



# INSIGHTS

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## STATE CORNER

### Absence of Claim of Wrongdoing Can Defeat Books and Records Demands

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In recent years, as potential stockholder plaintiffs have begun to heed the advice of the Delaware Supreme Court to use the “tools at hand” to investigate potential corporate wrongdoing before filing derivative litigation,<sup>1</sup> use of Section 220 books and records demands has become a routine precursor to derivative litigation. The announcement of an adverse corporate event now is frequently the trigger for one—and often many—Section 220 demands from potential stockholder plaintiffs seeking to inspect corporate books and records for the ostensible purpose of investigating whether to bring fiduciary duty claims against the directors and officers who permitted the adverse event to occur.

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Although proper use of Section 220 can help to limit nuisance lawsuits, responding to Section 220 demands also places a significant burden on corporations. While past decisions have noted that the stockholders’ burden of establishing a proper purpose for inspection in this context is not an onerous one,<sup>2</sup> the Delaware Court of Chancery recently has issued a series of decisions that demonstrate that a corporation can validly deny inspection to stockholders where the allegations of the demand do not provide a credible basis to infer that actionable wrongdoing may have occurred, or where the stockholder would be legally barred from asserting the claims it seeks to investigate.

#### Recent Cases

In *Wolst v. Monster Beverage Corp.*, the Court of Chancery concluded that an anticipated affirmative defense to potential litigation may negate the stockholder’s proper purpose.<sup>3</sup> Wolst, a Monster Beverage stockholder, sought to inspect documents for the purpose of determining “whether there [was] a basis to bring a derivative suit based on the wrongs alleged” in a derivative action brought in 2008 that was dismissed because the stockholders in that action failed to establish demand futility.<sup>4</sup> Monster argued that Wolst’s purpose was not proper because the derivative claims that Wolst sought to bring would be barred by laches.<sup>5</sup> While “[a] potentially viable affirmative defense to an anticipated derivative claim

will not necessarily defeat a books and records effort,” the Court found that, “in a specific factual setting, a time bar defense would eviscerate any showing that might otherwise be made in an effort to establish a proper stockholder purpose.”<sup>6</sup>

In *Fuchs Family Trust v. Parker Drilling Co.*, the Court denied a request for books and records where issue preclusion barred the future derivative claim that the stockholder sought to investigate, admonishing that a Section 220 inspection is not “for the merely curious.”<sup>7</sup> The Fuchs Family Trust requested books and records to “seek[] to assess the options, with the aid of counsel, for potential litigation and/or to demand that the Company take action” regarding an alleged bribery scheme perpetrated by Parker Drilling Company’s freight forwarding and customs agent.<sup>8</sup> Before the demand, a Texas federal court had dismissed with prejudice a separate stockholder derivative action for failure to plead demand futility.<sup>9</sup> The Court found that the Trust was barred from relitigating the derivative action under the doctrine of collateral estoppel; thus, no proper purpose existed.<sup>10</sup>

In *Southeastern Pennsylvania Transportation Authority v. AbbVie, Inc.*, the Court denied two stockholders’ Section 220 requests, finding that without stating a specific objective, they failed to show a credible basis for their stated purpose.<sup>11</sup> AbbVie withdrew from a planned merger with Shire plc after changes to the tax code eliminated the tax advantages of the merger, and was obligated to pay a reverse termination fee to Shire.<sup>12</sup> Stockholders SEPTA and James Rizzolo sought books and records for the purpose of investigating potential breaches of fiduciary duties, mismanagement, wrongdoing, and waste by the members of AbbVie’s board in connection with the withdrawal.<sup>13</sup> The Court rejected this demand, explaining that a conclusory statement of a proper purpose without an explanation of “an end to which that investigation will lead” is insufficient.<sup>14</sup> Furthermore, the Court found that even if SEPTA and Rizzolo were credited with the purpose of seeking information to support a potential derivative action, they had failed to plead any non-exculpated potential breach of the fiduciary duty of loyalty where

