

Del. Books And Records Ruling Offers 4 Lessons For Cos.

By Jennifer Luz and John Barker (January 22, 2021)

A recent decision by the Delaware Supreme Court cemented a trend in Delaware cases granting broad inspection rights to stockholders under Section 220 of the Delaware General Corporation Law and cautioning companies that aggressively defend against stockholder inspection demands.

The Dec. 10, 2020, decision, *AmerisourceBergen Corp. v. Lebanon County Employees' Retirement Fund*, could have significant impacts on companies responding to broad stockholder books and records demands.

The Delaware Supreme Court narrows defenses to Section 220 inspection demands.

The decision concerns a stockholder demand to inspect books and records of AmerisourceBergen, a publicly traded wholesale distributor of opioid pain medications.

Over the last decade, AmerisourceBergen was the target of numerous investigations by the U.S. Drug Enforcement Administration, federal prosecutors, state attorneys general and other regulators based on its alleged failure to implement and maintain effective monitoring and controls to prevent rogue pharmacies from fulfilling suspicious opioid prescriptions and ordering suspicious quantities of drugs.

The company is currently a defendant in a large multidistrict litigation where it faces potentially tens of billions of dollars of liability.

In May 2019, an AmerisourceBergen stockholder served a books and records demand on the company under Section 220, seeking a broad set of documents concerning the company's operations and potential involvement in the opioid crisis. The stockholder's stated purpose for inspection was to investigate potential corporate wrongdoing, consider potential remedies and evaluate litigation, and assess the independence and disinterestedness of the company's directors.

AmerisourceBergen rejected the demand in full, taking the position that the demand did not state a proper purpose for inspection, primarily because it failed to offer a credible basis to infer any actionable wrongdoing and was overbroad in the documents it sought.

Following the company's denial, the stockholder brought suit in the Delaware Court of Chancery. On a paper record, Vice Chancellor J. Travis Laster found for the stockholder, holding that the demand stated a proper purpose because it offered some evidence of wrongdoing and that a books and records demand need not establish that wrongdoing would be actionable.

The trial court also took the unusual step of *sua sponte* allowing the plaintiff to depose a representative of AmerisourceBergen following the decision to identify sources of potentially relevant documents. The Court of Chancery granted certification of an interlocutory appeal, and the company appealed.



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The Delaware Supreme Court affirmed the lower court decision. The court first outlined the familiar standard for assessing books and records demands, holding that a stockholder must show a proper purpose for inspection, and that when the stockholder's purpose is to investigate wrongdoing or mismanagement, it must show a credible basis from which the court can infer possible wrongdoing.

The court then squarely rejected the company's primary arguments, that a stockholder must also both (1) identify "the objectives of an investigation of corporate wrongdoing," and (2) provide a credible basis to support actionable wrongdoing.

As an initial matter, the court found that the stockholder did, in fact, identify several objectives of the demand, including both litigation and nonlitigation objectives. While this would have been enough to resolve AmerisourceBergen's argument that the demand failed to identify the stockholder's objective, the court went further, finding that corporate wrongdoing "in and of itself [is a] legitimate matter of concern that is reasonably related to a stockholder's interest as a stockholder."

The court therefore held that a stockholder who provides a credible basis to infer wrongdoing has stated a proper purpose for inspection and need not "specify the ends to which it might use the books and records."

AmerisourceBergen also argued that even assuming the stockholder had articulated potential wrongdoing, such wrongdoing was not actionable because any litigation concerning the purported misconduct would be barred by the exculpatory provision in the company's charter under Section 102(b)(7) of the Delaware General Corporation Law, and by the doctrine of laches.

Relying on cases suggesting that a stockholder must have a viable avenue for pursuing a claim arising out of the wrongdoing to have a proper purpose for inspection, AmerisourceBergen argued that the stockholder's inability to show actionable wrongdoing supported its rejection of the demand.

The Delaware Supreme Court held that while actionability "can be a relevant factor for the Court of Chancery to consider when assessing the legitimacy of a stockholder's stated purpose," a stockholder "is not required in all cases to establish that the wrongdoing under investigation is actionable."

As an initial matter, the court disagreed with AmerisourceBergen that litigation was the only objective of the stockholder's inspection, noting that the stockholder also identified nonlitigation objectives in its demand. Although the court acknowledged that it "need go no further" to resolve the company's actionability argument, it nevertheless analyzed actionability objections to inspection demands based on both merit and procedural defenses to a future litigation concerning the purported wrongdoing identified in a demand.

In so doing, the court held that a stockholder who shows a credible basis to infer wrongdoing "need not demonstrate that the alleged mismanagement or wrongdoing is actionable." On this score, the court discussed several previous decisions from Delaware's Supreme Court and Court of Chancery barring inspection because future litigation would have been "dead on arrival."

Such a dead-on-arrival basis for denying inspection, the court held, is justified only in the rare case when a stockholder's sole reason for investigating wrongdoing is to pursue

litigation, and a "purely procedural obstacle, such as standing or the statute of limitations," would foreclose such litigation.

The Delaware Supreme Court also affirmed the Court of Chancery's decision to sua sponte provide the plaintiff leave to take a deposition of AmerisourceBergen to "explore what type of books and records exist and who has them."

AmerisourceBergen affirms trend of Delaware courts rejecting aggressive defense of inspection demands.

