EFiled: Nov 14 2016 07:02PM EST
Transaction ID 59832089
Case No. 12729-VCMR

**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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|---|---|---|
| YVONNE WILLIAMS, on behalf of herself and similarly situated Sorrento Therapeutics, Inc. stockholders and derivatively on behalf of Sorrento Therapeutics, Inc., | ) | |
| Plaintiff, | ) | C.A. No. 12729-VCMR |
| v. | ) | |
| HENRY JI, WILLIAM S. MARTH, KIM D. JANDA, JAISIM SHAH, DAVID H. DEMING, DOUGLAS EBERSOLE, GEORGE NG, and JEFFREY SU, | ) | |
| Defendants, | ) | |
| and | ) | |
| SORRENTO THERAPEUTICS, INC., a Delaware corporation, | ) | |
| Nominal Defendant. | ) | |

# OPENING BRIEF IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS

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**TABLE OF CONTENTS**

PRELIMINARY STATEMENT ....................................................................1
BACKGROUND ....................................................................4
I. THE PARTIES ....................................................................4
II. SORRENTO OBTAINS UP TO $150 MILLION IN INVESTMENT TO FUND ITS CUTTING EDGE CANCER RESEARCH ......................6
III. THE YUHAN TRANSACTION CLOSES....................................................7
IV. SORRENTO DEVELOPS A CORPORATE STRUCTURE TO ATTEMPT TO MAXIMIZE FUTURE SHAREHOLDER VALUE ........8
1. Scintilla....................................................................10
2. Biologics....................................................................11
3. LA Cell....................................................................11
4. Concortis ....................................................................12
5. TNK Therapeutics....................................................................13
PROCEDURAL HISTORY ....................................................................15
I. WILDCAT LIQUID ALPHA FILES A BOOKS AND RECORDS CASE AND THEN FILES THE EARLIER WILDCAT ACTION ........15
II. FOUR MONTHS LATER, PLAINTIFF FILES THIS ACTION, WHICH IS DUPLICATIVE OF THE EARLIER WILDCAT ACTION ....................................................................16
ARGUMENT....................................................................16
I. LEGAL STANDARD ....................................................................16
II. PLAINTIFF FAILS TO STATE A CLAIM WITH RESPECT TO THE YUHAN VOTING AGREEMENT...............................................18
A. Voting Agreements Such As The Yuhan Voting Agreement Are Expressly Permitted Under Delaware Law....................................................................18
B. The Board Entered Into The Yuhan Voting Agreement For A Proper Purpose, And Plaintiff Fails To Plead Otherwise ....................................................................19

III. PLAINTIFF FAILS TO STATE A CLAIM WITH RESPECT TO THE GRANTS ....................................................................................22

A. Parent-Subsidiary Board Service Does Not Create A Conflict of Interest Under Delaware Law.............................22

B. Compensating Officers and Directors For Their Subsidiary Service Is Permissible Under Delaware Law .....23

C. Additionally, Plaintiff's Allegation that the Officer Defendants Received the Grants Does Not State A Claim...27

D. Even If The Court Were To Review The Grants To The Board Under An Entire Fairness Standard, Plaintiff's Claims Still Fail......................................................................27

IV. PLAINTIFF'S CLAIMS ARE UNRIPE.................................................28

A. Legal Standard ....................................................................28

B. Plaintiff's Yuhan Voting Agreement Claim Is Not Ripe......29

C. Plaintiff's Grants Claim Is Not Ripe....................................30

CONCLUSION..........................................................................................33

## TABLE OF AUTHORITIES

**Page(s)**

**Cases**

*In Re Allergan, Inc. Stockholder Litig.*,
2014 WL 5791350 (Del. Ch. Nov. 7, 2014) ....................30

*Amalgamated Bank v. Yahoo! Inc.*,
132 A.3d 752 (Del. Ch. 2016) ....................6

*Aronson v. Lewis*,
473 A.2d 805 (Del. 1984), *overruled in non-pertinent part by*
*Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) ....................17

*In re Chelsea Therapeutics Int'l Ltd. Stockholders Litig.*,
2016 WL 3044721 (Del. Ch. May 20, 2016) ....................31

*Kahn ex rel. DeKalb Genetics Corp. v. Roberts*,
679 A.2d 460 (Del. 1996) ....................20

*Freedman v. Adams*,
2012 WL 1345638 (Del. Ch. Mar. 30, 2012) ....................24

*H-M Wexford LLC v. Encorp, Inc.*,
832 A.2d 129 (Del. Ch. 2003) ....................17

*Hewlett v. Hewlett-Packard Co.*,
2002 WL 549137 (Del. Ch. Apr. 8, 2002) ....................18, 20

*Higher Educ. Mgmt. Grp., Inc. v. Mathews*,
2014 WL 5573325 (Del. Ch. Nov. 3, 2014) ....................6

*Lewis v. Hirsch*,
1994 WL 263551 (Del. Ch. June 1, 1994) ....................24

*Malpiede v. Townson*,
780 A.2d 1075 (Del. 2001) ....................17

*Multi-Fineline Electronix v. WBL Corp.*,
2007 WL 431050 (Del. Ch. Feb. 2, 2007) ....................29

*Rollins Int'l, Inc. v. Int'l Hydronics Corp.*,
303 A.2d 660 (1973) .......... 28

*Ryan v. Gifford*,
935 A.2d 258 (Del. Ch. 2007) .......... 27

*In re Santa Fe Pac. Corp. S'holder Litig.*,
669 A.2d 59 (Del. 1995) .......... 16, 17

*Schreiber v. Carney*,
447 A.2d 17 (Del. Ch. 1982) .......... 2, 18, 19, 20

*Sinclair Oil Corp. v. Levien*,
280 A.2d 717 (Del. 1971) .......... 19

*Stroud v. Milliken Enterprises, Inc.*,
552 A.2d 476 (Del. 1989) .......... 28

*Van de Walle v. Unimation, Inc.*,
1991 WL 29303 (Del. Ch. Mar. 7, 1991) .......... 23

*Warshaw v. Calhoun*,
221 A.2d 487 (Del. 1966) .......... 23, 26

*Weinberger v. Bankston*,
1987 WL 20182 (Del. Ch. Nov. 19, 1987) .......... 2, 19, 21

