

Delaware Chancery Court: Stockholders Seeking to Inspect Books and Records Under Section 220 Do Not Have to Present Evidence of an Actionable Claim Against the Company's Directors

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On January 13, 2020, the Delaware Chancery Court held that a stockholder seeking books and records pursuant to Section 220 of the Delaware General Corporation Law does not have to “introduce evidence from which a court could infer the existence of an actionable claim” against the company’s board. *Lebanon Cty. Emps. Ret. Fund v. AmerisourceBergen Corp.*, 2020 WL 132752 (Del. 2020) (Laster, V.C.). Rather, a stockholder must simply “establish, by a preponderance of the evidence, that there is a credible basis to infer possible corporate wrongdoing or mismanagement.” The court stated that “[w]hen a corporation has suffered a significant trauma, and when a stockholder can establish a credible basis to suspect a possible violation of positive law, the stockholder has stated a proper purpose for an inspection of books and records” under the Delaware Supreme Court’s decision in *Seinfeld v. Verizon Communications*, 909 A.2d 117 (Del. 2006).

Court Finds Stockholders Alleged a Credible Basis to Infer Possible Mismanagement or Wrongdoing Warranting Further Investigation

Section 220 provides that stockholders may “inspect for any proper purpose” the company’s books and records. 8 Del. C. § 220(b). The *AmerisourceBergen* court explained that “a mere statement of a purpose to investigate possible general mismanagement, without more, will not entitle a shareholder to broad § 220 inspection relief.” 2020 WL 132752 (quoting *Seinfeld*). Rather, “a stockholder must ‘show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation.’” *Id.* (quoting *Seinfeld*). The court emphasized that “[t]he ‘credible basis’ standard is the ‘lowest possible burden of proof.’” *Id.* (quoting *Seinfeld*). To meet this standard, a stockholder “may rely on circumstantial evidence” or “on hearsay, as long as it is sufficiently reliable.” The court stated that “[o]ngoing investigations and lawsuits can provide the necessary evidentiary basis to suspect wrongdoing or mismanagement warranting further investigation,” particularly “when governmental agencies or arms of law enforcement have conducted the investigations or pursued the lawsuits.”

In the case before the court, the stockholders sought “to investigate possible breaches of fiduciary duty, mismanagement and other violations of law” by the directors and the company’s management “in connection with [the company’s] distribution of prescription opioid medications.”

The court held that “the flood of government investigations and lawsuits relating to [the company’s] opioid-distribution practice is sufficient to establish a credible basis to suspect wrongdoing warranting further investigation,” particularly because the company “is suffering a significant corporate trauma” in connection with these matters. The court found that there was “a credible basis to suspect that [the company’s] situation did not result from an ordinary business decision that, in hindsight, simply turned out poorly.” Rather, the court found “strong circumstantial evidence” that the company “may have pushed opioids into the distribution chain under circumstances where [the company] knew or should have known that they would be diverted for improper purposes.”

Stockholders Need Not Specify How They Intend to Use the Results of the Section 220 Investigation

The court rejected the company’s position that “if a stockholder wants to investigate corporate wrongdoing and use the resulting documents to achieve an end other than filing litigation, then the stockholder must say so in the demand.” The court stated that “[a] responsible stockholder cannot identify all of the potential uses for books and records before knowing what the books and records reveal.” The court acknowledged that a number of recent cases have interpreted Section 220 to require that “a stockholder must not only state a proper purpose, but must state a reason for the purpose, i.e., what it will do with the information, or an end to which the investigation may lead.” The court found this “goes beyond what Section 220 and Delaware Supreme Court precedent require.”

Stockholders Do Not Have to Provide Evidence of an Actionable Claim Against the Board to Investigate Wrongdoing or Mismanagement

The court found the stockholders’ demand “signaled that they are not solely interested in filing a derivative lawsuit to pursue a damages remedy,” but are “open to considering other possible remedies, corrective measures, and methods of addressing the wrongdoing that they believe has occurred.” The company, however, “interpreted the [d]emand as confined to investigating a *Caremark* claim” and contended that the stockholders “must present evidence demonstrating a credible basis to suspect actionable wrongdoing on the part of the [b]oard.”

