IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SHAREHOLDER REPRESENTATIVE SERVICES, LLC, a Colorado limited liability company, in its capacity as Stockholder Representative,	)	
Plaintiff,	)	
v.	)	C.A. No. 12868-VCL
VALEANT PHARMACEUTICALS INTERNATIONAL, a Delaware corporation, and VALEANT PHARMACEUTICALS INTERNATIONAL, INC., a British Columbia corporation,	)	
Defendants.	)	

ORDER GRANTING MOTION TO DISMISS IN PART AS TO COUNTS II, III, AND IV

1. Pursuant to an Agreement and Plan of Merger dated August 19, 2015 (the "Merger Agreement" or "MA"), defendant Valeant Pharmaceuticals International (the "Buyer" or "Parent") acquired Sprout Pharmaceuticals, Inc. (the "Company"). To effect the acquisition, an acquisition subsidiary of the Buyer ("Merger Sub") merged with and into the Company. Defendant Valeant Pharmaceuticals International, Inc. (the "Parent Guarantor") guaranteed the Buyer's obligations under the Merger Agreement. Plaintiff Shareholder Representative Services, LLC served as the "Stockholder Representative" and was a party to the Merger Agreement for the purpose of enforcing the rights of the Company's stockholders.

2. The Company's key asset was a drug known as Addyi (the "Product"). The Merger Agreement contemplated a combination of an upfront cash payment plus milestone payments based on the drug's performance. Section 7.10(c) of the Merger Agreement obligated the Company and its affiliates post-merger to "use Diligent Efforts to pursue the development and commercialization of the Product . . . ." Section 7.10(c) identified four specific obligations included within the concept of "Diligent Efforts." In Section 6.2(d) of the Merger Agreement, the Buyer also represented that there was no pending or threatened litigation or other proceeding against it that would prevent it from performing its obligations under the Merger Agreement.

3. The Shareholder Representative has sued the Buyer and Parent Guarantor. The defendants have moved to dismiss the Complaint under Court of Chancery Rule 12(b)(6) for failing to state a claim on which relief can be granted. When a court evaluates a motion to dismiss for failure to state a claim, "(i) all well-pleaded factual allegations are accepted as true; (ii) even vague allegations are well-pleaded if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (iv) dismissal is inappropriate unless the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof." *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896–97 (Del. 2002) (footnotes and internal quotation marks omitted).

4. In Count I of the Complaint, the Stockholder Representative asserts a claim for breach of the Merger Agreement. The Complaint alleges both that the Buyer failed to use Diligent Efforts and that it breached the representation that it made in Section 6.2(d). The defendants have not moved to dismiss Count I.

5. In Count II of the Complaint, the Stockholder Representative asserts that the Buyer "breached the implied covenant of good faith and fair dealing by failing to fulfill its obligations in good faith to use Diligent Efforts to develop and commercialize" the Product. Compl. ¶ 91. The defendants have moved to dismiss Count II. They contend that the contractual standard in Section 7.10(c) specifically addresses each of the violations alleged by the Stockholder Representative. This aspect of the defendants' motion is largely denied. Count II states a claim.

a. The implied covenant of good faith and fair dealing "only applies where a contract lacks specific language governing an issue and the obligation the court is asked to imply advances, and does not contradict, the purposes reflected in the express language of the contract." *Fortis Advisors LLC v. Dialog Semiconductor PLC*, 2015 WL 401371, at *5 (Del. Ch. Jan. 30, 2015) (quotation omitted). "No contract, regardless of how tightly or precisely drafted it may be, can wholly account for every possible contingency." *Amirsaleh v. Bd. of Trade of City of New York, Inc.*, 2008 WL 4182998, at *1 (Del. Ch. Sept. 11, 2008). "[E]ven the most carefully drafted agreement will harbor residual nooks and crannies for the implied covenant to fill." *ASB Allegiance Real Estate Fund v.*

Scion Breckenridge Managing Member, LLC, 50 A.3d 434, 441 (Del. Ch. 2012), *rev'd on other grounds*, 68 A.3d 665 (Del. 2013).

> Under Delaware law, a court confronting an implied covenant claim asks whether it is "clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter."

