SULLIVAN & CROMWELL LLP

January 17, 2020

Delaware Chancery Court Orders Production of Board Materials and Deposition of Corporate Representative in Section 220 Books and Records Litigation

Court Rejects Argument That Stockholders Must Assert a Credible Basis of Actionable Wrongdoing to Obtain Books and Records and Places Burden on Company to Identify Relevant Documents

SUMMARY

In a January 13, 2020 decision, Vice Chancellor Travis Laster of the Delaware Court of Chancery held in *Lebanon County Employees' Retirement Fund and Teamsters Local 443 Health Services & Insurance Plan* v. *AmerisourceBergen Corp.*[1] that plaintiffs, putative AmerisourceBergen stockholders, were entitled under 8 Del. C. § 220 to inspect board-level documents that formally evidence the directors' deliberations and decisions (which the Court referred to as "Formal Board Materials") relating to whether AmerisourceBergen engaged in wrongdoing in connection with the distribution of opioids and also to take a Rule 30(b)(6) deposition to ascertain whether other pertinent information exists.

The Court described AmerisourceBergen's opioid issues as a "corporate trauma," and concluded that a wealth of circumstantial evidence as to potential illegal behavior was enough to justify the Section 220 request even if the stockholder was not yet in a position to show that the facts surrounding the trauma would lead to a legally cognizable claim. Indeed, the Court held that Section 220 did not require such a showing and that inspection of books and records to determine if a legal claim existed was a sufficient purpose under the statute to justify the inspection. The Court further reasoned that because Section 220 did not require a showing of a legal claim, AmerisourceBergen's Section 102(b)(7) charter provision

exculpating directors from liability for breaches of the fiduciary duty of care has no bearing on whether grounds exist to inspect documents. The Court also took the opportunity to explain in response to AmerisourceBergen's Section 102(b)(7) argument how AmerisourceBergen's opioid problems could lead to a claim that its directors breached their fiduciary duty of loyalty by inadequately supervising AmerisourceBergen's handling of the opioid issues.

The decision will likely be viewed favorably by stockholders seeking to use Section 220 in the wake of corporate trauma to bolster a *Caremark* claim seeking to hold directors and officers personally liable for breaching their duty of loyalty to monitor corporate operations.

BACKGROUND

AmerisourceBergen is one of the three largest distributors of opioids in the United States. As an opioid distributor, AmerisourceBergen must comply with the Comprehensive Drug Abuse Prevention and Control Act of 1970 and its implementing regulations (collectively, the "Controlled Substances Act").

In 2007, the DEA suspended AmerisourceBergen's license for one of its distribution centers because of its involvement with "rogue pharmacies" that "were diverting controlled substances into other than legitimate medical, scientific and industrial channels." The DEA and AmerisourceBergen settled the dispute in return for certain compliance reforms.

Nevertheless, since 2012, numerous government actors have initiated investigations into or filed lawsuits regarding AmerisourceBergen's opioid-distribution practices, including an action brought by the West Virginia Attorney General that the company paid $16 million to settle. Committees of the United States House of Representatives and Senate have issued reports concluding that since the DEA settlement, AmerisourceBergen has "failed to address suspicious order monitoring" and "consistently failed to meet their reporting obligations" regarding suspicious opioid orders.[2]

AmerisourceBergen is currently a defendant along with other opioid distributors in a multidistrict litigation that centralized 1,548 different lawsuits alleging that AmerisourceBergen and other distributors collaborated to increase DEA-imposed limits on the volume of opioids and to increase opioid sales by working through third-party organizations. The multidistrict litigation survived both a motion to dismiss and summary judgment. In response to the summary judgment motion, plaintiffs presented evidence that "AmerisourceBergen continued the practice of shipping some orders it identified as suspicious, with little or no documentation as to whether a due diligence investigation was conducted," and that the company's due diligence program was "ineffective and toothless."[3] Since September 2017, AmerisourceBergen has spent more than $1 billion in litigation and opioid-related costs.

In May 2019, plaintiffs served a books and records demand on AmerisourceBergen to (i) investigate possible breaches of fiduciary duty and mismanagement by the Board or management in connection with

the company's distribution of opioids; (ii) consider any remedies to be sought; (iii) evaluate the independence of the Board; and (iv) evaluate possible litigation or other corrective measures. The demand sought "Board Materials" relating to ten categories of information. The company rejected the demand in its entirety, contending that plaintiffs failed to state a proper purpose or a credible basis to suspect wrongdoing, and that the scope of the inspection was overly broad. Plaintiffs filed suit in July 2019.

