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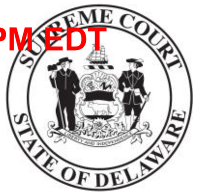

IN THE SUPREME COURT OF THE STATE OF DELAWARE

SALIX PHARMACEUTICALS, LTD. STOCKHOLDER LITIGATION ROBERTA FEINSTEIN and REX GONSALVES, Plaintiffs Below, Appellants, v. JOHN F. CHAPPELL, THOMAS W. D'ALONZO, WILLIAM P. KEANE, MARK A. SIRGO, VALEANT PHARMACEUTICALS INTERNATIONAL, INC., VALEANT PHARMACEUTICALS INTERNATIONAL, and SUN MERGER SUB, INC., Defendants Below, Appellees.	No. 308, 2016 On Appeal from C.A. No. 10721-CB in the Court of Chancery of the State of Delaware

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NATURE OF PROCEEDINGS

This post-closing damages action challenges the arm's length sale of Salix Pharmaceuticals, Ltd. ("Salix" or the "Company") to Valeant Pharmaceuticals International, Inc. ("Valeant") for $173 per share in cash (the "Merger"). Valeant won a bidding war for Salix against more than five unaffiliated third parties by submitting a premium offer that represented a 43.9% premium over Salix's unaffected stock price. Plaintiffs initially sought injunctive relief blocking the Merger but then abandoned those efforts in advance of a hearing on their motion to expedite. Several months after fully-informed, disinterested and uncoerced holders of approximately 88% of the Company's stock approved the transaction, Plaintiffs amended their complaint to seek money damages.

Defendants moved to dismiss. On May 19, 2016, the Court of Chancery heard argument and dismissed the complaint with prejudice. A-1060-86. On appeal, Plaintiffs challenge two of the court's holdings: (1) that the complaint failed to state a claim that the "step-down" feature of the challenged tender offer was coercive under Delaware law; and (2) that the complaint failed to state a claim that the members of the Salix board of directors (the "Board") breached their fiduciary duties by agreeing to terminate certain unvested equity awards without securing an incremental benefit for the Company's stockholders. These renewed claims are meritless, and the decision of the Court of Chancery should be affirmed.

SUMMARY OF ARGUMENT[1]

1. Denied. The Court of Chancery correctly rejected the argument that the "step-down" feature of the tender offer was inequitably coercive under Delaware law. A-1079-80. The Court of Chancery rightly held that "[t]he threat of a tender offer expiring by itself is not coercive" if the tender offer "provide[s] the same consideration to all stockholders" should the transaction close. *Id.*

2. Denied. The Court of Chancery correctly held that Plaintiffs failed to state a claim that the directors breached their fiduciary duties when they terminated the unvested equity awards between signing and closing without obtaining additional, incremental consideration for the Company's stockholders. The fully-informed, disinterested and uncoerced holders of a majority of the Company's stock approved the transaction by tendering their shares. By doing so, the stockholders insulated the transaction from all challenges other than waste. Moreover, even if non-waste claims survived stockholder approval, the Court of Chancery correctly held that Plaintiffs failed to state a claim that the Board acted disloyally when it terminated the unvested equity awards. Thus, Salix's Section 102(b)(7) provision barred the claim. A-1068; 1076-77.

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[1] This brief first addresses Plaintiffs' argument regarding the "step down" feature of the tender offer because it presents a threshold question that sets the stage for Defendants' argument that the Company's stockholders were uncoerced.

STATEMENT OF FACTS[2]

A. The Background Of The Company's Sale Process

Prior to the Merger, Salix was a specialty pharmaceutical company dedicated to acquiring, developing and commercializing prescription drugs and medical devices used in the treatment of a variety of gastrointestinal disorders. A-29 (¶29).

On July 29, 2014, Party A[3] offered to acquire the Company in an all-cash deal at a price of $180 per share, subject to the completion of due diligence. A-279. In connection with the offer, the Board engaged Centerview Partners LLC ("Centerview") to act as the Company's financial advisor. On August 20, 2014, Party A increased its proposal from $180 to $200 per share in cash, subject to the completion of due diligence. *Id.* On August 19, 2014, the Wall Street Journal reported that Party A had approached the Company regarding a potential transaction. *Id.* The Company's stock price closed up approximately 15.5% over the previous day's closing price of $139.17. *Id.* Following further discussions, on

[2] The following is a summary of the factual allegations as set forth in the amended complaint, which Defendants accept as true solely for purposes of this appeal. This brief also summarizes the content of the Schedule 14D-9 and certain 8-K filings, which the Court may consider because they are incorporated by reference in Plaintiffs' complaint. *See, e.g., In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 658-59 (Del. Ch. 2013) ("[T]he Complaint is largely based on pervasive references to the company's Schedule 14D-9 Recommendation Statement . . . filed in connection with the tender offer, and that document must also be considered as having been incorporated in the Complaint as well.").

[3] Plaintiffs alleged that Party A is Allergan, Inc. ("Allergan"). A-21 (¶9 n.1).

August 26, 2014, Party A increased its offer to $205 per share, and the Company agreed to allow Party A to conduct due diligence. A-280.

In September 2014, Party A advised the Company that it had become concerned about wholesaler inventory levels of certain of the Company's key products. *Id.* On September 23, 2014, Party A reduced its proposed purchase price to $175 per share. *Id.*

On September 23, 2014, Party B[4] expressed interest in acquiring the Company. *Id.* The next day, following a discussion with its legal and financial advisors, the Board rejected Party A's proposal at its lower price in an effort to obtain a higher bid. A-280-81. With Defendant John Chappell dissenting, the Board resolved to engage Party B to obtain more information. *Id.*

On September 30, 2014, Party B submitted a proposal to acquire the Company for between $178-$185 per share in cash and stock. *Id.* The following day, the Board determined, with Chappell dissenting, to provide Party B with access to due diligence, and it unanimously determined to reengage Party A. *Id.* After conducting due diligence, Party B withdrew from the sales process due to antitrust concerns. *Id.* On October 13, 2014, Party A advised that it would not proceed with a transaction at that time. A-281.