Id. at 440 (quoting *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986) (Allen, C.)).

b. Section 7.10(c) of the Merger Agreement required that the Buyer and its affiliates use Diligent Efforts "to pursue the development and commercialization of the Product." Section 1.1 of the Merger Agreement defined Diligent Efforts as follows:

> "Diligent Efforts" means, with respect to the Product, efforts of a Person to carry out its obligations in a diligent manner using such efforts and employing such resources normally used by Persons in the pharmaceutical business similar in size and available resources to such Person relating to the commercialization of an approved product that is of similar market potential at a similar stage in its development or product life, taking into account issues of market exclusivity, product profile, including efficacy, safety, tolerability and convenience, labelling, the competitiveness of alternate approved products in the marketplace (other than any such product owned or licensed by such Person or any of its Affiliates), the availability of existing forms or dosages of the Product for other indications, the launch or sales of a generic or biosimilar product, the regulatory environment, the profitability of the Product (including pricing and reimbursement status),

> regulatory considerations including blackbox requirements, contra indications, patient registries, enhanced pharmacovigilance and Risk Evaluation and Mitigation Strategy (REMS) programs, and other relevant considerations, including technical, commercial, legal, scientific and/or medical factors. For the avoidance of doubt, the following shall not operate to reduce, diminish or limit Diligent Efforts: (i) any other pharmaceutical product such Person or any of its Affiliates is then discovering, researching, developing, manufacturing or commercializing, alone or with one or more collaborators; or (ii) any royalty payments required to be made by any Person with respect to the Product pursuant to any written agreement entered into prior to the date of this Agreement, including the [Asset Transfer and License Agreement].

MA § 1.1.

c. Section 7.10(c) of the Merger Agreement also identified four specific obligations included within the concept of Diligent Efforts. Under Section 7.10(c), the Buyer was obligated to:

> (A) perform the obligations of the Surviving Corporation and its Affiliates under [an Asset Transfer and License Agreement] in order to maintain the rights to develop and commercialize the Product . . .;
>
> (B) make, or cause to be made, expenditures of no less than $200,000,000 in the aggregate in relation to the Product for selling, general and administrative, marketing and research and development expense during the six (6) full calendar quarters commencing on the later of (x) the first day of the first full calendar quarter after the Commercial Launch and (y) January 1, 2016;
>
> (C) as soon as possible following the Effective Time and in no event later than December 31, 2015, hire at

> least 150 new associate sales representatives and medical science liaisons; and
>
> (D) conduct and complete all post-marketing requirements that the FDA has formulated as a condition to the marketing approval of the Product, whether in the manner and within the deadlines as set forth in the Company's submissions to the FDA made prior to the date of this Agreement or with such modifications or deviations in scope, deadlines or otherwise as may be agreed with or not objected to by the FDA from time to time.

MA § 7.10(c) (formatting added). Assuming the allegations in the Complaint to be true, however, is reasonably conceivable that this provision will not so occupy the field as to foreclose the application of the implied covenant.

d. The Complaint alleges that "Valeant increased Addyi's price to a cost that made it unaffordable to millions of women and at which payors would not cover the drug." Compl. ¶ 91. It is reasonably conceivable that this could violate the implied covenant. Valeant has argued that pricing falls within the concept of "commercialization," but as I read Section 7.10(c) and the definition of Diligent Efforts, it is reasonably conceivable that they do not occupy the field. The concept of commercialization turns on measure of what other similar companies would do with similar drugs. Although it is possible that the Buyer violated the contractual standard, it is also true that the language of Section 7.10(c) and the Diligent Efforts provision maps imperfectly onto the idea of pricing, making it reasonably conceivable that there would be a gap to fill.

e. The Complaint alleges that "Valeant planned to sell Addyi through Philidor, its former specialty pharmacy, which Valeant knew was under criminal investigation . . . ." *Id.* It is reasonably conceivable that this could violate the implied covenant. Valeant again invokes the concept of "commercialization," but the same mismatch between the notion of using a pharmacy under criminal investigation and the contractual standard potentially leaves room for the implied covenant.

f. The Complaint alleges that "[t]o date, Valeant has failed to make the necessary expenditures . . . ." *Id.* In light of the scope of Section 7.10(c) and the definition of Diligent Efforts, it is not reasonably conceivable that this could violate the implied covenant. Clause (B) of Section 7.10(c) specifically addresses the concept of expenditures, and any related matters will be judged by the contractual standard for efforts and use of resources set forth in that provision.

g. The Complaint alleges that "Valeant has failed to have at least 150 sales representatives and medical science liaisons in the field since December 2015." *Id.* In light of the scope of Section 7.10(c) and the definition of Diligent Efforts, it is not reasonably conceivable that this could violate the implied covenant. Clause (C) of Section 7.10(c) specifically addresses the subject of sales representatives, and any related matters will be judged by the contractual standard for efforts and use of resources set forth in that provision.

h. The Complaint alleges that "Valeant has not taken any steps to remove the alcohol co-use restriction for Addyi . . . ." *Id.* It is reasonably

conceivable that this could violate the implied covenant. There is a reference in clause (D) of Section 7.10(c) to FDA requirements, but it is reasonably conceivable that removing the alcohol co-use restriction is an effort that would fall outside that language. The removal is not a concept that fits easily within the definition of Diligent Efforts, and it is reasonably conceivable that the implied covenant will apply.