THE COURT OF CHANCERY DECISION

Section 220 of the Delaware General Corporation Law permits stockholders to inspect books and records only if stockholders have a proper purpose for the inspection, and investigating potential wrongdoing is only a proper purpose if the stockholder can show, "by a preponderance of the evidence, a credible basis" of that wrongdoing.[4] The *AmerisourceBergen* Court noted that the credible basis standard is the "lowest possible burden of proof."[5]

The Court held that plaintiffs "may rely on circumstantial evidence" to meet this standard and that, in the *AmerisourceBergen* case, the "flood of government investigations and lawsuits relating to AmerisourceBergen's opioid-distribution practices is sufficient to establish a credible basis to suspect wrongdoing warranting further investigation."[6]

Attempting to set up a predicate for its defenses, AmerisourceBergen argued that the plaintiffs' only articulated purposes relate to seeking information to bring a derivative litigation. The company then argued that such a purpose is improper because plaintiffs did not allege a credible basis to infer that any actionable claims existed.

The Court rejected AmerisourceBergen's position for several reasons. *First*, the Court held that a stockholder need not "commit in advance to what it will do with an investigation before seeing the results of the investigation."[7] The Court stated that the fact that plaintiffs did not spell out potential uses for books and records besides initiating litigation did not preclude them from seeking documents for those purposes. In so reasoning, the Court distinguished a line of authority stating that a stockholder must "not only state a proper purpose, but also 'must state a reason for the purpose, i.e., what it will do with the information, or an end to which that investigation may lead.'"[8] The Court noted that those decisions "involved fact-specific contexts that supported rulings that the stockholders were only seeking books and records to pursue litigation" and that they had "not identified any other ends in their demands."[9]

Second, the Court rejected AmerisourceBergen's argument that plaintiffs "must present evidence demonstrating a credible basis to suspect *actionable* wrongdoing on the part of the Board."[10] The Court noted that the argument fails for the "threshold reason" that "plaintiffs are not seeking books and records for the sole purpose" of initiating litigation.[11]

The Court said, "[i]n substance," AmerisourceBergen "contends" that to receive documents a stockholder must "introduce evidence sufficient to support a claim that could survive a pleading-stage motion to dismiss pursuant" to that standard."[12] The Court rejected this position, pointing to Delaware Supreme Court authority stating that "to obtain books and records, a stockholder's evidence of corporate wrongdoing need not be sufficient to establish an actionable claim."[13]

Third, the Court held that, since the stockholders' purposes were not limited to asserting a claim, and stockholders need not establish an actionable claim, AmerisourceBergen's charter provision exculpating directors from liability for breaches of the fiduciary duty of care did not impact the books and records demand. The Court also held that, in any event, the topics "plaintiffs wish to investigate could well lead to non-exculpated" duty of loyalty claims given allegations that AmerisourceBergen's Board did not properly discharge their oversight duties.[14] The Court then took the opportunity to roadmap a potential non-exculpable claim the stockholders might assert claiming that the AmerisourceBergen directors and officers, in dealing with the company's opioid issues, failed to implement corporate controls or consciously disregarded red flags that put them on notice of potential corporate trauma.[15]

Moving onto the scope of plaintiffs' document demands, the Court noted that formal board materials are typically the "starting point (and often the ending point) for an adequate inspection," but that with a proper showing, "an inspection may extend to informal board materials" such as directors' emails with senior employees or "communications and materials that were only shared among or reviewed by officers and employees."[16]

The Court thus held that plaintiffs are entitled to at least the Formal Board Materials, but also stated that since "AmerisourceBergen prevented the plaintiffs from obtaining any information about what types of books and records exist and who has them," the Court "lacks a record on which to base a final order."[17] The Court then ruled that plaintiffs may depose a company representative "to determine what other types of books and records exist and who has them," and if the parties could not agree to a final production after the deposition, the plaintiffs could "make a follow-on application for Informal Board Materials or Officer-Level Documents."[18]

IMPLICATIONS

The Court of Chancery's decision in *AmerisourceBergen* is another victory for stockholders seeking to broaden the scope of Section 220 through what has become nearly routine books and records requests. The decision seems to permit stockholders to sidestep any requirement to assert a credible basis of actionable wrongdoing by alleging purposes for the request other than litigation; indeed, by its own terms the decision provides that plaintiffs are not even required to state how they will use any materials obtained. However, *AmerisourceBergen* is unlikely to be the final word on what purposes are proper and the extent to which plaintiffs must explicate those purposes in their demands. Just recently, Vice Chancellor Joseph

Slights III rejected a stockholder's attempt to obtain books and records that would be "material in the prosecution of a proxy context" where the stockholder did not allege a credible basis to infer mismanagement.[19] The Court there noted that the relevant law is "at best, murky," and that it "may well be that, in the right case, this court might endorse a rule that would allow a stockholder to receive books and records relating to questionable, but not actionable, board-level decisions so that he can communicate with other stockholders in aid of a potential proxy contest. After carefully considering the evidence and the arguments of counsel, however, I am satisfied this is not that 'right case.'"[20]

Moreover, corporations are wise to hope that the Court's order that AmerisourceBergen submit to a deposition regarding the documents available for inspection will not become a trend. A lengthy seven-hour deposition could lead to any number of unfortunate answers to carefully crafted leading questions on topics only loosely related to available documents and their custodians, and the ability to object to questions is limited under Delaware procedure. Finally, any analysis of the case cannot ignore the fact that it was written in the context of a company being accused of contributing to the ongoing opioid crisis. It is unclear whether the *AmerisourceBergen* court or other courts would have reached a similar conclusion if the underlying issues were not at that level of "Corporate Trauma."