AbbVie’s directors were exculpated from personal liability pursuant to 8 *Del. C.* § 102(b)(7) and, as such, had failed to demonstrate a credible basis for the Court to infer that wrongdoing, waste, or mismanagement had occurred.<sup>15</sup>

Finally, in *Beatrice Corwin Living Irrevocable Trust v. Pfizer, Inc.*, the Court found that the plaintiffs, trustees of a trust, had not established a proper purpose to inspect Pfizer’s books and records where they failed to provide any evidence suggesting a credible basis from which the Court could infer that possible waste, mismanagement, or wrongdoing had occurred.<sup>16</sup> The plaintiffs sought to evaluate potential litigation based on possible breaches of fiduciary duty by Pfizer’s board of directors for failing to assure compliance with applicable accounting rules relating to Pfizer’s treatment of deferred reparation tax liability.<sup>17</sup> The demand specified an intent to investigate board oversight, but did not offer any evidence focused on the board’s conduct or, more specifically, on Pfizer’s reporting system or the presence of red flags supporting a possible *Caremark* claim.<sup>18</sup> Additionally, the directors who potentially would be subject to the suit were protected under 8 *Del. C.* § 141(e) based on their reliance on Pfizer’s auditor and thus were exculpated, negating a proper purpose under *AbbVie*.<sup>19</sup> The Court also rejected the plaintiffs’ post-trial efforts to expand their proper purpose to investigate undefined “others” in addition to the board.<sup>20</sup>

## Conclusion

In summary, where a stockholder seeks to inspect corporate books and records for the purpose of investigating potential corporate wrongdoing, the stockholder must articulate a specific objective for the investigation, supported by some evidence providing a credible basis to infer that *actionable* wrongdoing may have occurred. Where the demand fails to do so, or where the corporation can demonstrate that the stockholder would be barred from asserting the claims it seeks to investigate, a corporation’s rejection of the books and records demand should be endorsed by the Court. The admonitions against

aimless articulations of purpose illustrated in each of *Monster Beverage*, *Fuchs*, *AbbVie*, and *Corwin* thus may provide a basis to defend against some Section 220 demands.

## Notes

1. See, e.g., *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. Ch. 1996) (citing *Rales v. Blasband*, 634 A.2d 927, 934 n. 10 (Del. 1993), overruled on other grounds by *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)).
2. See, e.g., *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 124 (Del. 2006).
3. *Wolst*, 2014 WL 4966139 (Del. Ch. Oct. 3, 2014).
4. *Id.* at \*1 (internal quotation marks omitted).
5. *Id.*
6. *Id.* at \*2 (quoting *Amalgamated Bank v. UICI*, 2005 WL 1377432, at \*2 (Del. Ch. June 2, 2005)); see also *Graulich v. Dell Inc.*, 2011 WL 1843813, at \*6 (Del. Ch. May 16, 2011) ("As this Court has held, in a factual setting, a time bar defense or a claim or issue preclusion defense would eviscerate any showing that might otherwise be made in an effort to establish a proper shareholder purpose." (internal quotation marks omitted)).
7. *Fuchs*, 2015 WL 1036106, at \*3 (Del. Ch. Mar. 4, 2015).
8. *Id.* (citation omitted).
9. *Id.* at \*5.
10. *Id.* at \*7.
11. *AbbVie*, 2015 WL 1753033 (Del. Ch. Apr. 15, 2015), *aff'd*, 132 A.3d 1 (Del. 2016) (TABLE).
12. *Id.* at \*9.
13. *Id.* at \*10.
14. *Id.* at \*11 (citing *Graulich*, 2011 WL 1843813, at \*5); see also *West Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 646 (Del. Ch. 2006).
15. *AbbVie*, 2015 WL 1753033, at \*13.
16. *Corwin*, 2016 WL 4548101 (Del. Ch. Sept. 1, 2016).
17. *Id.* at \*2.
18. *Id.* at \*5.
19. *Id.* at \*6.
20. *Id.* at \*7.

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