6. In Count III of the Complaint, the Stockholder Representative seeks a declaratory judgment regarding the same matters that are the subject of Counts I and II. The defendants have moved to dismiss Count III. This aspect of the defendants' motion is granted. Count III is dismissed as surplusage.

a. A claim for declaratory judgment "is meant to provide relief in situations where a claim is ripe but would not support an action under common-law pleading rules." *Great Hill Equity P'rs IV, LP v. SIG Growth Equity Fund I, LLLP*, 2014 WL 6703980, at *29 (Del. Ch. Nov. 26, 2014). Thus, where the declaratory judgment claim duplicates a claim for breach of contract, "the declaratory judgment count does not add anything." *ESG Capital P'rs II, LP v. Passport Special Opportunities Master Fund, LP*, 2015 WL 9060982, at *15 (Del. Ch. Dec. 16, 2015). In this case, Count III reframes the claims for breach set forth in the other counts. It performs no other work.

b. In an effort to keep Count III in the case, the Stockholder Representative argues that it may seek declarations about what steps Valeant is required to take to comply with the Merger Agreement going forward. The

Complaint does not currently plead a ripe dispute along those lines. Nor is it relief that the court likely would grant, given the difficulties involved in ongoing judicial supervision of the implementation of a commercial agreement. *See Carteret Bancorp., Inc. v. Home Gp., Inc.*, 1988 WL 3010, *8 (Del. Ch. Jan. 13, 1988) (Allen, C.). Although the *Carteret* case addressed the matter in the context of a request for an order of specific performance, the nebulous forward-looking relief that the Stockholder Representative alludes to here raises comparable concerns.

7. In Count IV of the Complaint, the Stockholder Representative asserts a claim for intentional misrepresentation. The defendants have moved to dismiss Count IV. This aspect of the defendants' motion is granted. Count IV fails to state a claim and is therefore dismissed.

a. "[C]ommon law fraud and intentional misrepresentation are essentially the same things." *Johnson v. Preferred Prof'l Ins. Co.*, 91 A.3d 994, 1017 (Del. Super. 2014). The elements are "(i) a false representation, (ii) the defendant's knowledge of or belief in its falsity or the defendant's reckless indifference to its truth, (iii) the defendant's intention to induce action based on the representation, (iv) reasonable reliance by the plaintiff on the representation, and (v) causally related damages." *Prairie Capital III, L.P. v. Double E Hldg. Corp.*, 132 A.3d 35, 49 (Del. Ch. 2015) (citing *Stephenson v. Capano Dev., Inc.*, 462 A.2d 1069, 1074 (Del. 1983)). A party cannot assert a claim for extra-contractual fraud if it has agreed in an anti-reliance provision that it has not relied on any information from its counterparty except what is set forth in the written

transaction agreement. *RAA Mgmt., LLC v. Savage Sports Hldgs., Inc.*, 45 A.3d 107, 118–19 (Del. 2012); *Abry P'rs V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032, 1058 (Del. Ch. 2006) (Strine, V.C.). *See generally* Steven M. Haas, *Contracting Around Fraud Under Delaware Law*, 10 Del. L. Rev. 49 (2008).

b. Section 6.1(w) of the Merger Agreement provided as follows:

> Reliance. In making its decision to execute and deliver this Agreement and to consummate the transactions contemplated by this Agreement, the Company has relied solely upon the representations and warranties of Parent and Merger Sub set forth in Section 6.2 (and acknowledges that such representations and warranties are the only representations and warranties made by Parent and Merger Sub) and has not relied upon any other information provided by, for or on behalf of Parent, Merger Sub or their Affiliates or Representatives, to the Company in connection with the transactions contemplated by this Agreement. The Company has entered into the transactions contemplated by this Agreement with the understanding, acknowledgement and agreement that no representations or warranties, express or implied, are made with respect to any projection or forecast regarding future results of operations or profitability of Parent or Merger Sub. The Company is not relying on, and acknowledges that no current or former stockholder, director, officer, employee, Affiliate, advisor or other Representative of Parent or Merger Sub or any other Person, has made or is making, any representations, warranties or commitments whatsoever regarding the subject matter of this Agreement, express or implied, other than the Ancillary Agreement.

