Ch. 2008) (stating that the procedural posture that the nominal defendant had moved to dismiss on grounds of demand excusal "is not one that will easily support a conclusion that the complaint should be dismissed for failure to make a demand on the board of directors."); *Sample v. Morgan*, 914 A.2d 647, at 651, 669 (Del. Ch. 2007) (questioning why outside directors did not attempt to distinguish themselves from the inside directors at the motion to dismiss stage and suggesting that separate counsel would have

been appropriate.). Having hitched their wagon to the wrongdoers, the May 11 Board cannot now undo that coupling and assert that it is capable of properly considering a demand. Plaintiff requests this Court reverse the 2017 Opinion and find demand excused with respect to the May 11 Board.

CONCLUSION

For the reasons set forth herein and argued before the Court of Chancery, Plaintiff respectfully requests the Court to reverse the Opinions of the Court of Chancery and remand the matter for proceedings on the merits with demand having been found to be futile with respect to the May 7 Board, or, in the alternative, the May 11 Board.

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