

**NOT FOR PUBLICATION
WITHOUT THE APPROVAL OF THE COMMITTEE ON OPINIONS**

Sylvia L. Rose, et al., Derivatively on
Behalf of Merck & Co, Inc.

Plaintiffs

v.

Fred Hassan, et al.,

Defendants

:
: SUPERIOR COURT OF NEW JERSEY
: CHANCERY DIVISION,
: GEN. EQUITY PART
: ESSEX COUNTY
: DOCKET NO.: ESX-C-264-2010

REASONS

Decided: August 9, 2011

By: Walter Koprowski, Jr., J.S.C.

Oral argument was held before this Court on August 5, 2011. The following attorneys and litigants appeared: Gary Graifman, Esq. of Kantrowitz, Goldhamer & Graifman, P.C. appeared on behalf of the Plaintiffs; Andrew Gordon, Esq. of Paul, Weis, Rifkind, Wharton & Garrison, LLP appeared pro hac vice and William B. McGuire, Esq. of Tompkins McGuire Wachenfeld & Barry both appeared on behalf of the Defendants.

The issue before the court is whether this derivative shareholder action filed against various board members and executives of Merck & Co, Inc, successor in interest to the former Schering-Plough Corporation, should be dismissed without prejudice or stayed pending the outcome of substantially similar litigation proceeding in the U.S. District Court for the District of New Jersey under the "First-Filed Rule".

The facts giving rise to this litigation as well as at least five other litigations pending in District Court in New Jersey are not disputed for purposes of this motion. Defendants are various board members, executives, and officers of the former Schering-Plough Corp. and its successor entity as a result of merger,

Merck & Co., Inc. In an effort to market several of its cholesterol control drugs, Schering-Plough conducted a series of clinical trials known as the ENHANCE trials the company hoped would demonstrate successful results for a combined use of two of its cholesterol drugs. It is alleged that the early returns from the trials, dated approximately late 2005 - early 2006, did not demonstrate the desired results, but the negative results of the tests were not publicly disclosed until 2008, ultimately triggering a substantial drop in the company's stock price. Plaintiffs claim the Individual Defendants were aware of the problems and shortcomings of the products, and yet they failed to tell the public of these problems and continued to publicize the benefits of the products until Defendants had no choice but to release the information about the trials. Starting on January 14, 2008, the Company began partial disclosures about the failed ENHANCE study results. The Company's stock prices began to "slide." When the Company finally released the full results to the public on March 30, 2008, the Company's stock dropped about 20%. (Complaint ¶ 158).

Steven Waldman was the first Schering shareholder to question Defendants' conduct regarding the ENHANCE trials, when on February 6, 2008, he made a demand on the Board to pursue these issues. The Schering Board formed a Special Committee ("SC") and referred the demand to the SC. Mr. Waldman is not a plaintiff in this matter. On February 25, 2008, another set of shareholders filed a shareholder derivative action in the New Jersey District Court against substantially the same officers and directors as Plaintiff has done here. The first-filed derivative action, Cain v. Hassan, is being litigated before the Honorable Dennis M. Cavanaugh. (Hereinafter "first-filed action"). These plaintiffs did not make a demand upon the Board. The first-filed action is one of a cluster of cases filed in the District Court which deal with the same common nucleus of factual allegations surrounding the ENHANCE study; these cases include the following: two derivative actions (including the first-filed action), two federal securities actions, and two actions arising under the Employee Retirement Income Security Act. The six pending federal actions have been coordinated for discovery and pre-trial purposes.

On June 5, 2009, Plaintiff, Sylvia Rose, a shareholder, made her demand letter upon the Schering Board referencing the ENHANCE controversy, the omissions and misrepresentations constituting wrongful action and demanded that the Board bring legal action to protect the Company and its shareholders, including actions for breach of fiduciary duty, unjust enrichment and other causes of action. (Complaint, Ex. C, Rose Demand). On October 31, 2009, the SC's counsel informed Plaintiff's counsel that the SC investigations had been completed and the Schering Board declined to pursue claims against any present or former officers or directors. (Complaint, Ex. D). Plaintiffs filed this complaint in General Equity on November 16, 2010, more than two and a half years after the negative results were disclosed and the first-filed action was commenced, and more than one year after the Schering board declined to pursue her demand.