MA § 6.1(w). This order refers to this provision as the "Company Anti-Reliance Representation."

c. If the Company had attempted to assert a claim for extra-contractual fraud, the Company Anti-Reliance Representation would result in dismissal. In this case, however, the Stockholder Representative is the party that has made the claim. The Stockholder Representative argues that the Company Anti-Reliance Representation only binds the Company. According to the Stockholder Representative, the stockholders did not make the same anti-reliance promise, so the Stockholder Representative can assert a claim for extra-contractual fraud.

d. There are at least two major problems with this argument. The first is that the Stockholder Representative is not entitled to bring any possible claim under the Merger Agreement. Under Section 11.4(h) of the Merger Agreement, "[t]he Stockholder Representative shall have the right to enforce and protect the rights and interests of the Stockholders and the SARs Holders arising out of or in any manner relating to this Agreement and each other agreement, document, instrument or certificate referred to herein or the transactions provided for herein . . . ." The Stockholder Representative thus only can bring a claim that the Company's stockholders otherwise could assert. The Complaint, however, does not plead that the Company's stockholders were defrauded. It does not identify any extra-contractual statements that were made to stockholders *qua* stockholders, only extra-contractual statements that were made to representatives of the Company acting as such during the negotiation of the Merger Agreement. Because those statements were made to the Company through its agents, only the

Company could have relied on them. For purposes of analyzing a claim for fraud, the question would therefore be whether the Company reasonably relied on the statements. Given the Company Anti-Reliance Representation, any reliance on extra-contractual representations would be unreasonable.

e. The second and broader problem is that, in light of a constellation of provisions in the Merger Agreement, including the Company Anti-Reliance Representation, the Company's stockholders could not reasonably rely on extra-contractual representations either. The obvious purpose of these provisions was to limit the representations made by both sides to the written representations in the agreement. The Company Anti-Reliance Representation accomplishes this on behalf of the Company. In a mirror-image provision, the Buyer and Merger Sub provided a reciprocal non-reliance representation. *See* MA § 6.2(i). Likewise, the Buyer and Merger Sub stated that no one from their side made any representations or warranties other than those set forth in the Merger Agreement. MA § 6.2(h). The Company provided a mirror-image representation that no one from its side made any representations or warranties other than those set forth in the Merger Agreement. MA § 6.1(v). The Merger Agreement contains an expansive integration clause. MA § 11.10. The Company signed on to this allocation of risk by executing the Merger Agreement.

f. Given this set of provisions, a stockholder of the Company could not reasonably rely on extra-contractual representations when approving the Merger Agreement. This is particularly true when the stockholders of the

Company who purportedly could assert the fraud claim were the principals of the Company who caused it to enter into the Merger Agreement. As a practical matter, the Stockholder Representative's argument would render the anti-reliance and limited representation provisions a nullity, because the same people would be able to bypass them by asserting claims for the same representations in their stockholder capacity. One might well wonder why sophisticated parties would go to the trouble of allocating risk through detailed representations and locking them down with anti-reliance and limited representation provisions if their counterparties could simply assert fraud in a different capacity. The Stockholder Representative concedes that no case has confronted this argument before. Although the Stockholder Representative views this positively as suggesting a question of first impression, I draw a different inference—namely, that everyone understands how these provisions work, and that invoking one's stockholder capacity does not render the provisions a nullity. Doubtless if the stockholders of the Buyer were suing the selling stockholders for fraud, the selling stockholders would be invoking the anti-reliance provision that the Buyer signed rather than blithely accepting that a party could bypass it at the stockholder level. Notably, this case does not involve specific allegations of a separate representation, made directly to a stockholder in its stockholder capacity, to induce the stockholder to sign the Merger Agreement. Everything that the Complaint cites was part of the negotiation between the Company and the Buyer, where the parties agreed that neither side would rely on extra-contractual representations.

g. In my view, it is not reasonably conceivable that a stockholder of the Company could reasonably rely on an extra-contractual representation when the Company itself disclaimed reliance and when the obvious purpose of the agreement as a whole was to limit the parties to contractually based representations. To the extent it relies on extra-contractual representations, Count IV is dismissed.

h. Although Count IV of the Complaint does not rely on any written representations in the Merger Agreement, the Stockholder Representative attempts in its opposition brief to recast one of its allegations as a claim for contractual fraud. The allegation is that "Valeant, through its then CEO, Mike Pearson, represented to Sprout's executive team that . . . Philidor was the best option to distribute Addyi, without disclosing Valeant's potential ownership interest in Philidor or its fraudulent conduct with Philidor, including the illegal billing practices used to sell Valeant's overpriced drugs." Compl. ¶ 99. The Stockholder Representative now claims that this allegation pled that Section 6.1(g), the Company's litigation-related representation, was false. The allegation plainly does not do that. It relies on an extra-contractual omission. The provisions of the Merger Agreement bar such a claim. *See Prairie Capital*, 132 A.3d at 54 ("[An anti-reliance] provision . . . has representation-defining effect, and that effect extends to claims based on omissions.").

Vice Chancellor J. Travis Laster
Dated: March 13, 2017