*Weinberger v. UOP*, *Inc.*,
457 A.2d 701 (Del. 1983) .......... 28

*In re Wheelabrator Techs., Inc. S'holders Litig.*,
1992 WL 212595 (Del. Ch. Sept. 1, 1992) .......... 17

*Wildcat Liquid Alpha, LLC v. Ji*,
C.A. No. 12338-VCMR .......... 1, 15, 16

*XL Specialty Ins. Co. v. WMI Liquidating Trust*,
93 A.3d 1208 (Del. 2014) .......... 29

**Statutes**

8 *Del. C.* § 122(5) .......... 24, 25

8 *Del. C.* § 122(15) .......... 24

8 *Del. C.* § 141(h)....................................................................................24

Delaware General Corporation Law Section 218(c) .............................................18

**Other Authorities**

Rule 12(b)(6)...........................................................................................1, 16

Defendants Henry Ji, William S. Marth, Kim D. Janda, Jaisim Shah, David H. Deming, Douglas Ebersole, George Ng, and Jeffrey Su and Nominal Defendant Sorrento Therapeutics, Inc. ("Sorrento" or the "Company") (collectively, "Defendants") respectfully submit this brief in support of their Motion to Dismiss Plaintiff's Verified Complaint (the "Complaint") pursuant to Court of Chancery Rule 12(b)(6).

## PRELIMINARY STATEMENT

Belatedly seeking to tag along with an action filed four months before, Plaintiff has brought a second action nearly identical to that in the case captioned *Wildcat Liquid Alpha, LLC v. Ji*, C.A. No. 12338-VCMR ("Earlier Wildcat Action"). But, Plaintiff's tag-along action fails for the same reasons as the Earlier Wildcat Action. Before waiting for a ripe claim, Plaintiff challenges two valid exercises of the prior Board of Director's (the "Board's") business judgment. Specifically, Plaintiff challenges: (1) a standard voting agreement between Sorrento and a new small investor, Yuhan Corporation ("Yuhan"), designed to prevent Yuhan, a potential competitor, from voting its small 2.75% of shares against the best interests of Sorrento (the "Yuhan Voting Agreement"); and (2) the Board's decision to establish stock incentive plans at its five subsidiaries to permit them to make routine option and warrant grants to the subsidiaries' own officers, directors and consultants in order to reasonably compensate those persons for

service to the subsidiaries (the "Grants"). As both of these decisions were well within the Board's reasonable business judgment – indeed, they pass muster easily compared to the bare allegations in the Complaint under any review standard – Plaintiff's claims fail and the "me-too" Complaint must be dismissed. In addition, and perhaps best addressed first by the Court, neither Plaintiff nor Sorrento have suffered any concrete injury; thus, both claims are not ripe.

To attempt to bypass the insurmountable hurdle of the business judgment rule, Plaintiff claims, incorrectly, that the Board derived some improper benefit from each of the challenged decisions. Plaintiff is wrong on both accounts.

First, with respect to the Yuhan Voting Agreement, Delaware courts have recognized that there is nothing improper about the management of a company entering into a voting agreement when it is done for a valid purpose. *Weinberger v. Bankston*, 1987 WL 20182, at *4 (Del. Ch. Nov. 19, 1987); *Schreiber v. Carney*, 447 A.2d 17, 25-26 (Del. Ch. 1982). Here, Plaintiff fails to plead any *facts* (not conclusions) to support the claim that Defendants entered into the Yuhan Voting Agreement for an improper purpose. In fact, the transaction documents tell the true story, showing that the Yuhan Voting Agreement was part of a transaction with a potential competitor whose interests could diverge from Sorrento, where the transaction with Yuhan brought $10 million in investments into Sorrento as a small part of a total of $150 million in new investments.

Second, Plaintiff challenges the decision by Sorrento's Board to establish typical stock incentive plans to permit each of its five subsidiaries' boards to award options and warrant grants to subsidiary officers, subsidiary board members and consultants for service to the subsidiaries. But, without any facts to show the compensation was excessive by some measure compared to the work to be performed – and Plaintiff alleges no such facts, just speculation about what might or might not happen in the future – Plaintiff has not pled a proper case for breach of fiduciary duty whether under business judgment review, "entire fairness" analysis, or any other review standard that may be applied. Plaintiff also fails to plead a case against the two officers that it named as defendants (George Ng and Jeffrey Su), who did not participate in the Board's decision to award the Grants, but rather simply received compensation for the work they are and will be doing for the five subsidiaries.

Finally, Plaintiff's claims regarding the Yuhan Voting Agreement and the Grants should be dismissed for another reason – both claims are unripe:

- Yuhan Voting Agreement. Plaintiff has not alleged facts to show that any vote is about to occur; that the agreement has actually been used for any improper purpose; or that potential voting of 2.75% of Sorrento's shares has harmed Plaintiff or would realistically matter to any vote.

- Grants. Sorrento and its subsidiaries are in the business of developing new treatments, none of which have generated any revenue or even been approved for sale. Plaintiff's allegations about the value of the subsidiaries are based on their potential speculative value at some future date if they achieve their desired result. If and when any of these events occur, and after the Court can assess the amount of effort put in by the Defendants to achieve those results, then one can judge the fairness of the compensation paid to the subsidiary officers, directors and consultants. As of now, Sorrento and its shareholders have not suffered any actual injury, and any comparison of the measure of the grants' worth versus the work performed for that value is simply speculative.

## BACKGROUND

### I. THE PARTIES

Sorrento is a company dedicated to developing cutting edge treatments for cancer and other unmet medical needs using its proprietary antibody technologies. (Compl. ¶ 20.) Sorrento currently has several clinical development programs underway, and recently sought new investments to support its important and groundbreaking work. (Compl. ¶¶ 20, 70.)

Dr. Henry Ji, Ph.D. founded Sorrento in 2006 and has served as a director ever since. (Compl. ¶ 9.) Starting in September 2012, Dr. Ji has served as Sorrento's President and CEO. (*Id.*) In addition to Dr. Ji, at the time of the events at issue in the Complaint, there were five independent, non-employee members of the Sorrento Board of Directors, each of whom has been named as a defendant in this lawsuit (Compl. ¶¶ 10-14)[1]:

- **William S. Marth**, the Chairman of the Board, is the current President and CEO of Albany Molecular Research, Inc. and the former President and CEO of Teva – Americas, one of the largest pharmaceutical companies in the world.