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[4] Plaintiffs alleged that Party B is Actavis plc. A-22-23 (¶13 n.3).

Shortly after the Company's November 6, 2014 announcements (discussed below), Party A reinitiated discussions with the Company. A-50 (¶97). The Board authorized management to discuss a potential transaction with Party A at a meeting scheduled for November 20, 2014. A-282. But on November 17, 2014, three days prior to the scheduled meeting, Party A and Party B jointly announced that they had agreed to combine. *Id.*

B. <u>The November 6, 2014 Announcements And The Market Check</u>

On November 5, 2014, Salix's CFO, Adam Derbyshire, resigned from the Company. A-282. Derbyshire's separation agreement provided the Board the right to terminate all outstanding unvested Company equity awards held by Derbyshire under certain circumstances, including if the Board determined that Derbyshire had engaged in "intentional[] … wrongdoing that has resulted … in material harm to" Salix. A-599; B-8 (¶8); *see also* A-43 (¶79).

On November 6, 2014, the Company announced Derbyshire's resignation. A-282. The Company also announced that (i) the inventory levels for certain of its products exceeded the estimated targets stated by Derbyshire on previous investor calls; (ii) it had adopted a plan to remediate the excess inventory levels by the end of 2016; (iii) the Audit Committee had retained outside counsel and was conducting a review of issues relating to the prior characterization of wholesale inventory levels; and (iv) it had disclosed the existence of the Audit Committee's

review to the Securities and Exchange Commission ("SEC"). *Id.* The following morning, Salix shares opened at $90.17 per share, approximately 35% below its closing price of $138.55 the day before. *Id.*

On November 22, 2014, the Board determined to retain J.P. Morgan Securities LLC ("J.P. Morgan") (together with Centerview, the "Financial Advisors") as an additional financial advisor in order to broaden the depth of the Company's contacts with potential bidders. A-51-52 (¶102). That same day, with Chappell dissenting, the Board instructed the Financial Advisors to commence a market check for the Company. A-52 (¶102).

On December 4, 2014, the Financial Advisors discussed fourteen potentially interested parties with the Board. After a discussion in which the list was divided into three tiers based on the Financial Advisors' judgment of each prospective bidder's ability to complete a transaction, the Board authorized the financial advisors to contact four of the five parties in the first tier and one party in the second tier, including Endo International plc ("Endo"), Parties D, E, F, and one additional party. A-283-84. The remaining potential bidders, including Valeant, were not contacted because the Board and its advisors believed that these companies lacked the interest or financial ability to acquire Salix, or were otherwise unlikely to bid. Endo and Parties D, E and F subsequently expressed interest in evaluating a transaction with the Company. A-53 (¶106).

C. The Company's CEO Retires; Discussions Begin With Endo, Parties D, E, F, G And Valeant

On January 5, 2015, Salix announced that its CEO, Carolyn Logan, would retire as an officer and director of the Company effective January 30, 2015. A-285. Logan's retirement agreement provided the Board the right to terminate all outstanding unvested Company equity awards held by Logan under certain circumstances, including if the Board determined that she had engaged in "intentional[] … wrongdoing that resulted … in material harm to" Salix. A-600; B-26 (¶6).

On January 8, 2015, Plaintiff Roberta Feinstein sent a litigation demand to the Board related to Salix's announcement of internal control and inventory issues. A-55 (¶114). Feinstein threatened to file suit in the event the Board failed to take action against allegedly culpable Salix directors and officers. A-56 (¶¶116-117). On February 23, 2015, Feinstein supplemented her demand with public information indicating that the Company's financial statements for fiscal year 2013 and the first three quarters of 2014 would be restated. A-67-68 (¶¶149-152).

During December 2014 and January 2015, the Company engaged Endo and Parties D, E and F in discussions. A-53-54 (¶¶106, 109-10). On December 19, 2014, Party D provided an indication of interest to acquire the Company for $150 per share in cash and stock, subject to due diligence. A-285. On January 9, 2015, Endo provided an indication of interest to acquire the Company for between $135

and $140 per share in cash and stock, subject to the completion of due diligence. *Id.* On January 12, 2015, Party F provided a non-binding indication of interest to acquire the Company for between $135 and $145 per share in cash and stock, subject to the completion of due diligence and other conditions. *Id.* On January 22, 2015, Party G provided an indication of interest in a transaction. A-286. Several days later, Party G indicated that it would be willing to pay a customary premium to the Company's unaffected trading price, but it did not specify a value range for the Company. *Id.* Neither Party D nor Party E provided an offer for the Company. A-285-86.

On January 20, 2015, J. Michael Pearson, the CEO of Valeant and chairman of its board of directors, indicated to J.P. Morgan that Valeant was interested in conducting due diligence in order to evaluate a potential acquisition of the Company. A-286. Pearson indicated to a Salix director, Thomas W. D'Alonzo, that if Valeant wished to proceed with a transaction, it would likely be an all-cash offer on an expedited timetable. *Id.*[5] The Company entered into a confidentiality and standstill agreement with Valeant effective January 20, 2015, and it proceeded to engage Valeant in discussions and provide Valeant with access to an electronic data room. A-54 (¶111).

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[5] D'Alonzo was named acting CEO of the Company following Logan's retirement. A-285.

During the month of February 2015, the Company's management and advisors continued to engage Valeant, Endo and Parties D, F and G in discussions on a daily basis. A-287. On February 6, 2015, Endo raised its offer for the Company to $150 per share in cash and stock, subject to the completion of due diligence. *Id.*

D. <u>The Company And Valeant Bargain; Enter Into A Merger Agreement</u>

On February 8, 2015, Valeant made an oral, non-binding indication of interest at $150 per share in cash. A-65 (¶138). In connection with this offer, Pearson advised D'Alonzo that Valeant was reviewing other potential acquisitions and that, if the transaction did not conclude quickly, Valeant would focus on those alternative opportunities. A-288. During the week of February 16, 2015, the Financial Advisors advised Endo and Parties D and G that time was growing short to submit or raise an offer for the Company. A-289.

