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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' REPLY BRIEF IN FURTHER SUPPORT OF INTERLOCUTORY APPEAL

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SUMMARY OF ARGUMENT

A federal court in California has already issued a final judgment holding that allegations substantially identical to those in this case were insufficient to carry the shareholder-plaintiffs' burden of showing that pre-suit demand would have been futile. Under the same federal court's law of collateral estoppel, successive shareholder-plaintiffs are precluded from relitigating the demand futility question. These fundamental principles, which are completely ignored by Plaintiffs, mandate dismissal here and should end the Court's analysis.

Plaintiffs also fail to defend the Court of Chancery's novel rulings even on their own terms. Plaintiffs concede that no other court has used the internal affairs doctrine to resolve privity questions like those here by reference to the state of incorporation instead of the state of the original forum. Critically, Plaintiffs do not contradict the reasoning of nine other courts that have recognized that the identity of the specific shareholder in derivative litigation is irrelevant to resolving the question of the sufficiency of demand futility allegations and, accordingly, that shareholders are in privity with one another for this purpose regardless of whether one has survived a Rule 23.1 motion.

Plaintiffs provide no support for the Court of Chancery's new "fast-filer" presumption, which conflicts with the established law of adequacy of representation and also conflicts with two recent decisions of this Court that blocked even more modest attempts by the Court of Chancery to reshape derivative litigation through judicial innovation.

Plaintiffs also attempt to avoid the preclusive effect of the prior judgment by suggesting that there might be differences between the two cases. The suggestion is unfounded: The two cases are legally and factually indistinguishable, as the Court of Chancery recognized.

On the merits of Rule 23.1, Plaintiffs actually embrace the Court of Chancery's selective, out-of-context quotation of two corporate documents to create a picture that is the photographic negative of what the documents actually show when read as a whole. The law, however, requires documentary evidence to be read in context; and the full documents make clear that Allergan's directors intended to comply with the law by expanding BOTOX® sales in conjunction with expanded regulatory approvals over time. Plaintiffs' theory of director liability is thus refuted by the very documents on which they rely.

Finally, Plaintiffs cannot justify the Court of Chancery's application of the incorrect legal test to the directors' Rule 12(b)(6) motion.

ARGUMENT

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

Plaintiffs do not dispute that, under elementary principles of full faith and credit, Delaware courts must give a prior federal judgment the same preclusive effect that the judgment would be given by the rendering court. *Iowa-Wis. Bridge Co. v. Phoenix Fin. Corp.*, 25 A.2d 383, 291 (Del. 1942); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1141 (Del. 1989); *Thompson v. D'Angelo*, 320 A.2d 729, 734–35 (Del. 1974); *see* OB 10–11.[1]

Plaintiffs also do not dispute that the U.S. District Court for the Central District of California, which rendered the prior judgment in this case, has squarely held that all elements of collateral estoppel are met when a successive shareholder attempts to relitigate the question of demand futility. *LeBoyer v. Greenspan*, 2007 WL 4287646 (C.D. Cal. June 13, 2007); *see* OB 11.

Plaintiffs do not dispute that *LeBoyer* is consistent with every other case to have decided this issue (with the exception, for the time being, of the Opinion below), including the decision of the U.S. Court of Appeals for the First Circuit in *In re Sonus Networks, Inc. Shareholder Litigation*, 499 F.3d 47 (1st Cir. 2007). OB 14. These cases reason that the futility question "is an issue that would have been the same no matter which shareholder served as nominal plaintiff," that "[t]he defendants have already been put to the trouble of litigating the very question at issue," and that "the policy of repose strongly militates in favor of preclusion." *Sonus*, 499 F.3d at 64.

Plaintiffs therefore do not dispute that if the Court of Chancery had followed *LeBoyer* (and *Sonus* and all of the other cases), it would have granted Allergan's motion to dismiss on the basis of collateral estoppel. OB 11.

Plaintiffs do not dispute any of these points because they cannot; and that should be the end of this Court's analysis. The Court of Chancery was required to give full faith and credit to the prior judgment—including the preclusive effect that the rendering court would afford that judgment—regardless of whether it agreed with *LeBoyer* and the other cases. Applying this fundamental, and

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[1] Allergan's Corrected Opening Brief is cited as "OB." Plaintiffs' Answering Brief is cited as "AB." Other terms and abbreviations have the same definitions as given in the Opening and Answering briefs.

uncontested, rule of preclusion here should lead to reversal and a judgment of dismissal.

