

October 22, 2010 | Posted By

## [Delaware Supreme Court Requires Credible Evidence Of A "Proper Purpose" To Review A Corporation's Books And Records](#)

In *City of Westland Police & Fire Retirement System v. Axcelis Technologies, Inc.*, 1 A.3d 281 (Del. 2010), the [Delaware Supreme Court](#) affirmed the dismissal of an action brought under Section 220 of the Delaware General Corporation Law, [8 Del. Code § 220](#), to review books and records of a corporation. The [Court of Chancery](#) had dismissed the action on the ground that plaintiff failed to present "some evidence" suggesting a "credible basis" from which the court could infer a "proper purpose" for the review, such as possible wrongdoing or mismanagement. The decision offers enhanced guidance on the "proper purpose" test, particularly with respect to corporations that follow "plurality plus" governance policies.

Axcelis Technologies, Inc. ("Axcelis") is a Delaware corporation specializing in the manufacture of ion implantation and semiconductor equipment. Plaintiff is a Michigan pension fund that beneficially owns Axcelis common stock. In 1983, Axcelis and a Japanese company, Sumitomo Heavy Industries, Ltd. ("Sumitomo"), became partners in a joint venture. In February and March 2008, Sumitomo made two unsolicited bids to acquire Axcelis. The Board of Directors of Axcelis rejected the bids, stating that the bids undervalued Axcelis and were not in the best interests of the company or its shareholders. The Board, however, expressed its willingness to meet with Sumitomo privately to explore whether the parties could reach an agreement on a transaction involving their joint venture.

In May 2008, Axcelis held its annual shareholders' meeting. Three directors stood for reelection at that meeting. Axcelis follows a "plurality plus" governance policy under which a director may be elected without receiving a majority of the votes cast. If a director is elected with less than a majority of the votes cast, however, the director must submit a letter of resignation for the Board's consideration. At the May 2008 meeting, the three directors who stood for reelection received less than a majority of the votes cast, triggering the "plurality plus" governance policy. In accordance with that policy, the three directors tendered letters of resignation. The Board decided, though, not to accept the resignations.

In June 2008, the parties agreed that Sumitomo would submit a revised acquisition proposal by August 1, 2008. After Axcelis furnished Sumitomo due diligence information, Sumitomo requested an extension of the deadline for the revised proposal. Axcelis did not agree to the extension and Sumitomo informed Axcelis it was putting all acquisition discussions "on hold." Axcelis publicly announced that development and its stock dropped significantly. This led plaintiff to send a written demand to review Axcelis' books and records. After the company rejected the demand, plaintiff filed a complaint seeking court-ordered

inspection of Axcelis' books and records under Section 220 of the Delaware General Corporation Law.

Section 220(c) requires that the person seeking inspection establish that it has a "proper purpose" for doing so. Plaintiff argued that it did so state a proper purpose for its demand: to investigate possible management wrongdoing. More specifically, plaintiff claimed that the Axcelis Board's rejection of Sumitomo's acquisition proposals and the directors' resignations established a credible basis from which the court could infer that wrongdoing may have occurred. Plaintiff contended that the Board's rejection of the acquisition proposals constituted improper "defensive measures" (*i.e.*, board entrenchment) and that the Board's refusal to accept the directors' resignations thwarted the will of the shareholders who did not vote for their reelection. The Chancery Court rejected plaintiff's assertions, finding that the uncontested facts in the record did not support any entrenchment motive other than plaintiff's bare accusations. The lower court thus found no credible basis to infer any possible wrongdoing or bad faith by the Axcelis Board.

On appeal, plaintiff conceded that the lower court invoked the proper standard for reviewing a Section 220 demand, namely, that a plaintiff seeking inspection of books and records must present some evidence, "through documents, logic, testimony or otherwise," to suggest a credible basis from which the court could infer that wrongdoing may have occurred. Plaintiff argued, however, that the lower court misapplied that standard by requiring plaintiff to provide *affirmative evidence* of wrongdoing. Plaintiff also argued that the uncontested facts, standing alone, established a credible basis to infer wrongdoing.

The Supreme Court disagreed. Relying upon [\*Seinfeld v. Verizon Communications, Inc.\*](#), 909 A.2d 117 (Del. 2006), it noted that a "mere statement of a purpose to investigate possible general mismanagement, *without more*, will not entitle a shareholder to broad § 220 inspection relief." A plaintiff may establish a credible basis to infer wrongdoing "through documents, logic, testimony or otherwise." Such evidence need not prove that wrongdoing, in fact, occurred. The credible basis standard "sets the lowest possible burden of proof" and a reduction of that burden "would be tantamount to permitting inspection based on the plaintiff-stockholder's suspicion of wrongdoing." Like the Chancery Court, the Supreme Court did not interpret the facts as plaintiff did. The Court concluded there simply was no credible basis in the record to infer that the Axcelis Board's decisions to reject Sumitomo's proposals and its request to extend the proposal deadline were other than good faith business decisions.

Regarding the Axcelis Board's decision to reject the director resignations, the Supreme Court disagreed with plaintiff that in cases where a plurality plus policy is triggered, a corporation's board must show it had a compelling justification for rejecting the resignations. Such a requirement, the Court observed, would improperly shift to the corporation plaintiff's burden to establish a "proper purpose." One judicially recognized proper purpose is "to determine an individual's suitability to serve as a director." [\*Pershing Square, L.P. v. Ceridian Corp.\*](#), 923 A.2d 810, 818 (Del. Ch. 2007). Plaintiff did not rely upon this purpose in seeking relief; but even if it had, the Court noted, "merely stating this purpose does not automatically

entitle a shareholder to relief.” The Supreme Court thus affirmed dismissal of plaintiff’s action.

The Supreme Court went on to elaborate on the director reelection/resignation issue because the “relationship between the shareholder inspection right and the ‘plurality plus’ policy adopted by the Axcelis board merits sharper focus for future guidance.” Where a board unilaterally confers upon itself the power to override an exercised shareholder voting right without prior shareholder approval, the board should be accountable for its exercise of that power. This accountability, the Court advised, should take the form of being subject to a shareholder’s Section 220 right to seek inspection of any documents and records upon which the board relied in deciding not to accept the tendered resignations. To be entitled to inspection, however, the shareholder-plaintiff must also show that the information it seeks is necessary and essential to assessing the suitability of a director for reelection. This, the Court opined, “strikes the appropriate balance between the shareholders’ entitlement to information and the directors’ entitlement to make decisions in the corporation’s best interest free from abusive litigation.”

This decision from the Delaware Supreme Court offers enhanced guidance on shareholder inspection rights, particularly with respect to Delaware corporations that follow board-adopted plurality plus policies.

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