The Delaware Supreme Court's holding in AmerisourceBergen cements a growing trend in recent Court of Chancery decisions granting broad inspection of books and records over objections by companies that the stockholder has failed to articulate a proper purpose.

Despite narrowing certain defenses available to companies facing inspection demands, the court acknowledged that the objective of an investigation and arguments about the merits of purported wrongdoing are still relevant to a court's analysis of a stockholder demand.

There are several important takeaways for companies to keep in mind when facing books and records demands.

1. AmerisourceBergen's holding that stockholders need not state an objective when investigating wrongdoing is limited.

AmerisourceBergen eliminated the need for a stockholder to articulate the objective of inspecting the company's documents if the stockholder can establish a credible basis to believe that there has been corporate wrongdoing. While notable, this holding is limited.

Importantly, the holding applies only to inspections for the purpose of investigating potential wrongdoing, because corporate wrongdoing is indisputably related to the stockholder's interest as a stockholder. Other types of inspection demand, such as a demand for a list of stockholders, will still likely require an articulation of what the stockholder plans to do with the information to confirm that the purpose is related to the stockholder's interest as a stockholder.

Moreover, the court cautioned stockholders that even though not necessary for certain inspection demands, this does not mean that "the stockholder's intended uses are irrelevant" and that it would be wise for stockholders to identify their objectives "in the interest of enhancing litigation efficiencies."

The court also emphasized that a company may still challenge the bona fides of a stockholder's purported purpose, and that planned use of the records may be critical to that inquiry.

2. Actionability is still a relevant consideration to the merits of a Section 220 demand.

While the court put guardrails around actionability as a total defense to inspection demands, it also clearly held that "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."

For example, the court clarified that procedural roadblocks to anticipated litigation are a valid defense to inspection demands where litigation is the sole reason for the investigation.

But as to merits defenses, the court cautioned that the Court of Chancery generally should "defer the consideration of defenses that do not bear directly on the stockholder's inspection rights, but only on the likelihood that the stockholder might prevail in another action."

However, the court also reaffirmed the requirement that a stockholder must "show by preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement or wrongdoing warranting further investigation."

Thus, while a full-blown analysis of the merits of the purported wrongdoing is not appropriate during consideration of a Section 220 demand, companies may still defend against demands on the basis that the stockholder's articulation of wrongdoing is deficient.

3. Delaware courts may grant inspection of broad categories of documents under Section 220.

The AmerisourceBergen decision follows closely on the heels of two Chancery Court decisions granting broad inspection of books and records after rejecting arguments that stockholders failed to state a proper purpose. In all three cases, significant inspection rights were ordered.

As discussed above, in AmerisourceBergen, the court sua sponte allowed the stockholder to take a 30(b)(6) deposition of the company to identify potentially responsive documents.

In an October Chancery Court **decision**, Police & Fire Retirement System v. Walmart Inc., Vice Chancellor Laster likewise rejected Walmart's argument that the stockholder lacked a proper purpose and ordered broad inspection rights, holding that it was not a "close call" in light of government investigations faced by Walmart and evidence that Walmart did not have meaningful controls in place to prevent the diversion of opioids.

After analyzing the categories of documents sought by the stockholder request-by-request, the court required Walmart to produce most of the documents requested, including more than 10 years' worth of documents in certain categories.

Similarly, in Pettry v. Gilead Sciences Inc., Vice Chancellor Kathaleen S. McCormick **ordered** Gilead Sciences to produce books and records regarding the development, marketing and sale of a drug developed by the company to treat HIV that in recent years has been the subject of numerous lawsuits and investigations.

Gilead had argued, in part, that the plaintiff stockholders failed to state a proper purpose because they would lack standing to pursue a derivative claim and because their allegations did not implicate senior Gilead officers or directors and would therefore not have been viable as a derivative claim.

Anticipating the Delaware Supreme Court's AmerisourceBergen decision that came down two weeks after her ruling, Vice Chancellor McCormick held that a proper purpose does not depend on the viability of "causes of action that have not yet been asserted," unless the plaintiff "identifies pursuing a derivative claim as its sole purpose" in making the demand.

The court ordered Gilead to turn over all of the documents the stockholders had requested.

4. Companies that aggressively defend books and records litigations on the proper purpose element also risk fee-shifting.

Companies would be wise to keep these recent decisions in mind when objecting to demands to inspect books and records. In addition to courts granting extensive inspection rights, recent cases also suggest the potential for fees to be shifted when companies assert what the courts view as aggressive defenses to Section 220 demands.

For example, in the Walmart decision, Vice Chancellor Laster observed that "My colleagues and I have been dealing with a multitude of these 220 trials," and "what we need to start doing is paring things down so that we don't waste time on the stuff that's really not fairly litigable."

Faced with what he viewed as a meritless defense by Walmart on the proper purpose, Vice Chancellor Laster questioned "whether there ought to be some fee shifting for having put us all through this."

Likewise, Vice Chancellor McCormick, in the Gilead Sciences decision, invited plaintiffs to file a motion for attorney fees. In so doing, she observed that Gilead's conduct in contesting the proper purpose element "exemplified the trend of overly aggressive litigation strategies by blocking legitimate discovery, misrepresenting the record, and taking positions for no apparent purpose other than obstructing the exercise of Plaintiffs' statutory rights."

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