For this Court to affirm the judgment below, it would have to reconsider and reject the rule of preclusion articulated and applied in *LeBoyer*, *Sonus*, and every other case to have considered the issue. But Plaintiffs never come to grips with the fact that this is not an avenue open to this Court. *See* OB 11.

In all events, Plaintiffs' arguments would fail even if this Court were writing on a blank slate. Plaintiffs contend that the California judgment does not collaterally estop them from proceeding because (a) they were not in privity with the California shareholder-plaintiffs, (b) the California shareholder-plaintiffs were not adequate representatives, and (c) the issues resolved in the California case were not identical to those in this case. Plaintiffs are wrong on each count.

A. Plaintiffs Misapprehend The Privity Doctrine.

Embarking on its own unauthorized reexamination of the *Sonus-LeBoyer* precedents, the Court of Chancery invoked the internal affairs doctrine to conclude that Delaware law, rather than federal law or the law of California, should govern certain elements of the collateral estoppel analysis. Op. 20; OB 12; AB 11–12.

The Court of Chancery's approach is irreconcilable with this Court's decisions. *See Cavalier Oil*, 564 A.2d at 1141; *see also Thompson*, 320 A.2d at 734–35. Even though *Cavalier Oil* involved a Delaware corporation, this Court expressly turned to the law of the rendering court both to determine the overall test for preclusion and to assess each sub-element of preclusion. 564 A.2d at 1141 & n.3; *see* OB 12–13. Plaintiffs' sole basis for distinguishing *Cavalier Oil* is that "privity" was not at issue in that case. AB 13. But Plaintiffs offer no reason why all other components of collateral estoppel should be governed by the law of the rendering jurisdiction, leaving only privity to vary according to the law of the state of incorporation.

According to Plaintiffs, "[w]hether two different shareholders who each filed complaints asserting derivative claims on behalf of a company can be said to have acted in privity with each other . . . is a question for Delaware courts to decide under the internal affairs doctrine." AB 12. The only authority that supports this proposition—a necessary predicate to their effort to dismantle *LeBoyer*—is the Court of Chancery's Opinion below. *Id.* But the Court of Chancery was as bereft of supporting authority as Plaintiffs are. That is because both are wrong.

The Court of Chancery's approach is irreconcilable with the sole case it cited for support on this point: *Sonus*. Op. 19; A650; A655. As Allergan has already explained, the *Sonus* court invoked the law of the forum state (Massachusetts) and not the law of the state of incorporation (Delaware). OB 13. (*Sonus* turned to Delaware law only to determine whether the earlier complaint had been "grossly deficient" under Delaware pleading standards. 499 F.3d at 66–71.) Plaintiffs' only rejoinder is to quote the *Sonus* court's observation that "no Massachusetts court has specifically said so" (AB 13), without explaining why this makes any difference. It remains undisputed that *Sonus* applied Massachusetts law (even in the absence of guidance from the Massachusetts courts). Of course, in this case the forum court has spoken and the applicable law is known. *LeBoyer*, 2007 WL 4287646.

Unable to defend the Court of Chancery's misplaced reliance on *Sonus*, Plaintiffs are forced to concede that no court has ever applied the internal affairs doctrine to the question of privity in the collateral estoppel context. Although Plaintiffs half-heartedly note that "no cases reject application of the internal affairs doctrine to the question of privity" (AB 13 (emphasis added)), this only serves to emphasize that the Court of Chancery's approach to the question was so novel that no court has yet had to address it.

The Court of Chancery's approach is irreconcilable with the U.S. Supreme Court's collateral estoppel precedents, which make clear that the preclusive effect of a federal judgment is determined by reference to the law of the jurisdiction in which the rendering court sits. *Semtek Int'l, Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 506–09 (2001); *Stoll v. Gottlieb*, 305 U.S. 165, 170–71 (1938). Nor could the law be otherwise; if preclusion were determined by the law of the successive forum, then states would be "free to ignore obligations created . . . by the judicial proceedings of others" (*Baker v. Gen. Motors Corp.*, 522 U.S. 222, 232 (1998))—as this case perfectly illustrates. Plaintiffs completely ignore these cases.

In this regard, it is important to recognize and respect the distinction between a Rule 23.1 motion, which indisputably implicates the internal affairs doctrine, and a collateral estoppel motion, which does not. OB 14. It is firmly established that whether demand on a Delaware board would have been futile is determined by the law of Delaware, regardless of where the derivative action is filed. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96–97 (1991). But once a court issues a final judgment on futility, the preclusive effect of that judgment is controlled by the law of the rendering court, not the law of Delaware. *Sonus*, 499 F.3d at 56, 64.