The court found the company’s asserted “actionable-wrongdoing requirement imposes an onerous burden on stockholders that goes beyond the standard established in *Seinfeld*.” The court emphasized that “[t]he Delaware Supreme Court has not required a stockholder seeking books and records to introduce evidence from which a court could infer the existence of an actionable claim,” nor has it ever “equated the credible-basis standard with an actionable-claim requirement.” The court explained that “[u]nder *Seinfeld*, the operative question is whether a stockholder has shown a credible basis to suspect possible mismanagement or wrongdoing at the corporation.” The court noted that “[t]his standard does not require tying the mismanagement or wrongdoing to the board.”

The court found it significant that “[t]he Delaware Supreme Court has repeatedly urged stockholders to use Section 220 to investigate possible wrongdoing *before* filing derivative actions, recognizing that without doing so, plaintiffs typically lack the facts necessary to plead an actionable claim against the board that can survive a Rule 23.1 motion.” The court explained that “[t]he logical implication of this message is that to obtain books and records, a stockholder does not have to introduce evidence from which a court could infer the existence of an actionable claim.”

The court rejected the company’s merits-based defenses to the stockholders’ Section 220 demand “for the threshold reason that the plaintiffs are not seeking books and records for the sole purpose of investigating a potential *Caremark* claim.” Moreover, the court found it “would be premature to allow [the company] to rely on its exculpatory provision to foreclose an inspection into possible corporate wrongdoing” because “[t]he issues that the plaintiffs wish to investigate could well lead to non-exculpated claims.” The court stated that “[a] failure to act in good faith may be shown if the directors act with a purpose other than that of advancing the best interests of the corporation, such as by consciously failing to attempt to take action in good faith to prevent a corporate trauma.” The court similarly found that it would be “premature to determine . . . that any possible claim that the plaintiffs might bring would be time-barred.” The court observed that “doctrines like fraudulent concealment or equitable tolling could enable the plaintiffs to pursue otherwise stale claims,” and they might also be able to “use the earlier information to show that the directors engaged in a sustained or systemic failure to exercise oversight.”

Court Permits Stockholders to Take a Rule 30(b)(6) Deposition to Ascertain the Scope of Their Section 220 Demand

With respect to the scope of a Section 220 demand, the court explained that a “plaintiff should receive access to all of the documents in the

corporation’s possession, custody or control, that are necessary to satisfy the plaintiff’s proper purpose.” If “a plaintiff has shown evidence of wide-ranging mismanagement or waste, a more wide-ranging inspection may be justified.” The court noted that “[t]he starting point (and often the ending point) for an adequate inspection will be board-level documents that formally evidence the directors’ deliberations and decisions and comprise the materials that the directors formally received and considered (the ‘Formal Board Materials’).” The court instructed that “[i]f the plaintiff makes a proper showing, an inspection may extend to informal materials that evidence the directors’ deliberations, the information that they received, and the decisions they reached (‘Informal Board Materials’).” Such materials “may include emails and other types of communications sent among the directors themselves, even if the directors used non-corporate accounts.” The court stated that “[i]n an appropriate case, an inspection may extend further to encompass communications and materials that were only shared among or reviewed by officers and employees (‘Officer-Level Materials’).” The court stated that “[w]hether a stockholder is entitled to a particular category of documents is fact specific and will necessarily depend on the context in which the shareholder’s inspection demand arises.” The court noted that “[i]t is often helpful when ruling on a Section 220 demand to have information about what types of books and records exist and who has them.”

Here, the company “prevented the plaintiffs from obtaining any information about what types of books and records exist and who has them.” The court therefore held that “the plaintiffs may conduct a Rule 30(b)(6) deposition” to ascertain what documents are available. The court found that the stockholders had already “shown that they are entitled to Formal Board Materials,” and held that they may also “make a follow-on application for Informal Board Materials or Officer-Level Documents” if the parties are unable to reach agreement on the scope of the demand after the Rule 30(b)(6) deposition.

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