The court notes that Schering-Plough and Merck completed a merger transaction in November of 2009 as well.

Defendants filed a motion to either stay or dismiss without prejudice this case under New Jersey's First-Filed Rule, pending the outcome of the various federal litigations. To prevent simultaneous and/or duplicitous litigation, New Jersey courts have long adopted the "first-filed rule." The parties agree the controlling case on this issue is Sensient Colors, Inc. v. Allstate Ins. Co., 193 N.J. 373 (2008). In that case, the Supreme Court of New Jersey set forth the motives, history, and applicable test for the first-filed rule. The court stated, "New Jersey has long adhered to the general rule that the court which first acquired jurisdiction has precedence in the absence of special equities. . . . Under the first-filed rule, a New Jersey state court ordinarily will stay or dismiss a civil action in deference to an already pending, substantially similar lawsuit in another state, unless compelling reasons dictate that it retain jurisdiction." Id. at 387 (internal citations omitted). The Court continued, "[t]he question is not whether a state court has the power to exercise jurisdiction over a case filed within its jurisdiction, but whether the court should restrain itself and not exercise that power." Id. 386-87. "If [New Jersey courts] are to have harmonious relations with . . . sister states, absent extenuating circumstances sufficient to qualify as special equities, comity and common sense counsel that a New Jersey court should not interfere with a similar, earlier-filed case in another jurisdiction that is 'capable of affording adequate relief and doing complete justice.'" Id. "Thus, any comity analysis should begin with a presumption in favor of the earlier-filed action." Id. (quoting O'Loughlin v. O'Loughlin, 6 N.J. 170, 179 (1951)).

The Court clearly held the presumption favoring the "first-filed" jurisdiction can be overcome only by a showing of "special equities" in existence, which justify the New Jersey court retaining jurisdiction over the matter. "Special equities are reasons of a compelling nature that favor the retention of jurisdiction by the court in the later-filed action. Special equities have been found when one party has engaged in jurisdiction shopping to deny the other party the benefit of its natural forum." Id. at 387. The New Jersey Supreme Court has identified at least four interrelated "special equities" that may be marshaled to rebut the presumption favoring dismissal or stay of a later-filed action: 1) inability of the first-filed action to provide adequate relief; 2) strong public policy interests of New Jersey; 3) further progression of the second-filed action; and 4) *forum non conveniens* factors. See Sensient Colors, 193 N.J. at 391-96. The Court explained that "[a]ll special equities are grounded in principles of fairness, and are implicated when a first-filed action may not do full justice to a party." Id. "Whether special equities exempt a court from deferring to a first-filed action depends on a fact-specific inquiry that weighs considerations of fairness and comity. The determination of whether to grant a comity stay or dismissal is generally within the discretion of the trial court." Id. at 389-90. (internal cites omitted).

A. The First-Filed Action Involves Substantially The Same Parties, Claims, And Legal Issues

As explained above, on February 25, 2008, two plaintiffs filed a shareholder derivative action against various officers and directors of Schering-Plough in New Jersey District Court under the name Cain v. Hassan. (Tarnofsky Aff., Ex. B). On November 5, 2009, another federal derivative action was brought against various officers and directors of Merck, which named defendants who were associated with Merck rather than Schering-Plough. (Tarnofsky Aff., Ex. E). Since the underlying controversy related to the same ENHANCE allegations as in the Schering-Plough federal derivative case, Judge Cavanaugh coordinated the Merck federal derivative case with the Schering-Plough federal derivative case due to their common question of fact and the desire to avoid duplicative discovery. (Tarnofsky Aff., Ex. G). The other federal actions which revolve around the same core facts are two federal securities actions, and two actions arising under the Employee Retirement Income Security Act. (Id. at Ex. I, K, and N and P). All of these matters were consolidated for discovery purposes in December of 2009.