On February 17, 2015, the Board considered potential responses to Valeant's $150 per share all cash offer. *Id.* Following discussion, the Board determined, with Chappell dissenting, to make a counterproposal to Valeant of $160 per share. *Id.*

Later that same day, the Company and Valeant agreed to proceed with negotiating a merger at a price of $158 per share on a non-exclusive basis, subject to the approval of both companies' boards of directors. A-289-90. The Board also

bargained the termination fee down from $544 million to $356.4 million, providing almost $200 million in savings to any potential topping bidder. A-288; A-290.

Over the next few days, counsel to the Company and Valeant exchanged drafts of the merger agreement (the "Merger Agreement"). A-290. On February 20, 2015, the board of directors of Valeant met and approved its acquisition of the Company. *Id.* Later that same day, the Salix Board met to consider the proposed transaction with Valeant with its advisors. Ultimately, with Chappell dissenting, the Board determined that the Merger was fair and in the best interests of the Company and its stockholders, approved the Merger Agreement, and determined to recommend that the Company's stockholders accept the tender offer and tender their shares. A-291.

E. Endo Makes An Unsolicited Proposal; Valeant Increases Its Offer

On March 11, 2015, the Company received an unsolicited written proposal from Endo to acquire all of the Company's stock for a combination of 1.4607 shares of Endo common stock and $45.00 in cash per share of common stock of the Company, representing a potential value of $172.56 per share (the "Endo Proposal"). A-393; A-399. Among other things, the completion of the Endo

Proposal was conditioned on regulatory approvals and the approval of the transaction by Endo's stockholders. A-394-95.[6]

On March 13, 2015, Valeant submitted a written proposal to the Company to amend the Merger Agreement to increase the consideration offered to the Company's stockholders to $169 per share in cash, subject to certain conditions, including (i) the Company determining that the Endo Proposal was not a superior proposal, (ii) the Company agreeing not to engage in discussions with Endo or any other potential bidder, (iii) reducing the consideration to $158 per share if a certain minimum number of shares were not tendered by April 1, 2015 (the "Step-Down Provision"), (iv) moving the Outside Date for closing from August 20, 2015 to May 1, 2015, and (v) increasing the termination fee. A-393-94.

On March 14, 2015, the Board met with its advisors to discuss the Endo Proposal and the increased offer from Valeant. A-394-95. After considerable discussion, the Board determined to meet the next day to discuss the proposals further, and it instructed D'Alonzo to engage Pearson to attempt to negotiate a higher price and more favorable terms. A-396.

[6] On March 12, 2015, the Company sent a letter to Endo requesting clarification of certain terms and conditions of the Endo Proposal. The following day, Endo responded to the Company's letter. A-393.

F. The Board Secures An Amendment To The Merger Agreement Increasing The Offer Price To $173 Per Share In Cash

On March 15, 2015, D'Alonzo and Pearson negotiated the terms of Valeant's revised proposal. *Id.* D'Alonzo requested that Valeant increase its proposal to $175 per share and extend the Step-Down Provision and the Outside Date by 30 days. *Id.* Pearson offered $172.50 per share (with a $75 million increase in the termination fee) or $173 per share (with a $100 million increase in the termination fee) but refused to extend the date of the Step-Down Provision or the Outside Date. *Id.* After further negotiation, Pearson agreed to offer $173 per share and to move the date of the Step-Down Provision to the end of the day on April 7, 2015. *Id.* Pearson refused to extend the Outside Date beyond May 1, 2015. *Id.*

The Board met that evening to discuss the revised proposal. The Board noted that accepting Valeant's proposal would provide near-term, highly certain value for stockholders and would not preclude Endo from submitting a higher bid. A-396-97. The Board also discussed the execution risks of the Endo transaction. A-397. The Financial Advisors then provided fairness opinions with respect to Valeant's $173 per share offer. *Id.* Following a final attempt by D'Alonzo to move the date of the Step-Down Provision outward to April 15, 2015, the Board, with Chappell dissenting: (i) determined that the Endo proposal was not, and was not reasonably likely to lead to, a superior bid; (ii) determined that the revised

Valeant proposal was fair and in the best interests of stockholders; (iii) approved the amendment to the Merger Agreement; and (iv) determined to recommend that stockholders tender their shares. A-397-98. The next morning, Endo withdrew its offer. A-398.

G. The Board Terminates Equity Awards Previously Granted To CEO And CFO

On or about March 24, 2015, allegedly at Valeant's request, the Board terminated all outstanding unvested equity awards previously granted to Logan and Derbyshire (the "Unvested Equity Awards"). A-80 (¶195).[7] On March 25, 2015, the Company announced the termination of the Unvested Equity Awards. A-71-72 (¶¶166-167). Several days later, Plaintiffs made a demand on the Board to apportion the value of the canceled shares to Salix's stockholders. A-72 (¶¶167-169). The Board refused the demand. *Id.* (¶170).

H. Plaintiffs Initiate Litigation, Then Quickly Abandon Their Preliminary Injunction Motion

On February 25, 2015, three days after the announcement of the proposed transaction, and before the Company had filed its Schedule 14D-9, Plaintiff Feinstein filed the first of six complaints brought by purported Salix stockholders (including Plaintiff Gonsalves on March 2, 2015). On March 13, 2015, Plaintiffs jointly filed a proposed order seeking to designate the Feinstein complaint as the

[7] Plaintiffs claimed in their Court of Chancery briefing that Valeant "muscled" the Board into terminating the Unvested Equity Awards. A-634.

operative complaint and to consolidate all existing and future actions relating to the Merger. A-16-17. On March 13, 2015, Plaintiffs filed a Verified Amended Class Action Complaint. A-16. On March 17, 2015, the Court granted Plaintiffs' proposed order. A-15.