- **David H. Deming** is a banker with TAG Healthcare Advisors, LLC, a boutique advisory firm. He has over 35 years of banking experience, including 27 years with J.P. Morgan, where he ran the healthcare investment banking group for 12 years.

- **Douglas Ebersole** is a healthcare consultant who primarily works with PDL BioPharma, with whom he has worked for over a decade. Prior to his work with PDL BioPharma, Mr. Ebersole was partner in a Silicon Valley law firm and general counsel of NeXT Computer.

- **Dr. Kim D. Janda** has been the Ely R. Callaway, Jr. Chaired Professor in the Departments of Chemistry, Immunology and Microbial Science at The Scripps Research Institute ("Scripps") since 1996 and the Director of the Worm Institute of Research and Medicine at Scripps since 2005.

- **Jaisim Shah** is Chief Executive Officer and a board member at Semnur Pharmaceuticals, which focuses on developing non-opioid medication for the treatment of back pain.

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[1] Douglas Ebersole resigned from the Board on August 1, 2016 for personal reasons and was replaced by Dr. Yue Alexander Wu, Ph.D. (Compl. ¶ 19.)

In addition to the Board, Plaintiff has also named as defendants two officers of Sorrento as Defendants (the "Officer Defendants") (Compl. ¶¶ 15-16):

- **George Ng** has served as Sorrento's Executive Vice President, Chief Administrative Officer, and Chief Legal Officer since March 2015.
- **Jeffrey Su** has served as Sorrento's Executive Vice President and Chief Operating Officer since October 2015.

Plaintiff Yvonne Williams purports to be a Sorrento shareholder, although she does not allege how many shares she owns or how she got them. (Compl. ¶ 6.)

## II. SORRENTO OBTAINS UP TO $150 MILLION IN INVESTMENT TO FUND ITS CUTTING EDGE CANCER RESEARCH

Sorrento is engaged in the development of cutting-edge treatments for cancer and other unmet medical needs. (Compl. ¶ 20.) As is typical for a clinical stage pharmaceutical company, Sorrento sought additional investment in order to try to accelerate its clinical development efforts. (Compl. ¶ 70; Ex. 1 (April 3, 2016 Form 8-K).)[2]

Specifically, on April 3, 2016, Sorrento entered into four separate Securities Purchase Agreements: one with Yuhan, a prominent, publicly-listed Korean

[2] As Plaintiff has incorporated many Sorrento SEC filings into the Complaint by reference, Defendants have attached them as exhibits hereto for the Court's consideration. *See Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 797 (Del. Ch. 2016) ("The incorporation-by-reference doctrine permits a court to review the actual document to ensure that the plaintiff has not misrepresented its contents and that any inference the plaintiff seeks to have drawn is a reasonable one."); *Higher Educ. Mgmt. Grp., Inc. v. Mathews*, 2014 WL 5573325, at *12 n.73 (Del. Ch. Nov. 3, 2014) ("At this motion to dismiss stage, this Court may take judicial notice of publicly available facts such as those contained in filings made with the SEC.").

pharmaceutical company (the "Yuhan Transaction") and three with institutional investors (all collectively, the "Transactions"). (*Id.*) The Transactions involved the sale of shares of common stock and warrants to purchase Sorrento common stock for a total of up to $150 million, money which could then be used to fund additional research and development. (*Id.*) The Transactions were made at purchase prices *above* the then-market price for Sorrento stock. (*Id.*) Sorrento's stock *rose* on their announcement.

## III. THE YUHAN TRANSACTION CLOSES

On April 29, 2016, the Yuhan Transaction closed. (Compl. ¶ 71; Ex. 2 (May 2, 2016 Form 8-K).) The Yuhan Transaction was the smallest of the Transactions, involving only $10 million of the $150 million being invested into Sorrento. (*Id.*) As a result, Yuhan obtained approximately 2.75% of outstanding Sorrento shares and warrants to buy additional shares. As described in the May 2, 2016 Form 8-K filed in connection with the closing, Yuhan is "one of the largest and most respected pharmaceutical companies in South Korea." (Ex. 2 (May 2, 2016 Form 8-K).) As a large pharmaceutical company, Yuhan might have competing interests with Sorrento. Therefore, as a condition of the Yuhan Transaction, Sorrento required Yuhan to enter into the Yuhan Voting Agreement, pursuant to which Yuhan agreed to vote its shares as instructed by the Board. (*Id.*) Because the other three transactions, totaling $140 million of the $150 million invested, involved

institutional investors, not potential competitors, Sorrento did not need to obtain voting agreements from them. (Compl. ¶ 72.)

## IV. SORRENTO DEVELOPS A CORPORATE STRUCTURE TO ATTEMPT TO MAXIMIZE FUTURE SHAREHOLDER VALUE

In addition to seeking outside investment, Sorrento also took other steps to increase working capital and maximize shareholder value. Upon the advice of its advisors, Sorrento adopted a corporate structure not uncommon in the industry to help realize the full value of its assets. (Compl. ¶ 21.) Under this corporate structure, Sorrento has created five subsidiaries to which it could seek to transfer assets that Sorrento believed to be undervalued when held at the parent level. (*Id.*) Sorrento could then either cause any or all of the subsidiaries to raise capital on the asset (for example, by incurring debt) or otherwise monetize the asset (for example, via an offering of a minority of the subsidiary's shares) as valued on a standalone basis.

As is typical in parent/subsidiary corporate structures, Sorrento and the five subsidiaries desired to share officers and directors (and to accordingly have those persons perform additional work for the subsidiaries). In light of the fact that these directors and officers would be taking on additional responsibilities, the subsidiaries' boards opted to provide them reasonable compensation similar to the compensation they receive for their service to Sorrento. As such, the subsidiaries issued the Grants to their personnel, directors and consultants pursuant to the

subsidiaries' respective stock option plans. (Compl. ¶¶ 23, 32, 36, 48, 52; Ex. 3 (March 15, 2016 Form 10-K); Ex. 4 (April 29, 2016 Am. 1 to Form 10-K).)

Properly understood, then, the Sorrento Board decision that is being challenged by Plaintiff on behalf of Sorrento is the decision to have the subsidiaries that were formed[3] create stock incentive plans and issue options and shares (rather than have Sorrento take 100% of the subsidiary shares) in order to compensate subsidiary officers, directors and employees, including members of the Sorrento Board who would be doing work for the subsidiaries.

