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Actionable Claim to Inspect Books and Records

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In *Lebanon County Employees' Retirement Fund, et al. v. AmerisourceBergen Corporation*, the Delaware Court of Chancery ordered the inspection of the books and records of AmerisourceBergen Corporation, one of the leading opioid distributors in the country, for the purpose of investigating potential mismanagement or breaches of fiduciary duty in connection with the company's distribution of opioids. In his decision, Vice Chancellor J. Travis Laster confirmed that stockholders are not required to show that the misconduct central to the investigation supports an actionable claim in order to meet their low burden to enforce inspection rights under Section 220 of the Delaware General Corporation Law. The decision also reinforced that, in appropriate circumstances, the Court will allow stockholders to inspect both board-level documents reflecting the directors' decisions at formal board meetings and less formal communications by and among directors, officers, and senior-level managers. This decision is notable because the Court rejected the company's efforts to impose heightened burdens on stockholders seeking to discover additional information about the types of books and records a company may or may not have, and in what formats those records exist. This decision also serves as a reminder to boards considering inspection demands that stockholders bear a low burden to show they are entitled to enforce their inspection rights under Delaware law, and if stockholders meet clear this threshold—which is seemingly easier in the context of publicly scrutinized events—Delaware courts are increasingly likely to find that stockholders are entitled to inspect minutes and other sources of information. Companies confronted with inspection demands should be strategic in what demands to oppose, and consider whether negotiation with the stockholder ultimately may produce a more favorable outcome than litigating the issue in court.

Background

Plaintiffs are stockholders of AmerisourceBergen Corporation ("Amerisource" or the "Company"), one of the largest wholesale distributors of pharmaceuticals, including opioid pain medication. Plaintiffs filed an action pursuant to Section 220 of the Delaware General Corporation Law ("DGCL") seeking to enforce their rights to inspect the books and records of Amerisource to determine whether the Company engaged in wrongdoing in connection with its distribution of opioids. Amerisource denied Plaintiffs' request in its entirety on the grounds that Plaintiffs' demand was overly broad and failed to state a proper purpose.

The widespread opioid epidemic in the United States is well known. In 2007, the DEA suspended Amerisource's distribution license in Orlando, Florida, as a result of the Company's dealings with so-called "rogue pharmacies" (pharmacies that fill large orders of prescriptions), finding that it failed to maintain effective controls at its Orlando distribution center. In response, Amerisource adopted a company-wide compliance program to correct these issues (the "2007 Settlement"), and Amerisource continued to work with the DEA to improve its operations. According to the Company's public filings, its senior officers and board of directors "play[ed] a significant role in monitoring and enforcing compliance."

Since 2012, Amerisource has received subpoenas from the DEA and U.S. Attorneys' Offices of numerous states alleging that it failed to maintain effective controls and other deficiencies concerning its compliance program. In 2017, 41 state attorneys general began investigating Amerisource, along with other opioid distributors and manufacturers. In 2018, the Energy and Commerce Committee of the United States House of Representatives issued a report condemning Amerisource and two other distributors' monitoring and enforcement compliance in West Virginia. The United States Office of the Ranking Member for Homeland Security and Governmental Affairs Committee issued a similar report relating to oversight of opioid distributions in Missouri. In 2019, the New York Attorney General amended her complaint against the Company alleging, based on public investigations, that Amerisource's policies failed to stop the unlawful diversion of opioids, and that Amerisource "has consistently stood out as compared to its major competitors [because of] its unwillingness to identify suspicious orders, even among customers that regularly exceeded their thresholds and presented multiple red flags of diversion." Amerisource was also sued in multidistrict litigation in the Northern District of Ohio by "state attorneys general, cities, counties, Native American tribes, union benefit funds, and other plaintiffs." To date, Amerisource has spent over $1 billion in connection with defending and settling opioid-related litigation.

In May 2019, Plaintiffs served their books and records demand on Amerisource, seeking to "investigate whether the Company's Directors and Officers have committed mismanagement or breached their fiduciary duties" regarding the distribution of opioids, and requesting ten categories of information (the "Demand"). In June 2019, Amerisource rejected the Demand in its entirety and refused to produce any documents for inspection. After limited discovery and a one-day trial, the Court of Chancery found that Plaintiffs stated a proper purpose and were entitled to obtain responsive documents.