On March 18, 2015, Plaintiffs filed a Verified Consolidated Amended Class Action Complaint. A-13. Later on March 18, 2015, Plaintiffs filed a Motion for Expedited Proceedings and a Motion for a Preliminary Injunction. *Id.* On March 20, 2015, the Salix Defendants and the Buyer Group[8] filed briefs in opposition to Plaintiffs' Motion for Expedited Proceedings. A-11-12. On March 22, 2015, one day before the scheduled hearing on the Motion for Expedited Proceedings, Plaintiffs withdrew both the Motion for Expedited Proceedings and their Motion for a Preliminary Injunction. A-11. Plaintiffs' counsel conceded that they "made a last-minute decision not to [seek to] enjoin" the Merger because Plaintiffs "were afraid that [Plaintiffs] would win the injunction, the time would run, and then … the shareholders would only get $158" per share. B-124-25.

[8] The Buyer Group consisted of Valeant, Valeant Pharmaceuticals International, and an entity created for the purpose of the merger, Sun Merger Sub, Inc.

I. The Stockholders Approve The Transaction, Plaintiffs Amend Their Complaint, and the Court of Chancery Dismisses The Case

On April 1, 2015, the Buyer Group completed the acquisition of Salix pursuant to 8 *Del. C.* § 251(h). Holders of 87.83% of the Company's stock tendered into the transaction. B-38.[9]

On September 25, 2015, more than five months after the consummation of the Merger, Plaintiffs filed a second amended complaint (the "Complaint"). A-9. On May 19, 2016, following full briefing and oral argument, the Court of Chancery dismissed the Complaint for failure to state a claim. A-1; A-1060-86.

The Court of Chancery held that the tender offer was not coercive because the Step-Down Provision applied equally to all Salix stockholders and, even if the Step-Down Provision had been coercive, Plaintiffs did not state a non-exculpated claim against the Salix directors for agreeing to it. A1078-1080.

The Court of Chancery considered Defendants' argument that tendering shares into a tender offer is the equivalent of formally voting on a merger for purposes of a claim-extinguishment defense. A-1067-68. The Court of Chancery determined it did not need to decide that argument, however, because it held that the Complaint failed to state any non-exculpated claims for breach of fiduciary

[9] As of the tender offer's expiration date, the Company's stockholders had tendered shares representing 75.25% of the Company's outstanding shares, and shares representing an additional 12.58% of the Company's outstanding shares had been tendered by notice of guaranteed delivery. B-38.

duty against any of Salix directors. *Id.* The Court of Chancery dismissed Plaintiffs' disclosure claims. The Court of Chancery emphasized that in a "post-closing damages case, it is not enough that the alleged omitted information simply be material," but instead that Plaintiffs demonstrate "that the [Board's] failure to make the disclosures … was done in bad faith or was otherwise the product of a breach of the fiduciary duty of loyalty." A-1082.[10]

The Court of Chancery also dismissed Plaintiffs' claim challenging the Board's decision to terminate the Unvested Equity Awards. The Court of Chancery concluded that Plaintiffs had "provide[d] nothing that could lead to a reasonable inference of bad faith or disloyalty from the board's failure to negotiate, in a post-signing context, additional consideration for what amounted to a relatively minor percentage of the overall merger consideration."[11] A-1077.

Plaintiffs appealed.

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[10] Plaintiffs did not appeal the Court of Chancery's dismissal of their disclosure claims.

[11] The Court of Chancery stated: "Plaintiffs do not contend that the board would have been in a position to negotiate additional post-signing consideration, and I'm hard-pressed to imagine a legal basis for them to claim such a right. Even if they could have negotiated for part or all of the $39 million benefit they allegedly conferred onto Valeant, plaintiffs' allegation that they failed to do so, without more, is not an allegation of disloyalty or bad faith as to the Salix defendants personally." A1076-77.

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY DISMISSED THE CLAIM THAT THE SALIX DIRECTORS BREACHED THEIR FIDUCIARY DUTIES BY AGREEING TO THE STEP-DOWN PROVISION

A. Question Presented

Whether the Court of Chancery correctly rejected the claim that the tender offer was structurally coercive under Delaware law because of the presence of the Step-Down Provision, and whether the Court of Chancery correctly rejected the claim that the Salix directors breached their fiduciary duties by agreeing to the Step-Down Provision. A-1078-80.

B. Scope Of Review

This Court reviews *de novo* the Court of Chancery's decision to dismiss the Complaint. *Nemec v. Shrader*, 991 A.2d 1120, 1125 (Del. 2010). In reviewing the grant of a motion to dismiss, this Court accepts all well-pleaded allegations as true, but it does not "blindly accept conclusory allegations unsupported by specific facts, nor [does it] draw unreasonable inferences in the plaintiffs' favor." *Id.*

C. Merits Of Argument

1. The Step-Down Provision Was Not Wrongfully Coercive Under Delaware Law

Plaintiffs' argument that the Step-Down Provision was wrongfully coercive fails at the outset. Under Delaware law, inequitable coercion occurs when "defendants have taken actions that operate inequitably to induce the

[stockholders] to tender their shares for reasons unrelated to the economic merit of the offer." *Gradient OC Master, Ltd. v. NBC Universal, Inc.*, 930 A.2d 104, 117 (Del. Ch. 2007) (citation omitted). A structurally coercive offer involves "the risk that disparate treatment of non-tendering shareholders might distort shareholders' tender decisions." *Paramount Commc'ns., Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 n.17 (Del. 1990) (*quoting* Ronald J. Gilson & Reinier Kraakman, Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 Bus. Law. 247, 267 (1989)). Conversely, "[i]f all that defendants have done is to create an option for shareholders, then it can hardly be thought to have breached a duty." *AC Acquisitions Corp. v. Anderson Clayton & Co.*, 519 A.2d 103, 113 (Del. Ch. 1986).