Plaintiff fails to allege any facts to show that the Grants were excessive in relation to the work to be performed by the Board and Officer Defendants. Indeed, in the same 10-K disclosing the Grants, Sorrento disclosed that neither Sorrento nor its subsidiaries have yet ever generated *any* product-based revenue:

> We have not generated any product related revenues to date, and do not expect to generate any such revenues for at least the next several years, if at all. To obtain revenues from sales of our product candidates, we must succeed, either alone or with third parties, in developing, obtaining regulatory approval for, manufacturing and marketing products with commercial potential. We may never succeed in these activities, and we may not generate sufficient revenues to continue our business operations or achieve profitability.

(Ex. 3 (March 15, 2016 10-K) at 19.) Because none of the five subsidiaries identified in the Complaint have any products on the market, Plaintiff instead

[3] The initial Board decision to form the subsidiaries is not being challenged and was obviously within the business judgment rule.

speculates about the potential *future* value of each of the five subsidiaries. But as discussed in detail below, none of these plans have yet come to fruition, and if and when they do, it will presumably be because of a commensurate amount of work performed by the Board and Officer Defendants to make any or all of the subsidiaries a success.[4] A separate description of each of the five subsidiaries, based on allegations in Plaintiff's Complaint, follows.

***1. Scintilla***

Plaintiff alleges that a first Sorrento subsidiary, Scintilla, entered into a binding term sheet to purchase all of the outstanding equity of Scilex Pharmaceuticals, Inc. ("Scilex"). (Compl. ¶ 25.) But as disclosed on November 8, 2016, the transaction between Scintilla and Scilex has been terminated and is not moving forward. (Ex. 5 (November 8, 2016 8-K).)

Plaintiff also alleges that Scintilla entered into a binding term sheet to purchase all of the outstanding equity of Semnur Pharmaceuticals, Inc.

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[4] Sorrento has disclosed that for accounting purposes, it has recorded vested Grants to the Board as an expense totaling $125,000 for the nine months ending September 30, 2016 and unvested Grants to the Board as an expense totaling $409,000 over three years. (Ex. 6 (November 9, 2016 10-Q).) Thus, even if Plaintiff attempted to amend the Complaint to base it on the actual current fair value of the options rather than some speculative future value, Plaintiff would be hard pressed to allege the Board was excessively compensated by this relatively minor compensation. As one measure, for six directors' service on five boards, the total compensation roughly averages out to $17,800 per director per board over a four-year period. It would be hard for Plaintiff to argue with a straight face that such compensation was not reasonable, especially in light of the Board members' qualifications.

("Semnur"). (Compl. ¶ 26.) The Semnur transaction has not yet closed and in the event that the Semnur transaction does close, any value resulting from the transaction remains speculative. As disclosed, Semnur's leading product is still undergoing clinical trials. (Ex. 7 (August 17, 2016 8-K).) Indeed, in speaking of the transaction, Semnur's CEO spoke of the "***potential***" of their leading product. (*Id.* (emphasis added).) Thus, any actual benefit to Scintilla of the Semnur transaction, together with the amount of effort by the Board and the Officer Defendants to make the acquisition a success, remains to be determined.

***2. Biologics***

Plaintiff alleges that a second Sorrento subsidiary, Biologics, holds a license agreement with Mabtech Limited to "***develop and commercialize***" certain antibodies. (Compl. ¶ 30 (emphasis added).) But like the Semnur transaction, all of these antibodies have yet to be developed, approved, or commercialized, and the amount of work to be performed by the Board and the Officer Defendants to develop the antibodies and obtain the approvals necessary to bring them to market, if they are indeed able to do so, is yet to be determined.

***3. LA Cell***

Plaintiff alleges that a third Sorrento subsidiary, LA Cell, licensed technology from City of Hope. (Compl. ¶¶ 38-40.) As described in the press release announcing the transaction, the technology licensed from City of Hope

could "***potentially*** enabl[e] a wave of new therapeutics" and the combination of technologies might "enable the ***development*** of effective antibody therapies against crucial yet elusive intracellular targets." (Ex. 8 (September 30, 2015 8-K) (emphasis added).) Again, LA Cell simply licensed technology with the understanding that it would need to engage in substantial work to develop a pharmaceutical, get it tested and hopefully approved, and then bring it to market. The amount of the work to be performed and its ultimate value are all a matter for the future.

***4. Concortis***

Plaintiff alleges that a fourth Sorrento subsidiary, Concortis: (1) generates revenue significant to Sorrento's revenue growth and (2) entered into a collaboration agreement with Morphotek to "generate novel antibody drug conjugates." (Compl. ¶¶ 46-47.) First, Plaintiff's description of Concortis's purported revenue generation omits key details. While Concortis did generate a small amount of revenue stemming from the "sale of customized reagents and providing contract development services," Plaintiff failed to mention that it also incurred significant *costs* of revenue stemming from these same offerings. (Ex. 3 (March 15, 2016 10-K) at 52-53 (cost of revenue increased due to "a full year of the sale of customized reagents and providing contract development services compared to the costs from our mid December 2013 acquisition of Concortis

through the prior year-end.").) And, Plaintiff's claim that Concortis's small amount of revenue drove Sorrento's revenue growth ignores the fact that, as described above, Sorrento has no products on the market and is not otherwise a revenue-generating company.

Second, Plaintiff alleges that Concortis "announced a collaboration with Morphotek to generate novel antibody drug conjugates." (Compl. ¶ 47.) But in the press release announcing the collaboration, the President and CEO of Morphotek noted, "we ***hope*** to utilize the full ***potential*** of our Morphotek antibody by developing agents that ***may have*** an enhanced efficacy and safety profile." (Ex. 9 (June 25, 2014 8-K) (emphasis added).) Yet again, any potential commercial success stemming from the collaboration, as well as the work that it will entail, is entirely speculative at this point.

***5. TNK Therapeutics***

Plaintiff alleges that Sorrento and its fifth subsidiary, TNK, entered into agreements to purchase the membership interests in CARgenix Holdings LLC (CARgenix) and the outstanding stock of BDL Products, Inc. on August 7, 2015. (Compl. ¶¶ 53-54, 56.) As described in the press release announcing the transactions, through these agreements, TNK acquired ***pre-clinical and clinical stage*** CAR-T programs which focus on targeting solid tumors as well as infectious diseases. (Ex. 10 (August 10, 2015 8-K).) Both transactions are contingent on a

"capital-raising financing resulting in gross proceeds to TNK of at least $50 million" and if such a financing did not occur by a certain deadline, the sellers would receive a certain amount of Sorrento stock. To date, no such capital-raising financing has occurred, and the sellers of CARgenix received 309,917 shares of Sorrento stock instead of the $6 million in TNK Class A common stock (the deadline for the BDL transaction is in March 2017). (Ex. 6 (November 9, 2016 10-Q).) As there has been neither a successful product nor a capital-raising financing, TNK has not monetized its acquisition and the value of TNK options or warrants is entirely speculative.