Takeaways

A Section 220 demand for the purpose of investigating mismanagement invokes the lowest burden of proof under Delaware law. Under Section 220(b), plaintiff must show that he or she has a "proper purpose" to inspect a company's books and records. A proper purpose is "a purpose reasonably related to such person's interest as a stockholder." When seeking to investigate wrongdoing or mismanagement, plaintiff need only show a "credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation[.]" This standard is the lowest possible burden of proof under Delaware law, and, importantly, a plaintiff can meet this standard simply through "logic, testimony or otherwise." Here, Vice Chancellor Laster found that plaintiffs readily met this standard, particularly due to the numerous reports, investigations and lawsuits detailing Amerisource's alleged misconduct, which the Court determined established a credible basis to investigate officer and board level

misconduct. The Court found that strong *circumstantial* evidence existed that Amerisource ignored indications of suspicious orders, failed to halt and investigate them, and distributed opioids to rogue pharmacies. The Court repeatedly pointed out that Amerisource is "suffering a significant corporate trauma" as a result of the numerous investigations and lawsuits, and under such circumstances, "it is likely that some level of investigation will be warranted."

Much of the evidence that the Court relied upon came from government investigations, other lawsuits, and media coverage involving Amerisource and the opioid crisis. The Court of Chancery reached a similar outcome in *In re Facebook, Inc. Section 220 Litigation*, in which plaintiffs sought to enforce their inspection rights after news outlets reported that Cambridge Analytica had acquired the private data of 50 million Facebook users, which Facebook never disclosed. There, Vice Chancellor Joseph R. Slights, III found that plaintiffs established that there was "a credible basis to infer the Board and Facebook senior executives failed to oversee Facebook's compliance with the Consent Decree [ordered by the Federal Trade Commission requiring Facebook to implement better data security protocols] and its broader efforts to protect the private data of its users." The Court relied upon public reports and findings regarding the inadequacy of Facebook's policies, the Consent Decree's mandates, Facebook's policies and business plan, news reports, regulatory authorities' investigations, and "numerous lawsuits" arising from the same conduct. Based on this information, the Court concluded that plaintiffs presented sufficient evidence showing a proper purpose in investigating the board's oversight failures. *Amerisource* and *Facebook* demonstrate that Delaware courts will rely upon publicly available information in assessing whether plaintiffs have asserted a proper purpose in connection with a Section 220 demand. However, given that *Amerisource* and *Facebook* both arose out of highly publicized scandals, the decisions may have limited applicability to Section 220 demands arising from less widely-known or publicized events.

Stockholders are not generally required to disclose the "ends" of their investigation to state a proper purpose. Amerisource argued that in order to investigate corporate wrongdoing, plaintiffs were required to disclose the "ends" of their investigation, or what they intended to do with the results of their inspection. Amerisource relied on a recent line of Court of Chancery decisions that suggested that this "purpose-plus-an-end" test is a general requirement for all Section 220 demands. Vice Chancellor Laster rejected the general application of that test as "go[ing] beyond what Section 220 and Delaware Supreme Court precedent require." The Court analyzed the first two cases that applied the "purpose-plus-an-end" test, in which the stockholders sought to inspect the company's books and records *solely* to pursue litigation. Distinguishing those cases from the present case, the Court explained that plaintiffs here were exercising inspection rights to "consider *any remedies*" and "to evaluate possible litigation *or other corrective measures*[.]" The Delaware Supreme Court has explained that stockholders may use the results of their Section 220 investigation to pursue litigation *or* other means to address a potential problem, such as proposing reforms to the board, preparing a resolution for the next annual meeting, or mounting a proxy fight. Because Section 220 "only requires that a stockholder state a proper purpose" and the Delaware Supreme Court has not otherwise expanded that requirement, the Court declined to find the Demand deficient for failing to state the ends of plaintiffs' investigation. The Court observed, however, that stockholders' intentions can be relevant in this context—for example, if there is a question as to whether the stated purpose is the stockholder's real purpose for the investigation, and the stockholder cannot identify any credible potential use for the documents, then the Court could infer that a stockholder's stated purpose is not its actual purpose and deny inspection rights.

Stockholders are not required to provide evidence of an actionable claim to state a proper purpose. Amerisource argued that plaintiffs were required to submit evidence showing "a credible basis to suspect actionable wrongdoing on the part of the Board" in order to state a proper purpose for investigating Amerisource's failure of oversight (known as a "*Caremark* claim"). Amerisource argued that the standard in the Section 220 context should align with that of a demand for board action pursuant to Court of Chancery Rule 23.1. As a threshold issue, the Court disposed of this argument because the Demand did not state that the only purpose of the inspection was to investigate a *Caremark* claim and therefore, plaintiffs were permitted to "use the fruits of their investigation for other purposes." The Court also rejected the notion that plaintiffs are required to provide evidence of an *actionable* The Court held that this standard would "impose an onerous burden on stockholders" and is inconsistent with existing precedent that only requires a showing that "there is a credible basis to infer possible corporate wrongdoing or mismanagement." The Court further explained that the Supreme Court has instructed plaintiffs to utilize their rights under Section 220 *before* filing derivative actions because otherwise, plaintiffs lack necessary facts and information to support the alleged claims. Therefore, if a books and records demand is necessary to gain information to support a derivative complaint, the standard to survive a motion to dismiss such a complaint cannot be the same as the standard to enforce inspection rights under Section 220. Indeed, the Court highlighted at least two cases in which the Court found plaintiffs failed to state a claim under Rule 23.1, dismissed the action without prejudice, and subsequently found plaintiffs stated a proper purpose in connection with a related Section 220 demand. Delaware courts have also, in dismissing plaintiffs' claims pursuant to Rule 23.1, "admonished the plaintiffs for not having used the 'tools at hand' to develop their claims before filing suit." Based on the Court's review of guiding Delaware precedent, the Court concluded that the "operative question is whether a stockholder has shown a credible basis to suspect possible mismanagement or wrongdoing at the corporation" and not whether plaintiffs presented "some evidence from which a *Caremark* claim could be inferred." Because plaintiffs had made such a showing here, the Court found plaintiffs stated a proper purpose in investigating possible mismanagement or wrongdoing.