The seminal example of a structurally coercive offer is a tender offer that treats similarly situated stockholders differently, such as the one in *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), which presented stockholders with the risk that they would receive junk bonds if they did not tender. According to the Court of Chancery, "the threat [in that circumstance] is obvious: shareholders may be compelled to tender *to avoid being treated adversely* in the

second stage of the transaction." *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 106 (Del. Ch. 2011) (emphasis in original) (citation omitted).[12]

Here, the Step-Down Provision did not provide front-loaded consideration or otherwise contemplate disparate treatment: all stockholders would receive the same form and same amount of consideration, regardless of when they elected to tender their shares. The Step-Down Provision was not coercive under Delaware law because stockholders faced no threat that they would be treated differently than their fellow stockholders if they declined to tender prior to April 8, 2015.[13]

Plaintiffs argue that the April 8 deadline somehow made the Step-Down Provision coercive. Op. Br. 23-31. But tender offers with set expiration dates are not coercive. *See In re Siliconix Inc. S'holders Litig.*, 2001 WL 716787, at *1 (Del. Ch. June 21, 2001) (finding tender offer set to expire one week after hearing was not coercive); *Gradient*, 930 A.2d at 104 (finding tender offer set to expire five days after preliminary injunction hearing was not coercive). The Step-Down

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[12] In this case, the Court of Chancery correctly recognized that "the plaintiffs confuse structurally coercive tender offers from tender offers that expire or lose value if they are not accepted within a certain time period." A-1079.

[13] In each case cited by Plaintiffs for the proposition that coercion may exist regardless of transaction structure, stockholders were compelled to tender their shares to avoid being treated differently and adversely later. *See Kahn v. U.S. Sugar Corp.* 1985 WL 4449, at *6 (Del. Ch. Dec. 10, 1985) (the non-tendering stockholders were left with shares expected to significantly decline in value because of a large loan used to pay for the shares tendered); *AC Acquisitions*, 519 A.2d at 113 (same); *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1062 (Del. Ch. 1987) (company told preferred stockholders of intent to request delisting of non-tendering shares from stock exchange). Here, by contrast, stockholders would all be treated the same as each other regardless of whether or when they tendered.

Provision was in fact more favorable than a tender offer set to expire at a set date, a structure that Delaware courts routinely approve. *See Macfadden Holdings, Inc. v. John Blair & Co.*, 1986 WL 7356, at *5 (Del. Ch. July 2, 1986) ("The fact that the timing and economic terms of a particular offer induce shareholders to tender does not make it 'coercive.'") (citation omitted).

Plaintiffs argue that the Court of Chancery's ruling "ignores the teachings and practice of the Delaware courts to view transactions through a lens of practicality and reality." Op. Br. 24. According to Plaintiffs, a stockholder would feel compelled to tender at the $173 per share price at the first-tier because of fear that they would receive less consideration later. Op. Br. 25-27. But Plaintiffs have failed to offer a cogent explanation as to why rational Salix stockholders would have tendered their shares at the $173 price unless they thought that price was fair. If Salix stockholders believed that the $173 price was insufficient, they could have refused to tender prior to April 8, 2015. If they likewise believed $158 was inadequate, they would have refused to tender before the Outside Date, and the deal would have failed. Stockholders would have been left holding stock in Salix as a standalone entity as a result of their own investment decisions.[14]

[14] The only way Salix stockholders would be stuck with the lower $158 per share consideration is if, during the time after April 8, 2015, but before the Outside Date, a majority of the stockholders decided that the $158 per share was a favorable transaction, after previously believing that $173 per share was not. This would not occur absent a significant change in circumstances.

2. Even If The Step-Down Provision Was Coercive, Plaintiffs Fail To Allege Disloyalty Or Bad Faith

Plaintiffs allege that the Board members breached their fiduciary duties by agreeing to the Step-Down Provision. Op. Br. 23. But even if the tender offer had been structurally coercive (it was not), Plaintiffs nowhere allege that the Salix directors' negotiation or approval of the Step-Down Provision resulted from disloyalty or a conscious disregard of their duties amounting to bad faith. Instead, Plaintiffs only challenge the reasonableness of the Step-Down Provision. That is not a claim for post-closing damages against disinterested directors. *See Corwin v. KKR Fin. Holdings, LLC*, 125 A.3d 304, 312 (Del. 2015) (emphasizing that *Revlon* was not "designed with post-closing money damages in mind"); *In re Cornerstone Therapeutics Inc., Stockholder Litig.*, 115 A.3d 1173, 1175–76 (Del. 2015) ("A plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct.") (citations omitted). In any event, Plaintiffs cannot credibly argue that the Complaint generates a reasonable inference of disloyalty when they admit that the Board's agreement to the Step-Down Provision secured an additional $1 billion in aggregate consideration for the Company's stockholders. *See* A-26 (¶19).

II. THE COURT OF CHANCERY CORRECTLY DISMISSED THE CLAIM THAT THE SALIX DIRECTORS BREACHED THEIR FIDUCIARY DUTIES IN CONNECTION WITH THE EQUITY TERMINATION

A. Question Presented

Whether the Court of Chancery correctly determined that the Complaint failed to state a claim that the Board members breached their fiduciary duties by terminating the Unvested Equity Awards between signing and closing without obtaining additional, incremental consideration for the Company's stockholders. A-1076-77.

B. Scope Of Review

This Court reviews *de novo* a decision on a motion to dismiss. *See* Section I(B), *supra*.

C. Merits Of Argument

1. The Business Judgment Rule Is The Appropriate Standard Of Review And Warrants Dismissal Of This Case

a. *Corwin* Applies To This Case

Plaintiffs allege that the Salix Board members breached their fiduciary duties in connection with their decision to terminate the Unvested Equity Awards. Relying on *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), Plaintiffs argue that the directors' actions should have been reviewed under Delaware's intermediate "enhanced scrutiny" standard. That argument fails.

"[W]hen a transaction not subject to the entire fairness standard is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies," even where the vote was statutorily required to consummate a transaction otherwise subject to enhanced scrutiny. *Corwin*, 125 A.3d at 308-09. After so-called "*Corwin* approval," dismissal is typically the result because the transaction then can be attacked only on grounds of waste, a concept that has "little real-world relevance" in an M&A transaction because "stockholders would be unlikely to approve a transaction that is wasteful." *Singh v. Attenborough*, 137 A.3d 151, 152 (Del. 2016) (ORDER).