Plaintiffs, like the Court of Chancery before them, erroneously seek to blur this distinction by invoking cases that involve not preclusion but rather genuine issues of corporate governance, mostly voting rights. *See CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982); *McDermott Inc. v. Lewis*, 531 A.2d 206, 215 (Del. 1987); *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1116 (Del. 2005). These cases cannot be extended from the corporate governance context into the realm of collateral estoppel.

According to Plaintiffs, applying the internal affairs doctrine to questions of privity in the collateral estoppel context would "promote[] the important objective of treating directors, officers, and stockholders uniformly across jurisdictions." AB 12 (quoting Op. 21). This argument proves too much, however, because it could equally justify applying Delaware law to any question involving a Delaware corporation in any lawsuit (derivative or otherwise) in any jurisdiction. That has never been the law; on the contrary, courts have long recognized that the best way to promote uniformity is by having the scope of preclusion determined by the law of the rendering court, not the successive court. *E.g.*, *Baker*, 522 U.S. at 232; *Hampton v. McConnel*, 16 U.S. 234 (1818); *Iowa-Wis. Bridge Co.*, 25 A.2d at 391.

Moreover, there are other procedures in place to help courts clarify developing areas of Delaware law, such as certifying a question to this Court. *See* Del. Supr. Ct. R. 41. If Plaintiffs here thought the California federal court was misapplying Delaware law, they could have intervened and asked the trial (or appellate) court to certify the issue to this Court, but they elected not to do so.

The Court of Chancery's choice-of-law ruling in fact undermines national uniformity because it makes Delaware an outlier. If the decision below stands, the law governing the elements of preclusion analysis will depend upon where the second suit is brought—and the rule will be different in Delaware than anywhere else.

In any event, even if the privity component of collateral estoppel should be resolved by Delaware law, this Court should adopt the same privity rule that *Sonus*, *LeBoyer*, and all of the other cases to have decided this issue followed.

At least nine cases have correctly held that privity among shareholders attaches even before one of them survives a Rule 23.1 motion. OB 14. That is because there can be but one answer to the question of whether a given set of allegations shows demand futility, and the identity of the shareholder does not affect that answer. The Court of Chancery's Opinion in this case is irreconcilable

with every one of those decisions, including a decision of the U.S. Court of Appeals (*Sonus*), six decisions of U.S. district courts,[2] a decision of a New York state court,[3] and a decision of the Court of Chancery, *In re Career Education Corp. Derivative Litigation*, 2007 WL 2875203 (Del. Ch. Sept. 28, 2007). Seeking to minimize the weight of authority against their position, Plaintiffs address only *Career Education* and three of the non-Delaware decisions, ignoring five other opinions. AB 16, 18–19.[4]

The only basis Plaintiffs proffer for asking this Court to disregard the privity holdings of the three federal cases is to say that they were "wrongly decided" under Delaware law. AB 17 (discussing *Sonus*, *LeBoyer*, and *Henik*). That is both irrelevant and wrong because, as explained above, it is not the province of the second court to review the wisdom of the rendering court's decision. Moreover, Plaintiffs do not attempt to refute the reasoning of those cases in any manner. In particular, Plaintiffs do not take issue with the key point that demand futility is an issue that will be resolved the same way regardless of the identity of the shareholder-plaintiff, and thus should be decided only once. *Sonus*, 499 F.3d at 64.

Plaintiffs attempt to distinguish *Career Education* by claiming that the plaintiffs in that case conceded certain elements of collateral estoppel. AB 19. That is irrelevant to this case; the point is that the Court of Chancery approved of the reasoning of the federal cases, which depended on "the unique position of the parties in derivative suits. Because the corporation is the true party in interest in a derivative suit, courts have precluded different derivative plaintiffs in subsequent suits. This commonality lends itself to the application of collateral estoppel or issue preclusion." *Career Educ.*, 2007 WL 2875203, at *10. Although *Career Education*, a decision of the Court of Chancery, is not binding

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[2] In addition to *LeBoyer*, the cases are: *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); and *Henik v. LaBranche*, 433 F. Supp. 2d 372 (S.D.N.Y. 2006).

[3] *Carroll v. McKinnell*, 2008 WL 731834 (N.Y. Sup. Mar. 17, 2008).