On November 16, 2010, Plaintiff filed her complaint in this case. The complaint names the same defendants, makes the same factual claims, raises the same legal issues, and pursues the same causes of action under New Jersey state law as the first-filed action. Specifically, the Rose Complaint is filed against the same defendants in the first-filed federal derivative action, except for two defendants who are not named in the federal derivative case (one is named in the securities case), and four defendants in the first-filed action, who are not named in this case. Moreover, the legal issues in both cases are substantially the same in that both cases are shareholder derivative actions and both cases allege the same legal causes of action, including: (1) breach of fiduciary duty; (2) unjust enrichment, (3) corporate waste, and (4) gross mismanagement. Both cases apply New Jersey law. If anything, the first-filed action seeks slightly broader relief than the Rose Case. Plaintiffs argue this case is distinguishable from the first-filed case because demand was made of the board in this case, and was not made of the board by the plaintiffs in the first-filed action.

Plaintiffs argue that it is significant that Plaintiffs herein made a demand upon the Board prior to initiating suit because when a demand made is improperly refused or not acted upon, in a subsequent litigation the defendants have the initial burden to demonstrate that the Board members were independent and disinterested, citing to In re PSE&G Shareholder Litigation, 173 N.J. 258, 286 (2002). When a demand is not made of the board by shareholders prior to commencing derivative litigation, the shareholders have the burden of proving demand would be futile, because the board is either conflicted, complicit, or otherwise unable to render an independent decision. When a demand is made of the board, and the board declines or refuses to pursue the litigation

demanded, the burden shifts to the board to demonstrate its decision not to pursue the action was reasonable under the business judgment rule. As Defendants argue, the procedural distinction between the two actions regarding demand-futility and demand-made has no bearing on the Sensient Colors first-filed analysis under New Jersey law. The existence of a board demand in a derivative suit does not alter the underlying claims or remedies – it simply shifts the burden of proof. Furthermore, if the federal derivative actions are dismissed on the issue of demand futility, then this Court can lift the stay or reinstate the case. Plaintiffs have not cited any case in their papers holding that the presence of a board demand distinguishes a later-filed action from an earlier one which involves the same parties, claims and issues.

The court finds that the parties, legal issues, factual circumstances, and relief sought are substantially the same in this case as they are in the pending federal derivative litigations. Identical similarity is not required. The presumption that the second-filed action should be dismissed or stayed pending the outcome in the first-filed litigation is therefore triggered.

B. There Are No Special Equities That Would Overcome The Presumption Of Stay Or Dismissal, And Compel The Court To Keep The Case Active

After establishing the elements required to trigger a presumption of dismissal or stay under the first-filed rule, the burden shifts to the non-moving party to demonstrate “special equities” or compelling reasons, for allowing the later-filed action to proceed. The New Jersey Supreme Court has identified at least four interrelated “special equities” that may be marshaled to rebut the presumption favoring dismissal or stay of a later-filed action: 1) inability of the first-filed action to provide adequate relief; 2) strong public policy interests of New Jersey; 3) further progression of the second-filed action; and 4) *forum non conveniens* factors. See Sensient Colors, 193 N.J. at 391-96.