Here, the Company's stockholders overwhelmingly approved the transaction after a well-publicized sale process. The Salix stockholders were disinterested and fully informed. *See* A-1083. Plaintiffs did not appeal this portion of the opinion below and have therefore waived any argument that the disclosures were deficient. Finally, the Salix stockholders were not coerced. *See* Section I(C)(1), *supra*. Because the Merger received the fully-informed approval of disinterested and uncoerced holders of a majority of the Company's stock, the business judgment

rule applies and insulates the transaction from all claims other than waste.[15] *See Singh*, 137 A.3d at 152; *Corwin*, 125 A.3d at 310 n.19.[16]

b. Stockholder Acceptance Of A Tender Offer Has The Same Cleansing Effect As A Stockholder Vote

Plaintiffs argued below that *Corwin* does not apply to this transaction because the Merger involved a tender offer, not a vote. This argument fails. Stockholder acceptance of a tender offer pursuant to a Section 251(h) merger has the same cleansing effect as a stockholder vote. *In re Volcano Corp. S'holder Litig.*, 2016 WL 3626521, at *15 (Del. Ch. June 30, 2016) ("I conclude that the acceptance of a first-step tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's outstanding shares in a two-step merger under Section 251(h) has the same cleansing effect under *Corwin* as a vote in favor of a merger by a fully informed, disinterested, uncoerced stockholder majority."); *see also Larkin v. Shah*, 2016 WL 4485447, at *20 (Del. Ch. Aug. 25, 2016).

[15] In *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 881 (Del. Ch. 1999), the Court of Chancery found that stockholder approval extinguished duty of loyalty claims that stopped short of waste.

[16] To the extent that Plaintiffs contend that stockholder approval does not shift the standard of review to business judgment until after the *Unocal* or *Revlon* standard for evaluating defensive measures has been met, that argument fails. *Corwin* and *Singh* make clear that even if enhanced scrutiny would otherwise apply, the approval of a merger by fully-informed, uncoerced, disinterested stockholders requires application of the business judgment rule and extinguishes all claims other than waste. Additionally, in *Corwin*, this Court emphasized that *Unocal* and *Revlon* were "primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing" and was not a tool "designed with post-closing money damages in mind." 125 A.3d at 312.

First, the language used in Section 251(h) of the Delaware General Corporation Law ("DCGL") confirms that stockholder acceptance of a tender offer should have the same cleansing effect as a stockholder vote. *See Volcano*, 2016 WL 3626521, at *12. "A target board's role in negotiating a two-step merger subject to a first-step tender offer under Section 251(h) … is substantially similar to its role in a merger subject to a stockholder vote under Section 251(c) of the DGCL." *Id*. Section 251(h) requires that a target corporation's board negotiate, agree to, and declare the advisability of the terms of both the first-step tender offer and the second-step merger, just as a target corporation's board must negotiate, agree to and declare the advisability of a merger under Section 251(c). *Id.*; *compare* 8 *Del. C.* § 251(a),(b),(h) *with* 8 *Del. C.* § 251(c).[17]

Moreover, the first-step tender offer in a Section 251(h) merger is no more coercive than a stockholder vote in a long form merger because (1) the first-step tender offer must be for all of the target corporation's common stock, (2) the second-step merger must "be effected as soon as practicable following the consummation of the" first-step tender offer, (3) the consideration paid in the second-step merger must be of "the same amount and kind" as that paid in the first-

[17] Even before DGCL § 251(h), the Court of Chancery indicated that tendering shares to approve a transaction had the same cleansing effect as voting those shares. In *Morton's*, 74 A.3d at 663 n.34 (Del. Ch. 2013), the Court of Chancery described deference to stockholder approval by tender offer as fitting within a "long and sensible tradition of giving deference to the stockholders' voluntary decision, invoking the business judgment rule standard of review, and limiting any challenges to the difficult argument that the transaction constituted waste."

step tender offer, and (4) appraisal rights are available in all Section 251(h) mergers, subject to the conditions of Section 262 of the DGCL. 8 *Del. C.* § 251(h); *see also Volcano*, 2016 WL 3626521, at *12. Simply put, Section 251(h) eliminates the policy bases for distinguishing between the cleansing effect of a first-step tender and a statutorily required stockholder vote.

Second, the policy considerations underlying the holding in *Corwin* provide no basis for distinguishing between a stockholder vote and a tender offer.[18] In *Corwin*, this Court explained that "the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves… The reason for that is tied to the core rationale of the business judgment rule, which is that judges are poorly positioned to evaluate the wisdom of business decisions…." 125 A.3d at 313.[19] When parties consummate a merger under Section 251(h), the first-step tender offer essentially replicates a statutorily required stockholder vote in that both require approval by

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[18] In a 2014 article, Vice Chancellor Laster summarized a line of Delaware authority equating approval by tender offer with a stockholder vote and concluded that approval by a tender offer "should have the same effect as an affirmative stockholder vote." J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1459 n.57 (2014).

[19] Since this Court decided *Corwin* last year, the Court of Chancery has applied *Corwin's* reasoning and dismissed post-closing challenges to merger transactions following a fully-informed, uncoerced stockholder approval (*see City of Miami Gen. Emps.' and Sanitation Emps.' Ret. Tr. v. Comstock*, 2016 WL 4464156, at *17 (Del. Ch. Aug. 24, 2016)) or tender of shares into a tender offer (*see Volcano*, 2016 WL 3626521, at *15; *Larkin*, 2016 WL 4485447, at *20).