It is difficult to successfully assert merit-based defenses in Section 220 litigation. Amerisource argued that plaintiffs failed to state a proper purpose because any potential claims filed as a result would not be actionable in light of the provision in Amerisource's charter precluding monetary liability on the part of directors to stockholders for breaches of due care (enacted pursuant to DGCL 102(b)(7)). Amerisource also argued that such claims would be time-barred. The Court rejected both of these arguments as a basis to reject the demand because (1) the stockholders' purpose was not limited to filing litigation and (2) plaintiffs are not required to show an actionable claim to assert inspection rights. The Court also held that, at this early stage of proceedings, it is unclear whether plaintiffs could assert any non-exculpated or timely claims. Based on the evidence presented, however, the Court concluded that the "fruits of a books and records investigation could potentially lead to non-exculpated claims" such as breaches of the duty of loyalty. Applying similar reasoning with respect to a statute of limitations defense, the Court stated that "[r]arely will a court be able to reach that conclusion because the scope of merits-related discovery in a summary Section 220 proceeding is limited, and this court has been hesitant in Section 220 proceedings to permit 'the factual development necessary to asses fairly . . . a time-bar affirmative defense.'"

Stockholders that seek inspection of books and records for purposes other than filing a lawsuit face fewer hurdles for stating a proper purpose. The Court rejected most of Amerisource's merit-based arguments because the Demand was not limited to filing a lawsuit. As

a result, any defenses that otherwise would warrant dismissal of a lawsuit were insufficient here. Stockholders may, therefore, increasingly state broader purposes for investigations to limit the number of defenses that defending companies may assert.

The Court will allow discovery "to understand what books and records exist" beyond formal board minutes and materials. The Court determined that Amerisource improperly denied plaintiffs discovery on the existence of books and records other than formal board documents, and ordered Amerisource to sit for a corporate deposition under Court of Chancery Rule 30(b)(6) so that plaintiffs could "determine what other types of books and records exist and who has them." The Court rejected Amerisource's argument that KT4 Partners LLC v. Palantir Technologies, Inc. operates as a bar to stockholders obtaining discovery into the types and sources of a company's books and records in a Section 220 proceeding. Accordingly, companies faced with an inspection demand should consider what documents exist and their custodians and locations while assessing the substance of plaintiffs' demand.

If stockholders show a proper purpose, the Court likely will order the production of board-level documents showing directors' deliberations and decisions, including the materials the board received in connection with such decisions. The Court distinguished among three levels of documents sought in connection with a Section 220 demand: Formal Board Materials, Informal Board Materials, and Officer-Level Materials. Formal Board Materials are "board-level documents that formally evidence the directors' deliberations and decisions and comprise the materials that the directors formally received and considered." Informal Board Materials include "materials that evidence the directors' deliberations, the information that they received, and the decisions they reached[,]" and may involve communications among directors and senior-level officers and managers, information disseminated outside of "formal channels" or "in between formal meetings," or director-director communications, including on non-corporate accounts. Officer-Level Materials are "communications and materials that were only shared among or reviewed by officers and employees." The Court stated that the "starting point (and often end point) for an adequate inspection" is the Formal Board Materials, but indicated a willingness to order broader inspection when appropriate. Because Amerisource had denied plaintiffs *any* documents, the Court ordered the production of Formal Board Materials, and ordered more discovery on what additional documents existed so that it could assess whether plaintiffs were entitled to review Informal Board Materials and/or Officer-Level Materials given the "significant role" the board, officers, and managers played in monitoring compliance.

Finally, while Plaintiffs are entitled only to documents that are "essential and sufficient" to the stated purpose of a Section 220 demand, access to so-called informal board materials, including emails and texts, is increasingly being permitted. In light of these recent legal developments, companies should confer with experienced counsel on the various strategic considerations implicated by a stockholder demand under Section 220.

Please click here for the full *Amerisource* opinion.

The complete publication, including footnotes, is available here.