No “special equities” exist here to rebut the presumption in favor of dismissal or a stay of this action. Plaintiffs have not shown that the first-filed federal actions are incapable of providing adequate relief because the federal derivative case seeks broader relief than the Rose Case. There is no reason the federal court cannot provide adequate relief in the Cain consolidated derivative case. The plaintiffs in that case seek the same relief, i.e. compensatory damages and fees, as well as the additional relief of 1) punitive and exemplary damages; 2) an order implementing corrective measures, including a system of internal controls to prevent future violations; 3) an accounting for all losses sustained by reason of the alleged unlawful conduct; 4) disgorgement of all incentive-based or equity-based compensation during the period of alleged breach; 5) disgorgement and a constructive trust on defendant’s assets or

proceeds of alleged insider trading; and 6) a pre- and post-judgment interest. The U.S. District Court has been managing the various litigations related to the ENHANCE trials for more than three years, and Plaintiffs have not demonstrated any reason that court could provide less than adequate relief. Arguments that the presence of different burdens resulting from the failure of the first-filed plaintiffs to make a demand on the board are not convincing as a reason why the federal court could not provide adequate relief. That is a tactical choice made by plaintiff's counsel in the first-filed action, and does not impact the adequacy of the relief the court could afford.

Second, Plaintiffs have not identified any strong public interest of New Jersey sufficient to rebut the presumption in favor of dismissal or stay because there are no specialized policy interests or public safety concerns here. Again, Plaintiff points to the presence of a demand in this case, and failure to make demand in the first-filed action as a reason to justify denial of a stay or dismissal for public policy grounds. There can be no doubt that New Jersey law encourages potential derivative plaintiffs to make demand on the board by erecting substantial burden-shifting obstacles to derivative claims made without demand on the board. In this way, the courts have chosen to incentivize derivative plaintiffs to make their demand on the board before filing litigation, allowing the board to consider the demand and rule on it as a business decision. However, the court cannot find that it is a strong public policy concern of the State of New Jersey to allow litigation to proceed in multiple venues simply because demand was made in one case, and not another. The Supreme Court has established the burdens of proof regarding demand-made and demand-futility cases, interpreting Court Rule 4:32-5¹. If it was a strong policy preference of the State of New Jersey to make demands on the board prior to commencing litigation, the Legislature could have elected to bar all cases in which prior demand is not made completely. It has not done so, leaving it to the courts, who have opted instead to shift the burden of proof, and leaving it to potential litigants to decide for themselves how to proceed.

Plaintiff's reliance on In re PSE&G, *supra*, to demonstrate that a demand requirement is a strong public policy preference is unavailing. In that case, the Supreme Court of New Jersey adopted a modified form of the business judgment rule, and held that if a demand was made, the burden was initially on the board to demonstrate the board acted independently, in good faith and with due care in their investigation, and reasonably under the business judgment rule. If a demand was not made, the burden shifted to the litigant, to establish reasonable doubt that either the directors are disinterested and independent, or the challenged transaction was otherwise the product of a valid exercise of business judgment. The court did not at any point state New Jersey had a strong public policy concern in requiring demands to be made of Boards. To the contrary, the procedural and evidentiary framework established by the court in PSE&G is the

¹ Pleading requirements regarding derivative shareholder litigation previously found at Rule 4:32-5 are now found at Rule 4:32-3.

product of “an appropriate balance between director autonomy and the interests of the shareholders in this context.” PSE&G, 173 N.J. at 310. The court continued, “More broadly, we are satisfied that the demand-futility doctrine and the modified business judgment rule each serve a discrete but critical function. . . . The practical reality is that in many cases a shareholder will want to make a demand on the board to avoid the burden of demonstrating demand-futility. Given the salutary purposes of the demand requirement, that practical reality convinces us that our approach is proper. It preserves the most useful elements of Rule 4:32-5 while advancing an overarching standard to guide judicial review.” Id. at 313.