[4] Plaintiffs cite in passing *Ji v. Van Heyningen*, 2006 WL 2521440, at *13 (D.R.I. Aug. 29, 2006). AB 16. The *Ji* court actually avoided deciding the collateral estoppel question, and instead dismissed the case on the merits of Rule 23.1. *Ji*, 2006 WL 2521440, at *12–13. To the extent *Ji* provides any support to Plaintiffs' position, it was abrogated by the First Circuit's later decision in *Sonus*. 499 F.3d at 66.

on this Court, this reasoning is persuasive regardless of any concessions made in that case.

Plaintiffs do not genuinely dispute that a shareholder derivative action is a constitutionally viable form of "nonparty preclusion" under *Taylor v. Sturgell*, 553 U.S. 880, 893–95 (2008), because they admit that a derivative shareholder can eventually represent other shareholders. AB 16. Plaintiffs' only real disagreement is about timing—they would like to delay nonparty preclusion until after a shareholder survives a Rule 23.1 motion. AB 17–18. But unlike a decision on a class certification motion (to which Plaintiffs try to draw an analogy), a court's decision on a Rule 23.1 motion has nothing to do with the relationships among plaintiffs. A Rule 23.1 determination looks only at the directors' conduct and relationships to determine whether control over litigation should be judicially shifted from the board to a shareholder—and as noted previously, resolution of this issue does not depend on the identity of the shareholder. Thus, a Rule 23.1 decision (whether granted or denied) does not transform the relationship among shareholders.

Plaintiffs' theory that the Court should "draw[] the collateral estoppel line at a Rule 23.1 denial" makes no sense for the further reason that it would eliminate collateral estoppel for all motions to dismiss derivative complaints. AB 16. Under the Court of Chancery's rule, if the corporation wins a Rule 23.1 motion, collateral estoppel cannot apply. If the company loses the Rule 23.1 motion, the plaintiff controls the case. In neither circumstance can the company assert collateral estoppel. In other words, "drawing the line" at Rule 23.1 actually means eliminating preclusion for companies with respect to motions to dismiss shareholder derivative actions. The "balance[]" that Plaintiffs claim to seek is no balance at all. AB 22 (citing *King v. VeriFone Hldgs., Inc.*, 12 A.3d 1140 (Del. 2011) ("*King II*")).

Contrary to Plaintiffs' suggestion (AB 14, 20), *Kohls v. Kenetch Corp.*, 791 A.2d 763 (Del. Ch. 2000), does not support the Court of Chancery's privity ruling. *Kohls* involved only direct claims (not derivative claims) in which the defendant tried to apply its victory against one plaintiff to a second plaintiff who had no pre-existing legal relationship with the first. 791 A.2d at 768–69. Plaintiffs claim that *Kohls* did not "rest on" a "direct versus derivative distinction." AB 20. That makes no sense because *Kohls* did not and could not have involved derivative claims, so there was no reason for the court to discuss derivative preclusion at all. The *Career Education* court, which recognized preclusion, did not cite *Kohls* as possibly in conflict with its ruling, undoubtedly recognizing it as inapplicable in the derivative context. *See Career Educ.*, 2007 WL 2875203, at *10. Fellow shareholders seeking to bring derivative claims do

have a "specific type of pre-existing legal relationship" that *Kohls* recognized could support preclusion. 791 A.2d at 769.

Nor do *West Coast Management & Capital LLC v. Carrier Access Corp.*, 914 A.2d 636, 642 (Del. Ch. 2006), or Court of Chancery Rule 15(aaa) prevent giving preclusive effect to the California judgment. AB 15. *West Coast Management* involved the same plaintiff who had already failed to show demand futility seeking books and records so it could file new futility allegations. The court found dubious the federal cases only to the extent they would preclude new fact allegations, which is not an issue here because the fact allegations are identical. *W. Coast Mgmt.*, 914 A.2d at 643 n.22; *see infra* pp. 11–12. And the court stated that the term "without prejudice" (also used in Rule 15(aaa)) refers only to the underlying claim that the corporation might have against its directors. *W. Coast Mgmt.*, 914 A.2d at 644.[5]

Contrary to Plaintiffs' suggestion (AB 20–21), recognizing privity here would not imply that one shareholder's decision to make pre-suit demand operates as a waiver of other shareholders' ability to allege demand futility. An out-of-court decision to send a letter to the board of directors meets none of the criteria for collateral estoppel, including most obviously the final judgment requirement.

