

Stockholders Granted Right to Inspect Stock Option

Records Predating Their Purchase of Stock

In *Melzer v. CNET Networks, Inc.*, C.A. No. 3023 (Del. Ch. Nov. 21, 2007), Chancellor Chandler granted plaintiffs access to stock option records predating their purchase of CNET stock. The plaintiffs initially brought suit in a California federal court, asserting federal securities and state law claims against CNET and its directors for backdating options. In response to defendants' motion to dismiss, the plaintiffs argued that demand was futile for two reasons. Under the first prong of *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), plaintiffs claimed that, if the directors received backdated options, they were not disinterested. Under *Aronson's* second test, plaintiffs argued that demand should be excused, as it was in *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007), because a majority of the board was interested, having engaged in backdating in violation of the corporate charter. The California court rejected these arguments because plaintiffs failed to allege particularized facts, but granted leave to amend pending adjudication in Delaware of a books and records inspection case brought pursuant to 8 *Del. C.* § 220.

The principal issue contested in the Delaware 220 action was the scope of inspection. Plaintiffs sought stock option information predating their purchase of CNET shares. CNET claimed the plaintiffs were not entitled to the information because of the contemporaneous ownership rule for derivative actions under 8 *Del. C.* § 327. The Chancellor rejected the argument, explaining that the plaintiffs did not seek facts supporting a claim, but facts supporting demand futility. Under the second prong of *Aronson*, plaintiffs could show demand futility by pleading particularized facts showing the board's actions were not the product of valid business judgment. The Chancellor concluded, "[b]ecause *Stone v. Ritter* held that a violation of the duty of loyalty/good faith described in *Caremark* can, in theory, excuse demand, and

because plaintiffs might need older documents to establish a 'sustained or systematic failure' of oversight," the request was reasonably related to the plaintiff's proper purpose.

Although this decision is not entirely unprecedented, it is important for several reasons. Most important is that a stockholder seeking to bring a derivative action can demand inspection predating ownership of shares to support demand futility. In that regard, the opinion expands the "tools at hand" available to shareholders investigating possible mismanagement claims. The opinion also recognizes that information predating stock ownership may be useful to shareholders bringing *Caremark* claims. Notably, the Chancellor emphasized in this decision that a stockholder's burden under Section 220 is "'the lowest possible standard' in Delaware jurisprudence."

November 29, 2007

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