The decision further emphasizes the continued need for companies to pay careful attention to the record being built at the board level. This, combined with Delaware case law suggesting that director emails and texts could be subject to a Section 220 request, poses a real risk of eroding the confidentiality of board proceedings and could push directors and management teams to being less open and collegial with each other—especially when combined with the possibility that directors may feel that they are being "watched" or "judged" by activist-designees who now sit on so many public-company boards.

* * *

ENDNOTES

1 No. 2019-0527-JTL (Del. Ch. Jan. 13, 2020).

2 *AmerisourceBergen*, No. 2019-0527-JTL, at *7-8.

3 *Id.* at *11.

4 *Id.* at *16.

5 *Id.* at *17.

6 *Id.* at *20.

7 *Id.* at *24.

8 *Id.* at *26-27 (quoting *W. Coast Mgmt. & Capital, LLC* v. *Carrier Access Corp.*, 914 A.2d 636, 646 (Del. Ch. 2006)).

9 *Id.* at *27.

10 *Id.* at *30 (emphasis added).

11 *Id.*

12 *Id.* at *30-31.

13 *Id.* at *33.

14 *Id.* at *40.

15 *Id.* at *40-48.

16 *Id.* at *51-53.

17 *Id.* at *57.

18 *Id.*

19 *High River Ltd. P'ship* v. *Occidental Petroleum Corp.*, 2019 WL 6040285, at *1 (Del. Ch. Nov. 14, 2019).

20 *Id.*

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

Werner F. Ahlers	+1-212-558-1623	ahlersw@sullcrom.com
Francis J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohena@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Scott B. Crofton	+1-212-558-4682	croftons@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
John Evangelakos	+1-212-558-4260	evangelakosj@sullcrom.com
Brian T. Frawley	+1-212-558-4983	frawleyb@sullcrom.com
Sergio J. Galvis	+1-212-558-4740	galviss@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Matthew B. Goodman	+1-212-558-4995	goodmanm@sullcrom.com
Brian E. Hamilton	+1-212-558-4801	hamiltonb@sullcrom.com
John L. Hardiman	+1-212-558-4070	hardimanj@sullcrom.com
Matthew G. Hurd	+1-212-558-3122	hurdm@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Keith A. Pagnani	+1-212-558-4397	pagnanik@sullcrom.com
Richard C. Pepperman II	+1-212-558-3493	peppermanr@sullcrom.com
Richard A. Pollack	+1-212-558-3497	pollackr@sullcrom.com
George J. Sampas	+1-212-558-4945	sampasg@sullcrom.com
Melissa Sawyer	+1-212-558-4243	sawyerm@sullcrom.com

Matthew A. Schwartz	+1-212-558-4197	schwartzmatthew@sullcrom.com
Alan J. Sinsheimer	+1-212-558-3738	sinsheimera@sullcrom.com
Krishna Veeraraghavan	+1-212-558-7931	veeraraghavank@sullcrom.com
Washington, D.C.		
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Rita-Anne O'Neill	+1-310-712-6698	oneillr@sullcrom.com
Adam S. Paris	+1-310-712-6663	parisa@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Robert A. Sacks	+1-310-712-6640	sacksr@sullcrom.com
Palo Alto		
Scott D. Miller	+1-650-461-5620	millersc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
London		
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
Jeremy B. Kutner	+44-20-7959-8484	kutnerj@sullcrom.com
Ben Perry	+44-20-7959-8477	perryb@sullcrom.com
Richard A. Pollack	+44-20-7959-8404	pollackr@sullcrom.com
Evan S. Simpson	+44-20-7959-8426	simpsone@sullcrom.com
Paris		
Olivier de Vilmorin	+33-1-7304-5895	devilmorino@sullcrom.com
Frankfurt		
Carsten Berrar	+49-69-4272-5506	berrarc@sullcrom.com
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
York Schnorbus	+49-69-4272-5517	schnorbusy@sullcrom.com
Brussels		
Michael Rosenthal	+32-2896-8001	rosenthalm@sullcrom.com
Melbourne		
Waldo D. Jones Jr.	+61-3-9535-1508	jonesw@sullcrom.com
Sydney		
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo		
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Kay Ian Ng	+852-2826-8601	ngki@sullcrom.com

Beijing			
	Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com