Plaintiffs suggest that even in the absence of collateral estoppel, the doctrine of *stare decisis* may "deter" new filings. AB 22. But there is no reason to believe that new plaintiffs will be deterred. As the Court of Chancery explained in this very case, new filings are cheap. Op. 57. Upon seeing a derivative complaint dismissed on Rule 23.1 grounds in one court, a new plaintiff can file a duplicative complaint in a new forum—a "lottery ticket," in the words of the Court of Chancery (Op. 56)—and hope to get a different result. Plaintiffs do not explain how *stare decisis* can deter such a strategy.

Plaintiffs echo the Court of Chancery by suggesting that its privity ruling will mean that Delaware corporations will need to litigate demand futility at most "twice." AB 22; A657–60. They fail to explain, however, how any Rule 23.1

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[5] Plaintiffs' citation to *Papilsky v. Berndt*, 466 F.2d 251 (2d Cir. 1972), is also off point. AB 16. *Papilsky* concerned the settlement or dismissal of derivative actions and notice to other shareholders, which is not an issue here. *Papilsky* also does not reflect the numerous developments in shareholder derivative actions that have taken place over the last forty years. *Henik*, which recognizes preclusion in the precise context of this case, is a more modern reflection of the law in the Second Circuit. 433 F. Supp. 2d at 381.

dismissal—whether the first, second, or tenth—could preclude yet another shareholder from filing suit again. OB 19. And although shareholder derivative actions may generally serve to "protect[] the corporation" (AB 21, 22), there is no corporate benefit to having the question of demand futility litigated more than once.

Because sound policy concerns support following the nine other cases to have decided this issue, and because nothing in Delaware or federal law is to the contrary, the Court of Chancery's privity ruling should be reversed.

B. Plaintiffs Misapprehend The Adequacy Of Representation Requirement.

The Court of Chancery adopted and applied a radical new "fast-filer presumption," concluding that the California shareholder-plaintiffs were inadequate because they did not seek books and records under Section 220 before filing their initial complaint—even though they received the entire Section 220 production before filing their operative amended complaint and even though the original plaintiff in this case (LAMPERS) also did not seek books and records before filing their initial complaint. That effort at judicial control of derivative litigation cannot be reconciled with this Court's decisions in *King II* and *White v. Panic*, 783 A.2d 543 (Del. 2001) ("*White II*"), which rejected similar attempts. *See* OB 23–24.

Plaintiffs note, correctly, that the precise question of "whether a shareholder plaintiff who fails to seek books and records under 8 *Del. C.* § 220 before filing a plenary action is an adequate representative for the purposes of collateral estoppel" was not presented in *King II* or *White II*. Both cases, however, reflect this Court's determination that fundamental changes in the workings of derivative litigation are reserved to the General Assembly, or this Court in its rulemaking capacity; they are not to be announced and applied by the Court of Chancery as the Court of Chancery did here. OB 23–24. Plaintiffs fail to address this point.

Plaintiffs also assert that Allergan should somehow have anticipated that the California plaintiffs would be deemed inadequate. AB 26–27. This argument is wrong on multiple levels. As a threshold matter, Allergan sought to stay the California litigation and to proceed in Delaware alone. OB 5, 26. Once the stay was denied, Allergan had no choice but to litigate in both forums. And there was no way for Allergan to anticipate that the "fast-filer presumption" would be applied in this case because it was not even briefed by the parties, had never

previously been adopted by any court, and in fact was rejected earlier in this very case. *See* OB at 24-25.

Plaintiffs ignore the fact that there exists an established doctrine of adequacy of representation for collateral estoppel purposes. The *Sonus* court, quoting the Restatement (Second) of Judgments, stated that a shareholder derivative plaintiff is not inadequate simply because it failed "to invoke all possible legal theories or to develop all possible resources of proof"; instead, a derivative plaintiff is inadequate only if its representation is "so grossly deficient as to be apparent to the opposing party." *Sonus*, 499 F.3d at 66. The Court of Chancery was not free to create and apply a new rule to disqualify a shareholder-plaintiff who was adequate under extant law.