Plaintiff next alleges that Sorrento and TNK entered into a binding term sheet to license technology from Cytolumina Technologies Corp. and Fetolumina Technologies Corp. in August 2015. (Compl. ¶ 55.) But Plaintiff has not alleged that this transaction closed or moved forward, or otherwise benefitted TNK. (*Id.*) Plaintiff also alleges that Sorrento entered into a partnership with the Karolinska Institutet, but fails to allege that any assets resulting from that partnership were transferred to TNK. (Compl. ¶ 58.)

Finally, Plaintiff alleges that TNK entered into a joint venture agreement with Shenyang Sunshine Pharmaceutical Company Ltd. "to ***develop and commercialize*** proprietary immunotherapies." (Compl. ¶ 58 (emphasis added).)

As before, Plaintiff fails to allege that TNK achieved any monetary success from this joint venture, and any potential future success in entirely speculative.

## PROCEDURAL HISTORY

### I. WILDCAT LIQUID ALPHA FILES A BOOKS AND RECORDS CASE AND THEN FILES THE EARLIER WILDCAT ACTION

Following Sorrento's announcement of the Transactions, on April 11, 2016, Wildcat Liquid Alpha ("WLA") sent Sorrento a legally-deficient letter demanding inspection of Sorrento's books and records. After Sorrento pointed out the deficiencies of the demand, WLA refused to try to cure it, and instead brought an action in this Court on April 25, 2016. (C.A. No. 12254-VCMR.)

Then, on May 13, 2016, WLA filed the Earlier Wildcat Action alleging claims identical to those in this case: alleged breaches of fiduciary duty that it claims arose from, *inter alia*, the Yuhan Voting Agreement and the Grants. (C.A. No. 12338-VCMR.) On August 12, 2016, WLA filed an amended complaint to reflect the fact that its original complaint was based on the incorrect speculation that all of the Transactions involved voting agreements, and not just the Yuhan Transaction. In its amended complaint, WLA brought its claim with respect to the Grants derivatively, and its claim with respect to the Yuhan Voting Agreement both derivatively and directly. On September 14, 2016, Sorrento and the Board moved to dismiss the Earlier Wildcat Action. That motion to dismiss is currently pending before the Court. Accordingly, the issues that Plaintiff seeks to raise in

this case are already pending before the Court in the Earlier Wildcat Action (and have been for approximately four months).

## II. FOUR MONTHS LATER, PLAINTIFF FILES THIS ACTION, WHICH IS DUPLICATIVE OF THE EARLIER WILDCAT ACTION

Perhaps because the filing of WLA's amended complaint caught Plaintiff's and her counsel's attention, on September 8, 2016, nearly five months after WLA made its initial books and records demand, and about four months after the Earlier Wildcat Action, Plaintiff filed this action. Like the Earlier Wildcat action, Plaintiff alleges breaches of fiduciary duty that it claims arose from the Yuhan Voting Agreement and the Grants. This Motion to Dismiss (and a concurrent Motion to Stay in the alternative) followed.

# ARGUMENT

## I. LEGAL STANDARD

Under Delaware Court of Chancery Rule 12(b)(6), a complaint should be dismissed when its allegations fail to state a claim upon which relief can be granted. When considering a motion to dismiss, the court accepts as true only well-pleaded facts alleged in the complaint. *See In re Santa Fe Pac. Corp. S'holder Litig.,* 669 A.2d 59, 65 (Del. 1995). But "[c]onclusory allegations will not be accepted as true without specific supporting factual allegations." *Id.* at 65-

66; *see also H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 139 (Del. Ch. 2003).

In addition, the trial court "need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences." *H-M Wexford LLC*, 832 A.2d at 139.[5]

Delaware law presumes that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled in non-pertinent part by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). The burden of rebutting this strong presumption falls on Plaintiff. *Aronson*, 473 A.2d at 812.

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[5] It is proper for the Court to consider a document attached to the complaint when the document is incorporated by reference into the complaint. *See id.; see generally In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d at 69-70 (citing numerous instances where Delaware and federal courts have considered documents referred to in a plaintiff's complaint when considering a motion to dismiss). "A complaint may, despite allegations to the contrary, be dismissed where the unambiguous language of documents upon which the claims are based contradict the complaint's allegations." *H-M Wexford LLC*, 832 A.2d at 139 (citations omitted); *see also Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001) ("[A] claim may be dismissed if allegations in the complaint or in the exhibits incorporated into the complaint effectively negate the claim as a matter of law." (citations omitted)); *In re Wheelabrator Techs., Inc. S'holders Litig.*, 1992 WL 212595 at *3 (Del. Ch. Sept. 1, 1992) ("[T]he Court is hardly bound to accept as true a demonstrable mischaracterization and the erroneous allegation that flows from it.").

## II. PLAINTIFF FAILS TO STATE A CLAIM WITH RESPECT TO THE YUHAN VOTING AGREEMENT

### A. Voting Agreements Such As The Yuhan Voting Agreement Are Expressly Permitted Under Delaware Law

Plaintiff fails to state a claim that the Board breached their fiduciary duty by entering into the Yuhan Voting Agreement because voting agreements, even those bought by management, are permissible under Delaware law. Section 218(c) of the Delaware General Corporation Law expressly sanctions voting agreements, providing:

> An agreement between 2 or more stockholders, if in writing and signed by the parties thereto, may provide that in exercising any voting rights, the shares held by them shall be voted as provided by the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed upon by them. 8 *Del. C.* § 218(c).

Furthermore, the Court of Chancery has held that "a vote-buying agreement is not illegal per se, *even when company management is buying votes*." *Hewlett v. Hewlett-Packard Co.*, 2002 WL 549137, at *5 (Del. Ch. Apr. 8, 2002) (emphasis added). Indeed, in *Hewlett*, Chancellor Chandler emphasized that "[i]t is certainly possible for management to enter into vote-buying arrangements with salutary purposes." *Id.* at *7.

