

Produce Those Documents; Conflict Allegations Sufficient to Merit Inspection of Books and Records Under Section 220 of the DGCL

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In [*Alexandria Venture Inv. LLC et al. v. Verseau Therapeutics, Inc.*, C.A. No. 2020-0593-PAF \(Del. Ch. Dec. 18, 2020\)](#), the Delaware Court of Chancery (the “Court”) granted plaintiff stockholder’s motion seeking to compel inspection of certain books and records of Verseau Therapeutics pursuant to Section 220 of the Delaware General Corporation Law (“DGCL”). The Court ruled that the stockholders met the low threshold necessary to establish a credible basis for believing that corporate wrongdoing had occurred. While disagreements with management decisions are insufficient to meet this burden, evidence of a conflict of interest in making management decisions is sufficient.

Alexandria Venture Investments, LLC., Alexandria Equities No. 7, LLC., and Alexandria Venture (collectively “Plaintiffs”) motion to compel inspection of books and records under Section 220 centers on Verseau’s (“Defendant”) rejection of Plaintiffs’ funding offer. Largely due to the COVID-19 pandemic, Defendant needed financing because the company did not have enough cash to sustain its operations. With seemingly no other financing options available, Defendant rejected Plaintiffs’ financing term sheet (“Term Sheet”). Plaintiffs contended that Defendant’s rejection was fueled by a conflict of interest, largely related to Defendant’s decision to favor compensating its directors rather than accepting an agreement that would benefit its shareholders, resulting in a breach of Defendant’s fiduciary duty to its stakeholders. Defendant argued that Plaintiffs’ primary issue was that of a bidder, not a stakeholder; the agreement’s terms amounted to Plaintiffs’ veto power over key strategic partnerships and prohibited its compensation of key company directors. Further, Defendant contends that Plaintiffs’ motion is a fishing expedition fueled by curiosity and disagreement with management decisions. Plaintiffs cannot infer wrongdoing from a decision to reject, rather than to accept funding terms.

To obtain an order compelling inspection of books and records under Section 220 of the DGCL a plaintiff must establish by a preponderance of the evidence that it: (1) is a stockholder of the corporation, (2) has complied with the statute’s technical requirements, and (3) has a proper purpose for conducting inspection. A common proper purpose is to investigate alleged mismanagement.

Here, Defendant did not dispute Plaintiffs' status as a stockholder or Plaintiffs' statutory compliance, but whether Plaintiff had established a proper purpose for conducting inspection and the scope of Plaintiffs' request for books and records. Plaintiffs argued they had established a proper purpose as Defendant needed a financial infusion (and it appeared that Plaintiffs' funding was the only source available) and because Defendant's rejection coincided with the resignations of the company's CEO and CFO, both of whom were directly involved in negotiating the Term Sheet. In agreeing with Plaintiffs, the Court reasoned that the totality of the evidence, both direct and circumstantial, satisfied the low threshold necessary to establish a credible basis to suspect that the directors may have favored the interests of certain directors or their affiliates over the company's interests in rejecting the Term Sheet.

Further, in regards to scope, the Court held "when a books and records action is brought with the goal of evaluating a possible derivative suit, the books and records that satisfy the action are those that are required to prepare a well-pleaded complaint." As a result Alexandria should be afforded the opportunity to inspect documents that would enable it to draft a well-pleaded complaint for any subsequent derivative litigation. The Court made clear, that Section 220 "does not open the door to the wide ranging discovery" like a well-pleaded complaint would.

Kara Maynard Guio contributed to this article.

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