But even if this Court were to look only to Delaware law, the fast-filer presumption cannot be reconciled with the other standards that already exist in Delaware to determine adequacy. OB 24–25; *Career Educ.*, 2007 WL 2875203, at *10 n.58; *Norfolk Cnty. Ret. Sys. v. Jos. A. Bank Clothiers, Inc.*, 2009 WL 353746, at *8 (Del. Ch. Feb. 12, 2009); *In re Fuqua Indus., Inc. S'holder Deriv. Litig.*, 752 A.2d 126, 129–30 (Del. Ch. 1999); *Youngman v. Tahmoush*, 457 A.2d 376, 379–80 (Del. Ch. 1983). None of those cases suggested, nor can they be reconciled with, a presumption of inadequacy based on the single factor of whether the plaintiff made a Section 220 demand before filing suit. Plaintiffs say nothing in response to this point.

Plaintiffs' tepid defense of the fast-filer presumption includes no explanation of how the supposedly "rebuttable" presumption could ever be rebutted, or by whom. As Allergan explained, there was no opportunity for the presumption to be rebutted in this case (even though, among other things, the plaintiffs in California had the same books and records as Plaintiffs had here and LAMPERS itself was a fast-filer). OB 23. As it was applied here, the rule is an irrebuttable presumption that a shareholder plaintiff who files suit without first seeking books and records is *per se* inadequate. *See* OB at 23. That is not and never has been the law of Delaware or any other jurisdiction.

Finally, Plaintiffs do not respond to Allergan's argument that the fast-filer presumption fails even to achieve its own goals. The presumption reflects a desire to punish fast-filing plaintiffs' law firms that seek to control litigation by initiating the first lawsuit, even if that means filing a barebones complaint that is unlikely to survive a Rule 23.1 motion. But the presumption actually does nothing to deter a fast-filing firm. Because the presumption attaches to the individual plaintiff, not the firm itself, any firm is free to use multiple shareholders to file quickly in one court while pursuing a books and records

investigation in another. OB 25–26. Corporations are the only entities to be punished by the presumption, by being forced to relitigate demand futility issues. This alone should be sufficient to invalidate the Court of Chancery's new rule.

C. The Issues Are Identical In The California Federal Case And This One.

In a last-ditch attempt to avoid the preclusive effect of the prior judgment, Plaintiffs now argue that there are important differences between their case and the California case. AB 24–25. This argument fails for several reasons.

First, Plaintiffs do not dispute that the plaintiffs in the California case had the identical Section 220 document production that formed the basis for the amended complaint in this case (and that case). OB 6; AB 24; *see* Op. 13.

Second, the decision below is premised on the Court of Chancery's understanding that the issues were identical. Op. 8. The Opinion therefore cannot be defended on the basis that the issues were different. Moreover, as the Court of Chancery explained, none of the cases recognizing preclusion in these circumstances requires complete identity of arguments and facts for preclusion to operate. A632–33; *see Career Educ.*, 2007 WL 2875203, at *13 (preclusion applied because differences between complaints were not "material"); *W. Coast Mgmt.*, 914 A.2d at 643 n.22 (second plaintiff would have to make "substantially different" allegations for preclusion not to apply). And as the *Sonus-LeBoyer* line of cases recognize, and as the Court of Chancery expressly pointed out in this case (A633), the legal "issue" is whether demand is futile; varying legal theories or allegations do not constitute different "issues." *E.g.*, *LeBoyer*, 2007 WL 4287646, at *2 ("[T]he issue here [is] whether a demand on the board to sue the directors . . . would have been futile").

Third, the Rule 23.1 analysis of the Opinion shows that the Court of Chancery was actually re-examining the exact same allegations that formed the basis for the federal dismissal. The Court of Chancery "part[ed] company with the California Federal Court"—it did not distinguish the federal court as relying on different arguments or facts. Op. 77. The Court of Chancery discussed the federal court's different interpretation of the exact same documents that formed the basis for the Opinion below: the 1997–2001 Strategic Plan and Plan Slides (Op. 78–80) and the Schim e-mail (Op. 80). Nor did the Court of Chancery ever suggest that the California plaintiffs had omitted any facts or legal theories that LAMPERS and UFCW alleged. *Cf. Sonus*, 499 at 66–70 (comparing complaints to determine whether earlier plaintiffs were remiss in failing to allege the facts and theories found in the successive complaint).

Plaintiffs point to a supposed waiver of a *Caremark* theory in the federal case. AB 24. But this supposed waiver appears to apply only to one facet of *Caremark*—a theory that the Company had inadequate internal controls. A424. As the California court stated, quoting the plaintiffs in that case: "The gravamen of the Complaint is that the Director Defendants consciously caused Allergan to engage in illegal off-label marketing activity for years." A424. Plaintiffs followed the identical theory of conscious illegality in this case: "Allergan's directors knowingly approved and oversaw a decade-long set of business plans that required illegal off-label marketing." AB 2. Thus, both cases alleged demand futility based on the supposed conscious decision by current board members to break the law, which is also why both cases applied the *Aronson* futility test. A424; Op. 48, 66; *see Aronson v. Lewis*, 473 A.2d 805 (Del. 1984)).