Similarly, in *Schreiber v. Carney*, 447 A.2d 17, 25-26 (Del. Ch. 1982), the court denied plaintiff's motion for summary judgment in a derivative lawsuit where management offered a loan to shareholder in exchange for votes in favor of

a merger. The court held that "voting agreements in whatever form, therefore, should not be considered to be illegal *per se* unless the object or purpose is to defraud or in some way disenfranchise the other stockholders." *Id.* Noting that Plaintiff offered nothing "from which an inference of a fraudulent object or purpose can be drawn" or to show that the voting agreement was "motivated and accomplished except with the best interests of all Texas International stockholders in mind," the court rejected plaintiff's claim that the voting agreement defrauded shareholders. *Id.*

### B. <u>The Board Entered Into The Yuhan Voting Agreement For A Proper Purpose, And Plaintiff Fails To Plead Otherwise</u>

As was the case in *Schreiber*, Plaintiff's claim should be denied because Plaintiff fails to specifically plead facts to show that the Board had any purpose in entering into the Yuhan Voting Agreement other than the salutary purpose of protecting the Company from a competitor. To plead a claim based on a voting agreement, a plaintiff must allege *specific facts* demonstrating that "the object or purpose [of the voting agreement] is to defraud or in some way disenfranchise the other stockholders." *Schreiber*, 447 A.2d at 26-27; *see also Weinberger*, 1987 WL 20182, at *4 (rejecting claim based on voting agreement where "Plaintiff offers no facts indicating that the purpose of the settlement was to defraud or disenfranchise stockholders"). Further, Plaintiff's allegations must be sufficient to overcome the presumption that the Board acted with a proper purpose. *See Sinclair Oil Corp. v.*

*Levien*, 280 A.2d 717, 720 (Del. 1971) (the business judgment rule applies to the Board's action unless the decision cannot be "attributed to any rational business purpose."). Plaintiff has not met this high burden. This is particularly true given:

1. **There was no existing threat to corporate control at the time the Yuhan Voting Agreement was entered into by Sorrento**. *See Kahn ex rel. DeKalb Genetics Corp. v. Roberts*, 679 A.2d 460, 466 (Del. 1996) ("Absent an actual threat to corporate control or action substantially taken for the purpose of entrenchment, the actions of the board are judged under the business judgment rule."). Plaintiff's Complaint does not and cannot, for example, allege that there was a known contested election, merger, or other transformational corporate event where there was a close shareholder vote. *Cf. Hewlett,* 2002 WL 549137 at *4, *7 (involving a "hotly contested proxy contest about an extraordinary transaction that would significantly transform the corporation" and "an extremely narrow margin of victory"); *Schreiber*, 447 A.2d at 19 (involving voting agreement with shareholder who threatened to block merger).[6]

2. **Plaintiff has not and cannot plead that the 2.75% of outstanding shares governed to the Yuhan Voting Agreement is material to control of Sorrento**. The court has rejected entrenchment claims where the amount of stock

[6] Plaintiff does not even allege that the Defendants' Board seats were at risk, and in fact, the opposite was true. On June 30, 2016, every Board member was easily reelected without a single vote against them. (Ex. 11 (June 30, 2016 Form 8-K)).

governed by a voting agreement was minimal. *Weinberger*, 1987 WL 20182 at *4 (rejecting claim that voting agreement disenfranchised shareholders where agreement governed only 4% of outstanding stock).

3. **The court has held that where a voting agreement is part of a larger transaction, it should be considered in the context in which it was negotiated**. *Weinberger*, 1987 WL 20182 at *4. In *Weinberger*, the court rejected a similar, conclusory claim that a company had entered into a voting agreement in the context of a litigation settlement in order to "disenfranchise" stockholders. *Id.* Under the terms of the settlement, the corporation, TI paid two shareholders a sum of money in exchange for dismissal of the lawsuit and an irrevocable proxy with respect to their shares. *Id.* at *1. Another shareholder then filed a derivative action challenging the settlement agreement alleging that the proxy "disenfranchised the company's stockholders and was a form of unlawful vote buying." *Id.* at *4. The court rejected this claim since, as in this case, plaintiff "offer[ed] no facts indicating that the purpose of the settlement was to defraud or disenfranchise stockholders." *Id.* The court also noted that, as here, "the corporation received substantial financial and non-pecuniary benefits from the Settlement Agreement." *Id.* And again, as here, the court also noted that it was "clear from the terms of the Settlement Agreement itself that the proxy provisions in that agreement represent one of the less important aspects of the overall settlement." *Id.*

## III. PLAINTIFF FAILS TO STATE A CLAIM WITH RESPECT TO THE GRANTS

Plaintiff's allegations regarding the Grants are equally meritless. Plaintiff alleges that Sorrento's five subsidiaries each granted various options and warrants to Defendants, who serve as officers and directors of both Sorrento and its subsidiaries. (Compl. ¶¶ 98-100.) But this does not state a claim. As discussed below, there is nothing improper about: (1) a parent and subsidiaries sharing officers and directors, (2) a parent transferring assets to its subsidiaries to achieve a higher valuation, or (3) a subsidiary compensating its officers and directors for their service. Further, Plaintiff has failed to allege *facts* to show that the Grants were excessive as compared to the expected service by any measure. As Plaintiff fails to allege *facts* (not conclusions) showing that the Grants were anything other than routine compensation of Defendants for additional work in service to the subsidiaries, it fails to state a claim.

### A. <u>Parent-Subsidiary Board Service Does Not Create A Conflict of Interest Under Delaware Law</u>

First, Plaintiff fails to state a claim based on the fact that Defendants caused Sorrento to transfer assets to its subsidiaries because such transfers were a proper exercise of Defendants' business judgment, which is presumed even in the case of shared officers and directors. There is no inherent conflict when a parent and its subsidiaries share directors and officers, and indeed it is very common. *See*

*Warshaw v. Calhoun*, 221 A.2d 487, 492 (Del. 1966) ("Individuals who act in a dual capacity as directors of two corporations, one of whom is parent and the other subsidiary, owe the same duty of good management to both corporations. This duty is to be exercised in the light of what is best for both corporations."). Furthermore, there is no conflict where a shared board of directors monetizes assets of a subsidiary. *See Van de Walle v. Unimation, Inc.*, 1991 WL 29303, at *11 (Del. Ch. Mar. 7, 1991). For example, in *Van de Walle*, the court found that there was no conflict of interest when shared directors of parent and subsidiary voted to sell the subsidiary because both companies had an interest in achieving a fair price for the asset. *Id.*

Here, both Sorrento and its subsidiaries have an interest in ensuring that assets are properly valued, a goal which, in their judgment, can be achieved by transferring assets to subsidiaries, where the assets can be valued on a standalone basis. And, Plaintiff fails to plead otherwise. Plaintiff simply pleads that the Company transferred Company assets to its subsidiaries, but does not plead any conflict of interest or extreme lack of consideration between Sorrento and its subsidiaries that could make such a transfer improper.