stockholders representing at least a majority of a corporation's outstanding shares to effectuate the merger. *See Volcano*, 2016 WL 3626521, at *13. In both types of mergers, stockholders have a "free and informed chance to decide on the economic merits of a transaction for themselves," and judges are just as "poorly positioned to evaluate the wisdom of" stockholder approved mergers.[20] *See id.*

c. Stockholder Approval Extinguished All Claims Other Than Waste

To the extent Plaintiffs contend that duty of loyalty claims survive a *Corwin* vote, that argument is meritless. Fully-informed, disinterested and uncoerced stockholder approval bars all claims but waste. *See Volcano*, 2016 WL 3626521, at *17 ("Because Volcano's fully informed, uncoerced, disinterested stockholders approved the Merger by tendering a majority of the Company's outstanding shares into the Tender Offer, the business judgment rule irrebutably applies" and the transaction "only can by challenged on the basis that it constituted waste."); *Larkin*, 2016 WL 4485447, at *21 ("[T]he only claim that Plaintiffs could state that would overcome the otherwise irrebutable application of the business judgment rule is a claim for waste."); *Harbor Fin.*, 751 A.2d at 890 ("[T]he effect of untainted stockholder approval of the Merger is to invoke the protection of the business judgment rule and to insulate the Merger from all attacks other than on

[20] In *Corwin*, this Court used the terms "approve" and "vote" interchangeably. *See, e.g.*, 125 A.3d at 306, 308-09.

the ground of waste.").[21] In other words, disinterested and fully informed stockholder approval does not merely shift the standard of review to business judgment, it also extinguishes all fiduciary duty claims other than waste. *See Corwin*, 125 A.3d at 313 ("[W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves."); *Volcano*, 2016 WL 3626521, at *13, *17 (describing the application of the business judgment rule as "irrebutable"); *Larkin*, 2016 WL 4485447, at *21 (same).[22]

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[21] To the extent Plaintiffs rely on *In re Wheelabrator Tech., Inc. S'holder Litig.*, 663 A.2d 1194 (Del. Ch. 1995) for the proposition that stockholder approval can never extinguish a duty of loyalty claim, that reliance is misplaced. This broad interpretation of *Wheelabrator* is impossible to square with *Harbor Finance*, where the Court of Chancery found that stockholder approval extinguished duty of loyalty claims that stopped short of waste. *See Harbor Fin.*, 751 A.2d at 881. The better interpretation of *Wheelabrator*, and the only one consistent with *Corwin*, is that a claim for waste, which itself is a species of loyalty claim, survives stockholder approval, but other duty of loyalty claims do not.

[22] *See also Singh*, 137 A.3d 151, 151-52 (Del. 2016) ("When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."); *In re PLX Tech. Inc. S'holder Litig.*, C.A. No. 9880-VCL, Tr. at 85 (Del. Ch. Apr. 15, 2015) (Transcript) ("If the disclosures were good, I do think that it lowers the standard of review to business judgment and everyone, for all intents and purposes, gets to go home."); *Effect of Stockholder Approval*, 40 WM. MITCHELL L. REV. at 1459 (describing rationale for the "additional effect [of ratification,] barring a stockholder plaintiff from seeking to rebut the presumptions of the business judgment rule.").

d. Plaintiffs Do Not Adequately Plead Waste

In their briefing below, Plaintiffs conceded that waste "has no application" in this case. A-590. Moreover, even if they were not bound by that concession, Plaintiffs have not pled facts demonstrating waste.

"The standard for adequately pleading corporate waste is high and rarely satisfied." *Higher Ed. Mgmt. Grp., Inc. v. Mathews*, 2014 WL 5573325, at *11 (Del. Ch. Nov. 3, 2014); *see also Harbor Fin.*, 751 A.2d at *901 ("[I]t [is] logically difficult to conceptualize how a plaintiff can ultimately prove a waste or gift claim in the face of a decision by fully informed, uncoerced, independent stockholders to ratify the transaction.").

Plaintiffs' allegation that the Board "did Valeant's bidding and succeeded in saving it over $40 million without securing any additional consideration for Salix's stockholders," A-80 (¶196), does not satisfy this standard. All bidders in the sale process knew about the Company's restated earnings, the terms of the Company's arrangements with Logan and Derbyshire and the Company's right to terminate the Unvested Equity Awards. *See* A-43 (¶79); A-599-600; B-8 (¶8); B-26 (¶6). Thus, all bidders could and undoubtedly did price the potential termination of Unvested Equity Awards into their bids. Plaintiffs' suggestion that the Board somehow gave away the right to terminate the Unvested Equity Awards for no consideration flies in the face of their allegations that the Board secured $15.8 billion for the

Company[23] after a frothy bidding war in which several of the most sophisticated M&A players in the world fought to buy the Company, including all of its potential claims against Logan and Derbyshire.

2. Plaintiffs Allege A Derivative Claim And Cannot Recast It As A Direct Claim

Plaintiffs' claim regarding the termination of Unvested Equity Awards founders for another fundamental reason – it is derivative. "Delaware law is well-settled that claims arising from transactions involving corporate assets that allegedly operate to reduce the consideration received by stockholders in a merger are … derivative in nature." *In re First Interstate Bancorp Consol. S'holder Litig.*, 729 A.2d 851, 861 (Del. Ch. 1998); *see also Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1245 (Del. 1999) ("In order to state a direct claim with respect to a merger, a stockholder must challenge the validity of the merger itself, usually by charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price."); *Golaine v. Edwards*, 1999 WL 1271882, at *6 (Del. Ch. Dec. 21, 1999) ("[I]f the side transactions were not so costly that they enable the plaintiffs to allege that the consideration offered to the target stockholders was reduced to an unfair level, then a price attack on them must be labeled as derivative and extinguishable by the merger.").

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[23] $15.8 billion represents the enterprise value of the Company at $173 per share.

Here, Plaintiffs allege that the Board failed to maximize stockholder value by terminating the Unvested Equity Awards without increasing the consideration for Salix stockholders. That is a derivative claim for the amount of the Unvested Equity Awards (approximately $39 million). *See First Interstate Bancorp*, 729 A.2d at 861; *Parnes*, 722 A.2d at 1245; *Golaine*, 1999 WL 1271882, at *6. Plaintiffs cannot recast that claim as direct simply by asserting, in conclusory fashion, that the termination resulted in a reduction of Valeant's aggregate purchase price by approximately $.60 per share.

