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Locke Lord QuickStudy: Delaware Supreme Court Rules Stockholders Are Entitled to ?Books and Records Based on “Investigatory Purpose” Without Stating Objectives of ?Investigation

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In an important decision, the Delaware Supreme Court, in *AmerisourceBergen Corp. v. Lebanon ?Cty. Employees’ Ret. Fund*, No. 60, 2020, 2020 WL 7266362 (Del. Dec. 10, 2020), ruled that ?stockholders may obtain access to a corporation’s books and records based on a credible showing ?of issues of wrongdoing without needing to identify any particular course of action they intend ?to take with the books and records obtained or explain whether any suspected wrongdoing is ?actionable. This decision affirmed the Court of Chancery’s finding (discussed by us last February ?here) that followed an increasing trend of lowering the threshold needed for stockholders to gain ?access to corporate information through a Section 220 books and records demand.?

During the ongoing opioid epidemic, AmerisourceBergen, one of the country’s largest opioid ?distributors, has been investigated by numerous law enforcement and government agencies. In ?May 2019, amidst this “flood of government investigations and lawsuits relating to ?AmerisourceBergen’s opioid practices,” the plaintiffs made a Section 220 demand on ?AmerisourceBergen, requesting inspection of thirteen categories of books and records. The ?plaintiffs requested Board materials relating to certain settlements, acquisitions, investigations, ?and other events related to AmerisourceBergen’s operations and its potential involvement in the ?opioid crisis. The demand listed four purposes:?

(i) to investigate possible breaches of fiduciary duty, mismanagement, and other ?violations of law by members of the Company’s Board of Directors and ?management . . . in connection with [the Company]’s distribution of prescription ?opioid medications;?

?(ii) to consider any remedies to be sought in respect of the aforementioned ?conduct;?

?(iii) to evaluate the independence and disinterestedness of the members of the ?Board; and

?(iv) to use information obtained through inspection of the Company’s books and ?records to evaluate possible litigation or other corrective measures with respect to ?some or all of these matters.?

AmerisourceBergen argued that this demand was “an indiscriminate fishing expedition or out of ?mere curiosity.” AmerisourceBergen also argued that the stockholders’ sole purpose in seeking ?the inspection was to investigate a potential breach of fiduciary duty (*Caremark* claim) because ?the stockholders’ demand “reserved the ability to

consider all courses of action that their ?investigation might warrant pursuing." It further argued that the stockholders needed at least to ?demonstrate that they sought to investigate "actionable" wrongdoing.?

The Delaware Supreme Court found that Section 220(c) provides that stockholders may inspect a ?corporation's books and records where they establish that "(1) [s]uch stockholder is a ?stockholder; (2) [s]uch stockholder has complied with [Section 220] respecting the form and ?manner of making demand for inspection of such documents; and (3) [t]he inspection such ?stockholder seeks is for a proper purpose." The heart of the *AmerisourceBergen* opinion centered ?on whether the stockholders had established a proper purpose. ?

While the Court recognized that "[t]o avoid 'indiscriminate fishing expedition[s],' a bare ?allegation of possible waste, mismanagement, or breach of fiduciary duty, without more, will not ?entitle a stockholder to a Section 220 inspection," the Court found that the AmerisourceBergen ?stockholders had established a credible basis to infer possible mismanagement. The Court ?reasoned that "the credible basis standard is the 'lowest possible burden of proof,'" and found ?that a stockholder need not show that corporate wrongdoing or mismanagement has occurred in ?fact, but rather the "threshold may be satisfied by a credible showing, through documents, logic, ?testimony or otherwise, that there are legitimate issues of wrongdoing." The Court also found ?that "although the actionability of wrongdoing can be a relevant factor for the Court of Chancery ?to consider when assessing the legitimacy of a stockholder's stated purpose, an investigating ?stockholder is not required in all cases to establish that the wrongdoing under investigation is ?actionable."?

In upholding the stockholders' Section 220 demand, the Court cited with approval the recent ?Court of Chancery decision in *Pettry v. Gilead Sciences, Inc.*, 2020 WL 6870461 (Del. Ch. Nov. ??24, 2020). In *Pettry*, the Court of Chancery granted a stockholder's inspection request over the ?corporation's objections that the stockholder lacked standing to pursue follow-on derivative ?claims, which, in any event, would be time-barred and barred by the corporation's exculpatory ?charter provision. The *AmerisourceBergen* Court clarified that a Section 220 proceeding "is not ?the time for a merits assessment of Plaintiffs' potential claims against [the corporation's] ?fiduciaries." The Court reiterated the new standard for assessing Section 220 demands, and ?stated:?

In the rare case in which the stockholder's sole reason for investigating mismanagement ?or wrongdoing is to pursue litigation and a purely procedural obstacle, such as standing or ?the statute of limitations, stands in the stockholder's way such that the court can ?determine, without adjudicating merits-based defenses, that the anticipated litigation will ?be dead on arrival, the court may be justified in denying inspection. But in all other cases, ?the court should—as the Court of Chancery did here—defer the consideration of ?defenses that do not directly bear on the stockholder's inspection rights, but only on the ?likelihood that the stockholder might prevail in another action. ?

Finally, in another noteworthy part of the decision, the Delaware Supreme Court ruled that it was ?not an abuse of discretion for the Court of Chancery to order a corporate representative ?deposition in a Section 220 proceeding. The Court further clarified that its previous ruling in *KT4 ?Partners LLC v. Palantir Technologies Inc.*, 203 A.3d 738 (Del. 2019), did not constrain the ?Court of Chancery from exercising its discretion to permit a Rule 30(b)(6) deposition, nor did ?*Palantir* "establish any bright-line rules regarding discovery to be applied in all Section 220 ?actions."?

Conclusion

Following *AmerisourceBergen*, stockholders are well-advised to broaden their Section 220 ?demands so that it does not appear, on the face of the demand, to be motivated only by a desire ?to pursue litigation. In the wake of *AmerisourceBergen*, *Pettry*, and recent Delaware court trends ?regarding Section 220 demands, Locke Lord reiterates its suggestion that corporations consider ?take the following steps:?

Dealing with stockholder Section 220 demands:?

- Responding to Section 220 demands in a timely manner and with records that reasonably ?fall within the proper purpose specified in the demand can foreclose access to other ?information.?
- Because courts may allow discovery beyond formal meeting minutes in order to ?determine “what records exist,” including potentially a corporate representative ?deposition, it can be advantageous to maintain detailed and accurate formal board ?materials, including but not limited to minutes, consents, letters, and resolutions.?
- Company board members can protect personal information by using company email ?platforms for board-related communications and other messaging platforms for personal ?emails and other communications.?

Mitigating exposure to Caremark claims:?

- Companies should ensure that board-level policies and company compliance practices and ?procedures are well documented and that board meeting discussions are accurately and ?timely documented in board minutes.?
- Company boards should regularly evaluate the company’s risk policies and should ?address and timely record discussions of risks pertinent to company operations.?
- Companies in regulated businesses might consider having board members with special ?background and expertise to assess its mission-critical risks.?

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