The policy interests that have been recognized as creating “special equities” are those that concern “significant state interests...[which] are implicated” such as: the remediation of polluted site, Sensient, supra, 193 N.J. at 387; parental rights in child custody cases, Innes v. Carrascosa, 391 N.J. Super. 453, 492-94 (App. Div.) certif. denied, 192 N.J. 73 (2007); Van Haren v. Van Haren, 171 N.J. Super. 12 (App. Div. 1979), and determinations of mental incapacity, In re Glasser, 2006 WL 510096 (N.J. Ch. 2006) (New Jersey public policy strongly favors adjudicating incapacity issues in the state of domicile). In short, the public policy concerns previously found to constitute “special equities” all involve situations in which New Jersey courts are presumed best able to judge how to apply New Jersey law. The following cases illustrate some of the policy arguments made by parties which New Jersey Courts have rejected. In Karzhevsky v. Loving Care Agency, Inc., 2010 N.J. Super. Unpub. LEXIS 88 (App.Div. Jan. 14, 2010) the Appellate Court was not convinced by Plaintiffs’ argument that the trial court erred by dismissing their complaint on comity grounds because New Jersey has a strong public policy in enforcing the LAD. The Court did not find that New York is any less committed than New Jersey to addressing unlawful discrimination in employment on the basis of national origin and religion. Id. at *15-16. Furthermore, in Continental Ins. Co. v. Honeywell Intern., Inc., 406 N.J. Super. 156, 193 (App. Div. 2009) looking at the special equities the Court noted that “it is New Jersey’s interest in the health and safety of *its* citizens and the remediation of property within *its* boundaries.” Id. citing to Sensient, supra, 193 N.J. at 394; Century Indem. Co., 398 N.J. Super. at 437.

At oral argument, Plaintiff’s counsel cited Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007), a Delaware chancery case in which the court declined to stay the Delaware action pending the outcome of several similar actions filed in U.S. District Court in California. That case is easily distinguishable. In that case, which involved claims against board members and executives for breach of fiduciary duty for backdating stock options, the Delaware Court retained jurisdiction and allowed the case to proceed because the issue was one of first impression, and the court held it was too important to allow another forum to interpret Delaware law where the Delaware courts themselves had not ruled on the issue. There is no such claim in this case, and Plaintiffs do not argue that the issues before the federal court in the first-filed action constitute uncharted legal

waters that require a New Jersey court to interpret the issue. Plaintiffs in the first-filed case undoubtedly weighed the merits of making a demand versus filing their complaint without a demand, and elected to take the risk that they could establish demand futility. There is no strong New Jersey public policy concern regarding demand letters requiring this court to retain jurisdiction. The Supreme Court (not the Legislature) has spoken on the issue, and established different burdens of proof in different scenarios regarding demands on the board in derivative actions. The Court left plaintiffs with a tactical choice, and the first-filed plaintiffs have elected to proceed without a demand.

Third, Plaintiffs have not shown that this action has progressed further than the first-filed federal action. Plaintiffs' argument that this case, like previous Vioxx litigation against Merck, could quickly "catch-up" to the first-filed demand futility action because the discovery has already been checked for privilege, bates-stamped, sorted, and electronically stored, is unconvincing. Plaintiffs further argue production of that discovery would then allow this case to race ahead of the first-filed litigation, which is "bogged down" by motion practice concerning the futility of the demand. This argument is also not convincing. To the contrary, the end of fact-discovery in the first-filed case is drawing near. More than 11 million pages of discovery have already been produced, and dozens of depositions have been taken. This case is just getting started. The first-filed case is years ahead of this case, and Plaintiffs' arguments to the contrary are speculative at best.

Finally, Plaintiffs have not shown or argued that the first-filed federal actions are in an inconvenient forum, which could be grounds to overcome the presumption of the first-filed rule as a special equity. This line of argument would not apply in this case, because the first-filed case before Judge Cavanaugh and the second-filed case before this court are both venued in New Jersey.

CONCLUSION

The parties, causes of action, and underlying facts are substantially the same in this case and Cain v. Hassan, pending before the U.S. District Court for the District of New Jersey. A presumption is triggered in favor of staying or dismissing this case. There are no special equities present to rebut or overcome the presumption. The case is dismissed without prejudice, subject to revival upon application by the Plaintiff and pending the outcome in U.S. District Court for the District of New Jersey.