Finally, Plaintiffs suggest that the details of the California case are obscured by certain redactions in the record in this case. AB 26. This argument is meritless. Plaintiffs fail to point to a single allegation in this case that was not addressed by the federal court. *See, e.g.*, A425, A530–31 (federal court's discussion of 1997–2001 Strategic Plan); A425 (federal court's discussion of the Schim incident). The three unredacted opinions of the California court are also in the record in this case and make clear that the facts and legal theories were identical, a point confirmed by the Court of Chancery's open disagreement with the federal judge's analysis of the same documents.

II. DEMAND WOULD NOT HAVE BEEN FUTILE.

The Court of Chancery's decision on the merits of Rule 23.1 was based on snippets from two documents attached to the Plaintiffs' complaint, from which the Court of Chancery concluded that every director intended the Company to act unlawfully. Op. 69–81. As Allergan has already explained, the full context of those very same documents shows that Allergan's directors intended the Company to increase sales in conjunction with obtaining additional regulatory approvals, and the Court of Chancery's inferences to the contrary were unreasonable. OB 29–32.

Plaintiffs do not dispute that the two documents on which their complaint is premised, read in context, establish that Allergan's board of directors contemplated entirely lawful activities. *See* AB 30. And Plaintiffs admit that "[t]he strength of an inference cannot be decided in a vacuum." *Id.* at 31 (citing *Tellabs, Inc. v. Makor Issues, Ltd.*, 551 U.S. 308, 323 (2007)). That admission is fatal to the selective reading of the documents proffered in Plaintiffs' complaint.

Nonetheless, Plaintiffs actually defend the Court of Chancery's use of snippets, going so far as to contend that the court's inferences drawn from "portions of documents" were "reasonable." *Id.* But courts are required to construe all allegations in context and where, as here, allegations are premised on documentary evidence, the entirety of the documents must be considered. *Tellabs*, 551 U.S. at 323; *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 70 (Del. 1995) (where "document is integral to a plaintiff's claim and incorporated in the complaint," courts consider the full document at motion-to-dismiss stage because otherwise "'complaints [could] quote[] only selected and misleading portions of such documents'") (quoting *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir.1991)). It is not reasonable to draw an inference from a documentary snippet that is refuted by the remainder of the very same document, yet that is what the Court of Chancery did here. Plaintiffs also have no response to Allergan's argument that any board document from any corporation could be excerpted to suggest, misleadingly, a corporate willingness to sacrifice compliance for the sake of profits. OB 33.

Plaintiffs make four additional meritless arguments. First, Plaintiffs argue that Allergan's directors are not entitled to a presumption of good faith because the complaint accuses them of conscious misconduct. AB 28–29. This is obviously wrong. A presumption of good faith would be meaningless if plaintiffs could rebut it with simple accusations. That is the kind of "bootstrapping" argument that this Court has repeatedly rejected. *E.g.*, *Aronson*,

473 A.2d at 817–18 (directors are not interested simply by being named as defendants).

Second, Plaintiffs contend that the Court of Chancery's futility finding was actually based on more than just two documents (the 1997–2001 Strategic Plan and Slides, and the Schim e-mail). AB 29, 31. This is wrong. The Opinion carefully lays out the evidence it relied upon to infer illegal intent. Op. 69–74. Every single reference to particularized evidence points either to the Plan and associated Slides, or to the Schim e-mail. It is not surprising that the Court of Chancery declined to rely on any of the other documents that Plaintiffs now cite, because those documents either lack any connection to board members or the allegations in which they are cited are not particularized. AB 31. For example, Plaintiffs' references to a 2007–2011 plan are not particularized at all, deriving only from excerpts that were published publicly in the government's sentencing memorandum. AB 31 (citing B11, 68). In a few instances, Plaintiffs also ask this Court to infer conscious illegal intent from a handful of corporate programs that are perfectly legal, such as helping physicians obtain reimbursement for drug uses that were the standard of care despite not yet being fully approved, like juvenile cerebral palsy. AB 31. Legal conduct plainly cannot be used to support an inference of illegal intent.

