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## [Delaware Chancery Court Dismisses Derivative Plaintiff's Section 220 Books And Records Action](#)

In *King v. VeriFone Holdings, Inc.*, C.A. No. 5045-VCS (Del. Ch. May 12, 2010), the [Delaware Court of Chancery](#) dismissed a derivative plaintiff's Section 220 books and records action on the ground that the purpose for the request – to bolster demand futility allegations in the prematurely filed derivative complaint – was improper. The court criticized plaintiff for filing a derivative complaint before counsel was able to complete his investigation, solely to “win the race to the courthouse.” This decision reflects the Chancery Court's willingness to impose consequences on plaintiffs who do not follow appropriate procedures in their haste to obtain lead plaintiff status.

VeriFone provides secured electronic payment technologies such as point-of-sale software and terminals, security and encryption software. On December 3, 2007, VeriFone announced it would restate its financial statements for the first three quarters of fiscal year 2007 due to accounting errors that occurred when VeriFone acquired Lipman Electronic Engineering, Ltd. The disclosure led to an investigation and the filing of a civil complaint by the Securities and Exchange Commission (“SEC”), as well as a stock price drop and the filing of, among other actions, a shareholder derivative suit in the [United States District Court for the Northern District of California](#).

Prior to bringing suit, however, plaintiff did not undertake any pre-suit investigation. VeriFone challenged the complaint based on failure to establish that demand on the VeriFone board of directors would have been futile. The district court granted VeriFone's motion to dismiss the derivative complaint, rejecting plaintiff's argument that demand was futile because the independent board majority at VeriFone faced the prospect of personal liability for committing accounting fraud. Plaintiff amended his complaint, but that complaint was dismissed on the same ground.

In an effort to bolster his demand futility allegations and rectify the shortcomings of his twice-dismissed complaint, plaintiff filed an action in Delaware Chancery Court under [Section 220 of the Delaware General Corporation Law](#) seeking disclosure of internal books and records from VeriFone. Plaintiff's only stated purpose for examining the books and records of VeriFone was to help him plead a viable theory of demand futility for the derivative action in the California federal court.

The Chancery Court dismissed the Section 220 action, applying the Delaware Supreme Court's oft-repeated

view that derivative plaintiffs should seek books and records and otherwise conduct adequate investigation into demand futility *before* filing a derivative complaint. To allow otherwise would result in a waste of judicial resources by allowing numerous actions in differing jurisdictions. The court stressed that plaintiffs in derivative actions have heightened pleading standards so that shareholders cannot cause the corporation to waste money and resources on discovery for meritless claims based upon conclusory allegations. Additionally, filing the Section 220 action in Delaware while the related suit was pending in California went against public policy of avoiding subjecting defendants to concurrent suits in different forums.

The court noted and discussed the conflicting incentives of plaintiffs to either conduct preliminary discovery or be the first to file suit and obtain lead plaintiff status. The court explained that derivative suits are a method through which shareholders should further the corporation's interests; they are not meant to further a single plaintiff's interests. Allowing plaintiff here to pursue his Section 220 action after filing his original suit would only serve to incent plaintiffs to "race to the courthouse" rather than reward diligent research. Without specifically setting forth a method to deal with the conflicting interests, the court suggested that premature derivative complaints should be dismissed with prejudice as to the named plaintiff, effectively leaving the lawsuit in place allowing the named lead plaintiff to be replaced with one who has conducted the necessary preliminary investigation. The court acknowledged, however, that there is no simple solution to the problem, but that consistently rewarding haste and ill-preparedness only served to increase costs.

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