### B. Compensating Officers and Directors For Their Subsidiary Service Is Permissible Under Delaware Law

Second, there is nothing improper about directors and officers receiving compensation from a subsidiary for their additional service to that subsidiary, and

such compensation falls within the (subsidiary) board's business judgment. *See* 8 *Del. C.* § 122(5) (corporation has power to "[a]ppoint such officers and agents as the business of the corporation requires and to pay or otherwise provide for them suitable compensation"); 8 *Del. C.* § 141(h) ("Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors shall have the authority to fix the compensation of directors."); 8 *Del. C.* § 122(15) (corporation has power to "[p]ay pensions and establish and carry out pension, profit sharing, stock option, stock purchase, stock bonus, retirement, benefit, incentive and compensation plans, trusts and provisions for any or all of its directors, officers and employees, and for any or all of the directors, officers and employees of its subsidiaries."). As a general matter, executive compensation is precisely the type of board decision that is protected by the business judgment rule. *Lewis v. Hirsch*, 1994 WL 263551, at *3 (Del. Ch. June 1, 1994) ("[E]xecutive compensation is a matter ordinarily left to the business judgment of a company's board of directors."); *Freedman v. Adams*, 2012 WL 1345638, at *14 (Del. Ch. Mar. 30, 2012) ("'[I]n the absence of fraud the Court's deference to the directors' business judgment is particularly broad in matters of executive compensation.'") (quoting *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 362 (Del. Ch.1998)).

Here, Plaintiff simply alleges that the Board caused Sorrento's subsidiaries to make the Grants. But without more, there is nothing improper about Defendants

being compensated for their service as officers and directors of the subsidiaries. Although Plaintiff characterizes the Grants as "looting," there are no *facts* pled to show that extra pay for extra work was outlandish, and a review of the March 15 10-K disclosing the Grants that was incorporated by reference into the Complaint clearly shows that the Grants were awarded pursuant to Stock Option Plans adopted by each of the subsidiaries to compensate company personnel, directors and consultants. (Compl. ¶ 63; Ex. 3 (March 15, 2016 Form 10-K).) Plaintiff also complains that Dr. Ji obtained warrants in the subsidiaries after becoming President and CEO. (Compl. ¶¶ 23(b), 32(b), 36(b), 48(b), 52(b).) But it is a reasonable exercise of the Board's business judgment to compensate an officer who has taken on additional leadership responsibilities at a subsidiary. *Cf.* 8 *Del. C.* § 122(5) (corporation has power to compensate officers).

Furthermore, Plaintiff has failed to allege that the Grants were excessive. While Plaintiff speculates about what the value of the Grants might be years in the future if the subsidiaries are able to successfully develop, gain the required approvals for, and bring to market a novel pharmaceutical, she does not acknowledge that it is also possible that any or all of the five subsidiaries might never develop a marketable product. Nor does Plaintiff compare that speculative value to the work that must necessarily be performed if any of the subsidiaries actually do succeed in achieving their goals.

Beyond the general ability of a corporation to compensate its officers and directors, the court has specifically held that director compensation by a subsidiary does not itself give rise to a fiduciary duty claim. In *Warshaw*, shareholders of a parent company claimed that the shared parent/subsidiary directors breached their fiduciary duties to the parent by selling certain rights of the parent to purchase shares in the subsidiary, claiming that they were motivated by compensation received from the subsidiary. 221 A.2d at 493 ("The plaintiff suggests that the salaries paid them by [Subsidiary] were their real motive, and that they had no real interest in the welfare of [Parent]."). The Court rejected this argument, holding that "the mere statement of fact of salary payments by [Subsidiary] to some of the [Parent] directors does not, in itself, overcome the presumption of good faith accorded to the acts of directors." *Id.* Similarly, the fact that Sorrento's subsidiaries compensate their directors and officers for their service does not overcome the presumption that they acted in good faith in approving asset transfers, and Plaintiff has failed to plead any facts alleging otherwise. Because Sorrento's subsidiaries are allowed to compensate their officers and directors, even when they are shared with Sorrento, the fact that Defendants were awarded the Grants does not state a claim.

### C. **Additionally, Plaintiff's Allegation that the Officer Defendants Received the Grants Does Not State A Claim**

Furthermore, Plaintiff does not state a claim against the Officer Defendants, as simply receiving stock options does not give rise to a cause of action against an officer-recipient. As Chancellor Chandler explained in *Ryan v. Gifford*, 935 A.2d 258, 270 (Del. Ch. 2007), "merely holding and allowing options to vest is unrelated to the duties an officer owes to the corporation; it is instead merely incidental to employment with a corporation and the compensation or incentive structure the corporation utilizes."[7] Because Plaintiff does not allege that the Officer Defendants did anything other than receive the Grants, the claims must be dismissed with respect to them.

### D. **Even If The Court Were To Review The Grants To The Board Under An Entire Fairness Standard, Plaintiff's Claims Still Fail**

Plaintiff will argue that the Board Grants should be reviewed under an entire fairness standard of review because the Board members were interested in those transactions. But the standard of review here does not matter much when Plaintiff has not pled any *facts* to support the claim that any of the Grants were excessive

[7] Chancellor Chandler also found that even the receipt of improperly granted options did not give rise to a claim where there was no allegation that the officer knew of the impropriety. *Ryan*, 935 A.2d at 27 ("To conclude otherwise would be akin to holding an officer liable for depositing a check fraudulently issued to him by the company when the officer has no knowledge of and did not participate in the wrongful issuance."). Here, Plaintiff has not alleged that the Officer Defendants knew that the Grants were improper (they were not and they did not), but merely alleged that the Officer Defendants received the Grants.