To recast the derivative claim, Plaintiffs would need to satisfy the Court of Chancery's three-pronged *Primedia* test. *See, e.g., Houseman v. Sagerman*, 2014 WL 1600724, at *11 (Del. Ch. Apr. 16, 2014) (applying *Primedia* to allegations that merger consideration failed to include value of derivative litigation claims against directors). Under the *Primedia* test, a party must first plead an underlying derivative claim that has survived a motion to dismiss or otherwise could state a claim on which relief could be granted. 67 A.3d at 477. Second, the value of the derivative claim must be material in the context of the merger. *Id.* at 482. Third, the complaint challenging the merger must support a pleadings-stage inference that the acquirer would not assert the underlying derivative claim and did not provide value for it. *Id.* at 483.

Plaintiffs cannot satisfy the *Primedia* test. Plaintiffs fail the first prong of the test because they have not pled any facts that demonstrate that the Board breached its fiduciary duties. Plaintiffs do not challenge the Board's disinterestedness and independence.[24] Moreover, Plaintiffs do not allege that the Board would have been in a position to negotiate additional post-signing consideration from Valeant. *See In re TIBCO Software Inc. S'holders Litig.*, 2015 WL 6155894, at *2 (Del. Ch. Oct. 20, 2015) (dismissing claim for reformation where "plaintiff has failed to allege facts demonstrating existence of an antecedent agreement between [acquirer] and [target] inconsistent with the price term of the merger agreement").

Plaintiffs fail the second prong of the *Primedia* test because they cannot show that the value of these claims (approximately $39 million) was material in the context of the $15.8 billion Merger. *See In re Massey Co.*, 2011 WL 2176479, at *28 (Del. Ch. May 31, 2011). The aggregate amount of the Unvested Equity Awards was approximately $.60 per share in a $173 per share offer.[25]

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[24] Plaintiffs conceded the Salix directors' disinterestedness and independence with respect to the termination of the Unvested Equity Awards by sending a demand letter relating to that issue. *See Boeing Co. v. Shrontz*, 1994 WL 30542, at *2 (Del. Ch. Jan. 19, 1994). Plaintiffs did not challenge this issue on appeal.

[25] Plaintiffs argue that the timing of Plaintiffs' decision to terminate the Unvested Equity Awards – "just days before the tender offer was set to expire" – demonstrates materiality. Op. Br. 21 n.82. But materiality in this context is determined based on the prospects for recovery compared to the size of the acquired entity. *See Massey*, 2011 WL 2176479, at *28; *Primedia*, 67 A.3d at 483. Here, it is clear that regardless of timing, the value of the Unvested Equity

Plaintiffs fail the third part of the *Primedia* test because they cannot show that Valeant would not have pursued any valuable derivative claims. Plaintiffs' allegation that Valeant "muscled" the Board into terminating the Unvested Equity Awards, A-634, suggests the opposite – that Valeant was not only aware of the potential claims but would have pursued them.

Because Plaintiffs cannot recast their derivative claim as a direct one, the Court of Chancery properly dismissed the claim.

3. Even If Plaintiffs Could Allege A Direct Claim, They Fail To State A Cognizable One

Finally, Plaintiffs have not pled a non-exculpated claim against the Salix directors in connection with the termination of the Unvested Equity Awards.

Plaintiffs do not challenge, and thus concede, that the Company's certificate of incorporation contains an exculpation provision pursuant to § 102(b)(7) that exculpates the directors from all relevant claims except those for breach of the duty of loyalty. A-208; A-323; A-810; A-1068. Moreover, Plaintiffs have already conceded the Salix directors' disinterestedness and independence with respect to the termination of the Unvested Equity Awards by sending a demand letter relating to that issue. *See* note 24, *supra*. So Plaintiffs must allege bad faith to state a non-exculpated fiduciary claim. *See Wayne Cty. Emp. Ret. Sys. v. Corti*, 2009 WL

Awards represented a tiny fraction (0.30%) of the equity value of the Company and an even smaller fraction (0.25%) of the Company's enterprise value.

2219260, at *14 (Del. Ch. July 24, 2009), *aff'd*, 996 A.2d 795 (Del. 2010) (explaining that where plaintiff "failed to raise any credible challenge to the independence or disinterestedness of the Director Defendants … to survive dismissal, the Complaint must plead facts that support a claim that the Director Defendants failed to act in good faith").

But to state a claim for bad faith conduct, Plaintiffs must allege an "extreme set of facts" establishing that the Salix directors "intentionally fail[ed] to act in the face of a known duty to act, demonstrating a conscious disregard for [their] duties." *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009) (citation omitted). To state a post-closing claim against exculpated directors, it is not enough to allege "the directors failed to do all that they should have [done] under the circumstances," because that failure implicates only an exculpated breach of the duty of care. *Id.* Rather, Plaintiffs must establish that the Salix directors "knowingly and completely failed to undertake their responsibilities" and "utterly failed to attempt to obtain the best sale price." *Id.* at 243-44. Plaintiffs fail to meet this high standard.

Plaintiffs assert that the Salix directors acted in bad faith by failing to terminate the Unvested Equity Awards prior to the execution of the Merger Agreement (when the per share merger transaction was set). According to Plaintiffs, Valeant earmarked merger consideration to pay out the Unvested Equity

Awards and the Board allowed Valeant to secure a windfall by terminating the Unvested Equity Awards after signing. Op. Br. 16.

Plaintiffs complain that the Board should have bargained with Valeant to obtain additional, incremental consideration for the Company's stockholders. Op. Br. 21. But Plaintiffs do not plead facts demonstrating that Salix's market check was ineffective, that the Board in any way favored Valeant over other bidders, that Valeant failed to price the potential termination of the Unvested Equity Awards into its bid or that the Board could even negotiate for additional consideration after having executed a Merger Agreement contemplating that Valeant would pay a specific price per share. Nor do Plaintiffs allege that Valeant was willing to pay an additional $39 million to acquire the Company. In short, Plaintiffs do not plead facts demonstrating that the Board "utterly failed to attempt to obtain the best sale price." *Lyondell*, 970 A.2d at 243.

CONCLUSION

For the foregoing reasons, the Court should affirm the Court of Chancery's order dismissing the Complaint with prejudice.

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