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Delaware Chancery Court Considers Scope of Section 220 Books and Records Demand Made Where Sole Purpose Is to Investigate a Potential Derivative Suit

In [*Graulich v. Dell, Inc.*](#), 2011 WL 1843813 (Del. Ch. May 16, 2011), the [Delaware Court of Chancery](#) rejected a stockholder's demand under [Section 220](#) of the Delaware General Corporation Law ("Section 220"). Section 220 provides that a stockholder in a Delaware corporation may, under certain conditions, request that that corporation make available certain books and records, provided that the request is made for a "proper purpose." In *Graulich*, the Court held that the plaintiff stockholder, who sought books and records for the purpose of investigating and possibly filing a derivative lawsuit against the company's officers and directors, nonetheless lacked a "proper purpose" because the stockholder did not have legal standing to bring the derivative suit and the potential claims the stockholder wished to pursue were time-barred and barred by claim preclusion.

Plaintiff in *Graulich* made a Section 220 demand to defendant Dell, Inc. ("Dell") to inspect Dell's books and records. Plaintiff's demand letter to Dell requested that Dell make available for inspection documents regarding alleged corporate mismanagement relating to Dell's sale of OptiPlex computer systems from 2003 to 2005 and its 2006 corporate disclosures. Issues with defective parts in Dell's OptiPlex computer systems had led to extensive losses. Plaintiff's demand stated that he wished to inspect Dell's books and records for the purpose of commencing "an appropriate suit." Dell refused plaintiff's Section 220 demand, asserting that plaintiff failed to state a proper purpose under Section 220 because plaintiff was not a stockholder at the time of the alleged misconduct and because Dell had entered into a settlement in a Texas state court related to the OptiPlex issues at Dell (the "Texas Action") whereby Dell obtained a full release of all claims — including future claims — relating to OptiPlex.

After receiving Dell's rejection of his Section 220 demand, plaintiff filed an action in Delaware Court of Chancery alleging that Dell had improperly rejected his Section 220 books and records request. The court disagreed, holding that plaintiff lacked a proper purpose in making his Section 220 books and records request. The Court cited three

reasons requiring this conclusion.

First, the court held that plaintiff lacked standing to file a derivative lawsuit. In order to have legal standing to bring a derivative suit, a plaintiff must have been “a stockholder of the corporation at the time of the alleged wrongdoing.” Plaintiff’s claims in this action, however, “all involve[d] alleged wrongdoing that took place from 2003 through 2006,” but plaintiff admitted that, at best, he had acquired Dell’s shares in February 2007. Because plaintiff could not satisfy the “contemporaneous ownership” rule, the court concluded that plaintiff lacked standing to file a derivative lawsuit.

Second, the court held that plaintiff’s potential derivative lawsuit was time-barred. Noting that the statute of limitations for breach of fiduciary duty claims in Delaware typically is three years, the court held that plaintiff’s proposed derivative lawsuit would be filed at least two years after the statute expired. The court rejected plaintiff’s contention that the doctrine of fraudulent concealment or equitable tolling applied to extend the statute of limitations, determining that plaintiff was “put on inquiry notice in November 2005 (if not earlier), when Dell publicly filed its Form 10-Q disclosing problems with the OptiPlex systems and associated charges incurred by the company.”

Third, the court held that plaintiff’s claims were barred by claim preclusion from the Texas Action. The Court recognized that “[t]he Texas Action was based on the same set of facts” that plaintiff sought to investigate by reviewing Dell’s books and records.” The court rejected plaintiff’s argument that the two suits differed because plaintiff’s proposed suit was targeted at a “failure to supervise,” finding that “the underlying facts alleged in the Texas Action *did* cover the same core facts plaintiff” was purporting to investigate.

Taking these three reasons together, the court concluded that plaintiff had “failed to state proper purpose under 8 *Del. C.* § 220.” The court did note, however, that if plaintiff had stated a purpose *other than* filing a derivative suit, his Section 220 demand might have been proper, noting that plaintiff “could have purported to seek to investigate corporate mismanagement . . . to ‘take appropriate action’ such as ‘engag[ing] in a proxy contest, or communicat[ing] directly with the board’ or to take ‘some specific action other than evaluating the actions of the board for a potential derivative suit.’”

Graulich confirms that courts look carefully at a books and records demand made pursuant to Section 220 to determine if such a demand is made with a “proper purpose.” Where, as here, the demand is made solely for the purpose of investigating and then initiating a possible derivative suit, a court will scrutinize the underlying

infirmities of such a derivative suit before forcing a company to comply with a Section 220 demand for its books and records.

For further information, please contact [John Stigi](#) at (310) 228-3717 or [Martin White](#) at (415) 774-3233.