(i.e., facts to show that the value of the Board Grants far exceeded the value of the additional work to be performed). Thus, even if the Court were to review these Grants using an entire fairness standard of review, Plaintiff's claim still fails.

As is well known, "[t]he concept of fairness has two basic aspects: fair dealing and fair price." *Weinberger v. UOP*, *Inc*., 457 A.2d 701, 711 (Del. 1983). Here, Plaintiff has failed to allege any facts to show a lack of fair dealing, that is, that the Board Grants were anything other than routine compensation pursuant to the subsidiaries' stock option plans. Likewise, Plaintiff has made no allegations whatsoever with respect to "fair price," as Plaintiff assigns no specific present value to the Board Grants nor has Plaintiff valued (nor could Plaintiff value) the work to be performed, the future value of those Grants, etc. Thus, even under entire fairness review Plaintiff's claims still fail.

## IV. PLAINTIFF'S CLAIMS ARE UNRIPE

### A. <u>Legal Standard</u>

"Courts in this country generally, and in Delaware in particular, decline to exercise jurisdiction over cases in which a controversy has not yet matured to a point where judicial action is appropriate." *Stroud v. Milliken Enterprises, Inc.*, 552 A.2d 476, 480 (Del. 1989). *See also Rollins Int'l, Inc. v. Int'l Hydronics Corp.*, 303 A.2d 660, 662-63 (1973) (Delaware uses four-part test to determine whether case is justiciable, item four of which is that "the issue involved in the

controversy must be ripe[.]”). To determine whether a matter is ripe, Delaware courts employ “a common sense assessment of whether the interests of the party seeking immediate relief outweigh the concerns of the court ‘in postponing review until the question arises in some more concrete and final form.’” *XL Specialty Ins. Co. v. WMI Liquidating Trust*, 93 A.3d 1208, 1217 (Del. 2014) (quoting *Cont'l Air Lines, Inc. v. C.A.B.*, 522 F.2d 107, 124–25 (D.C.Cir.1974). “A dispute will be deemed not ripe where the claim is based on uncertain and contingent events that may not occur, or where future events may obviate the need for judicial intervention.” *XL*, 93 A.3d at 1217-18 (internal quotation marks omitted). “[W]hen the material facts are not static and litigation in the matter is not immediate and inevitable, a [] court should move with great caution and hesitancy and should normally close the courthouse doors to the litigants on the particular matter[.]” *Multi-Fineline Electronix v. WBL Corp.*, 2007 WL 431050, at *8 (Del. Ch. Feb. 2, 2007).

### B. Plaintiff’s Yuhan Voting Agreement Claim Is Not Ripe

Plaintiff’s claim challenging the Yuhan Voting Agreement is not ripe because Plaintiff in his direct claim has not alleged any actual injury from any prior vote where the Yuhan Voting Agreement made any difference. The claim is also unripe as presently there is no vote in which the voting agreement is being called into use. Nor does the size of the Yuhan Voting Agreement (2.75 percent of

shares) make it likely that the agreement will ever make a material difference in any future vote. Common sense should lead the Court to delay any review (and dismiss this claim) until a time when the issue arises in some concrete form.

This Court's recent decision in *In Re Allergan, Inc. Stockholder Litig.*, 2014 WL 5791350, at *7 (Del. Ch. Nov. 7, 2014) is on point. There, this Court decided that a matter was not ripe for adjudication where stockholders challenged a provision in a company's certificate of incorporation and bylaws that prevented removal of the entire board by written consent but where "no stockholder is currently pursuing the strategy of removing the entire Allergan board."

### C. Plaintiff's Grants Claim Is Not Ripe

Plaintiff's challenges to the subsidiary option and warrant grants are similarly unripe. In particular, the material facts concerning any "excessive compensation" challenge to the Grants is far from static or concrete. Still to be determined in the future are (1) any value (beyond a de minimis value) that the Grants will have, (2) the work ultimately to be done for the subsidiaries by the recipients for which the Grants have been made, (3) the outcome of that work (for example, a successful capital-raising transaction or commercial partnership of one of the subsidiaries) and (4) the ultimate comparison of the value of the Grants and the value of the work for the subsidiaries.

There are a myriad of future possible outcomes or scenarios, any one of which could avoid litigation (or render its outcome obvious). For example, under one scenario, the corporate structure that includes Sorrento's contributing assets to subsidiaries that is in the process of being put in place by Sorrento could be a fantastic success; the recipients of the Grants could devote substantial time and efforts to make it a success; the options could become very valuable; but any reasonable comparison of that value to the ultimate outcome could show the Grants well-deserved with everyone benefitting.

Or, under an opposite scenario (but one with the same result), the corporate structure could fail to raise money at the subsidiary levels; the assets would get returned to Sorrento; the recipients of the Grants may or may not have done substantial work; but in any event the Grants would be worth nothing. Again, litigation over that result would appear to be very unlikely or easily resolved.

For many of these same reasons, Delaware courts are reluctant to entertain claims based on the speculative value of pharmaceuticals whose success is contingent on FDA approvals outside of the company's control. For an analogous example, in *In re Chelsea Therapeutics Int'l Ltd. Stockholders Litig.*, 2016 WL 3044721, at *8 (Del. Ch. May 20, 2016), the court recently held that the plaintiff failed to plead a breach of fiduciary duty where directors instructed its advisors not to rely on certain projections that were based on speculation that the FDA might

make certain favorable decisions. In dismissing the claim, the court noted, "[b]oth sets of projections involved contingencies over which the Company had no control, and which might never come to pass."

Here, as described above, none of the subsidiaries have any products that have even been approved for sale, let alone any product-based revenue. To the extent that certain of the five subsidiaries have obtained technology licenses or entered into joint ventures, it could take years before such efforts by the Board and Officer Defendants on behalf of those subsidiaries bear any fruit. And of course, success is not guaranteed: the Grants may ultimately have little value if any or all of the subsidiaries are not able to both develop an effective pharmaceutical and receive the necessary approvals. At this stage, it is simply not possible to determine whether the Grants were excessive where neither the effort nor the results of that effort are known.

In short, common sense favors letting the facts develop before litigating this case in a vacuum amidst changing developments and numerous potential outcomes.

## CONCLUSION

For the reasons stated above, the Court should dismiss Plaintiff's Complaint for failure to state a claim. In addition, or in the alternative, the Court should dismiss the Complaint as unripe. The Court should also award Defendants such other and further relief it deems just and proper.

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DATED: November 14, 2016