Plaintiffs' citation to a litany of other drug development, reimbursement, and sales initiatives (AB 31) is equally unpersuasive. The question is whether Allergan's directors approved plans that "necessarily" required breaking the law, as the Court of Chancery held. Op. 69. But the initiatives Plaintiffs cite do not reasonably, much less "necessarily," imply conscious illegal intent by Allergan's directors when the core board documents actually show plans to obtain expanded approvals through research and development. OB 29–30.

Third, Plaintiffs attempt to defend the Court of Chancery's interpretation of portions of the 1997–2001 Strategic Plan and Plan Slides. AB 30. Again, Plaintiffs have no answer to Allergan's showing that the Plan and Slides actually call for expanding sales in conjunction with obtaining additional regulatory approvals. OB 29–30. Instead, Plaintiffs continue to cite a handful of statements about new BOTOX® uses, divorced from context, and repeat that "none of those uses was approved by the FDA at the time." AB 30. Plaintiffs entirely ignore all of the pages and slides Allergan cited demonstrating the evolving clinical testing and regulatory approvals scheduled to take place in the same time frame. OB 29–30 (citing A270, A281, A288, A290–91, A294, A311, and A362–63). The context of the statements on which Plaintiffs rely destroys the inference that Plaintiffs seek to draw from them.

Fourth, Plaintiffs attempt to defend the Court of Chancery's selective quotation from the Schim e-mail. AB 31–32. The Court of Chancery believed that the e-mail showed a "culture of non-compliance." Op. 80. But reading the full e-mail belies that supposed inference. The e-mail, a report from the general counsel to board members, shows a corporation responding to and attempting to remedy an inadvertent regulatory violation—*i.e.*, a culture of compliance. A417–18. And Plaintiffs' final suggestion that the board should not have adopted a 2007–2011 Strategic Plan in the wake of the 2006 Schim incident is bizarre. AB 32. The Company obviously cannot stop making plans for the future simply because it discovered a regulatory violation in the past.

Any company operating in a regulated industry runs the risk of legal violations, but this does not mean that every violation necessarily evidences a conscious intent by the directors to break the law. In fact, there is a strong presumption that individuals who agree to serve as directors of public companies intend the corporation to fully comply with the law. In this case, the two board documents that the Court of Chancery relied upon actually show a pharmaceutical company doing what it should: planning future research and approvals with a goal of expanding sales.

The only way to infer illegal intent by Allergan's most senior leadership is to ignore the approval plans while focusing on the sales plans, which is what the Court of Chancery did and what Plaintiffs would have this Court do. That does not track the way business decisions are made in the real world and thus is manifestly unreasonable; it is inconsistent with a presumption of good faith; and if accepted it would severely hamper the proper functioning of corporate boards.

III. THE COMPLAINT FAILS TO STATE VIABLE CLAIMS.

Allergan's Opening Brief showed that the Court of Chancery was incorrect in holding that a showing of demand futility always and in every case means that the complaint has stated a claim on each count and as to each defendant. This is demonstrated, among other places, in *McPadden v. Sidhu*, 964 A.2d 1262, 1273–74 (Del. Ch. 2008), which denied a Rule 23.1 motion but nevertheless proceeded to analyze the Rule 12(b)(6) motion and ultimately dismissed certain counts for failure to state a claim. Plaintiffs offer no response.

Plaintiffs also misconstrue the Delaware law of waste, seeking to analogize ten years of strategic decisions by the board to "transactions" for inadequate consideration. AB 34. Such strategic decisions are not "transactions" at all; nor could a corporate plan to obtain new drug approvals while increasing drug sales possibly be interpreted to "irrationally squander[]" corporate assets. *White II*, 783 A.2d at 554.

CONCLUSION

The federal court in California, reviewing an amended complaint filed after the shareholder-plaintiffs received books and records under Section 220, determined that demand would not have been futile and dismissed the complaint under Rule 23.1. That judgment should have collaterally estopped the Court of Chancery from allowing Plaintiffs to relitigate the identical issue in this case. To avoid the preclusive effect of the prior judgment, the Court of Chancery misapplied two elements of collateral estoppel—privity and adequacy—in ways that are literally unprecedented. Correcting those errors, and the others made by the court below, requires reversal of the judgment and dismissal with prejudice.

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September 28, 2012

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on September 28, 2012, he caused to be served by LexisNexis File & Serve a copy of the foregoing APPELLANTS' REPLY BRIEF IN FURTHER SUPPORT OF INTERLOCUTORY APPEAL upon the following counsel of record:

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