



IN THE SUPREME COURT  
OF THE STATE OF DELAWARE

FRANK D. SEINFELD,	)	No. 624, 2005
	)	
Plaintiff Below,	)	
Appellant	)	Court Below:
	)	Court of Chancery of the
v.	)	State of Delaware in and
	)	For New Castle County
VERIZON COMMUNICATIONS, INC.,	)	C.A. No. 1100-N
	)	
Defendant Below,	)	
Appellee	)	

**PLAINTIFF BELOW-APPELLANT'S SUPPLEMENTAL BRIEF**

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**NATURE AND STAGE OF PROCEEDINGS**

This is an appeal from a Chancery Court decision dismissing Plaintiff's \$220 demand for corporate information relating to the compensation of three Verizon executives. After briefing, oral argument was heard by a panel of three justices on May 3, 2006. Following that, the Court issued an Order on May 17, 2006, providing for further briefing and for oral argument before the Court, *En Banc*.

This is the Plaintiff's supplemental brief submitted pursuant to the Court's May 17, 2006 Order.

**ARGUMENT**

**I. A §220 BOOKS & RECORDS REQUEST SHOULD BE GRANTED  
IF IT MEETS THE RATIONAL BASIS TEST.**

Plaintiff Below-Appellant ("Plaintiff") respectfully submits that the first question posed by the Court be answered as follows:

**QUESTION:**

A) Should a stockholder with a proper purpose be entitled to inspect carefully limited categories of corporate books and records, pursuant to Section 220, upon a showing that the stockholder has a rational basis for the stated purpose and no other purpose that would militate against inspection?

**RESPONSE:**

Plaintiff submits that a rational basis test should apply to a stockholder's stated purpose for an inspection of books and records under 8 Del. C. §220.

A rational basis test has ordinarily been applied by this court to issues of statutory and regulatory constitutionality. *Price Corner Liquors, Inc. v. Delaware Alcoholic Beverage Control Comm.*, 705 A.2d 571, 576 (Del.Supr. 1998) (regulation survives challenge "if there is any reasonably conceivable state of facts that could provide a rational basis for the classification," quoting from *FCC v. Beach Communications, Inc.*, 508 U.S. 307, 315 (1993)). The rational basis test is distinguished from the strict scrutiny test which is applied to an equal protection challenge to a statute or regulation based on a suspect category such as race, alienage, or national origin or where fundamental interests are

involved. *Brank v. State*, 528 A.2d 1185, 1190 n.2 (Del.Supr. 1989). Under the rational basis test, a constitutional challenge will fail if the "rational relationship is at least debatable. [Citation omitted.]" *Brank v. State, supra*, 528 A.2d at 1190. When the strict scrutiny test is inapplicable, constitutionality is upheld "if any state of facts reasonably may be conceived to justify it. [Citation omitted.]" *Justice v. Gatchell*, 325 A. 2d 97, 102 (Del. Supr. 1974).

This court has encouraged stockholders to make use of 8 Del.C. §220 to prepare a derivative complaint. *Rales v. Blasband*, 634 A.2d 927, 934 n.10 (1993). To sustain such a complaint against a motion to dismiss, "the threshold for the showing a plaintiff must make to survive a motion to dismiss is low." *Doe v. Cahill*, 884 A.2d 451, 458 (Del.Supr. 2005). In all actions, including stockholders' derivative actions, the Delaware courts will deny a motion to dismiss under Del.Ch.Ct. Rule 12(b)(6) unless the court "determine[s] with 'reasonable certainty' that a plaintiff could prevail on no set of facts that can be inferred from the pleadings." *Solomon v. Pathe Communications Corp.*, 672 A.2d 35, 38 (Del.Supr. 1996). The standard is more stringent to survive on demand issues under Del.Ch.Ct. Rule 23.1, but only because "Rule 23.1 requires pleading of facts with 'particularity.'" *Solomon v. Pathe Communication Corp.*, *supra*, 672 A.2d at 39. Those particularized allegations need only state that "a reasonable doubt

is created" as to disinterest and independence or (in the disjunctive) the valid exercise of business judgment. *Brehm v. Eisner*, 746 A.2d 244, 256 (Del.Supr. 2000).

Plaintiff submits that the standards that apply to stockholder's success under 8 Del.C. §220 should not be more stringent than those that apply to surviving a motion to dismiss the complaint which the §220 proceeding is meant to aid. Moreover, as a practical matter, no stockholders in need of inspection can sustain a burden imposed by the lower court, i.e., evidence of wrongdoing. In *State ex rel Brumley v. Jessup & Moore Paper Co.*, 77 A. 16, 22 (Del. Supr. 1910) this court acknowledged the practical difficulties of a rule that enforces stockholders' inspection rights "only when they have ascertained in some way, without the books, that their affairs have been mismanaged, or that their interests are in danger," citing *Huyler v. Craigin Cattle Co.*, 2 A. 274, 278 (N.J. Ch. 1885).

Indeed, the United States Supreme Court also reaffirmed this common law rule with approval in *J. W. Guthrie et al v. Harkness*, 199 U.S. 148, 154-55 (1905):

Stockholders are entitled to inspect the books of the company for proper purposes at proper times . . . and they are entitled to such inspection though their only object is to ascertain whether their affairs have been properly conducted by the directors or managers. Such a right is necessary to their protection. To say that they have the right, but that it can be enforced only when they

have ascertained, in some way without the books, that their affairs have been mismanaged, or that their interests are in danger, is practically to deny the right in the majority of cases. Oftentimes frauds are discoverable only by examination of the books by an expert accountant. The books are not the private property of the directors or managers, but are the records of their transactions as trustees for the stockholders.

8 Del.C. §220 modified the procedures for a stockholder's enforcement of his common law right of inspection. Before the enactment of 8 Del.C. §220, a stockholder was required to seek a writ of mandamus in the Superior Court. The statute replaced the "formalized and burdensome mandamus procedure" with a "summary procedure in the Court of Chancery ... for swift access to the corporate books and records." *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 468 (Del.Supr. 1995). The statute itself, 8 Del.C. §220(c), provides "The Court may summarily order the corporation to permit the stockholder to inspect the corporation's ... books and records." The stockholder at bar sought such a summary order from the lower court.

However, designating the application for a summary order as a motion for summary judgment should not require the standards of a summary judgment motion, *i.e.*, the identification of "evidence to sustain a charge of wrongdoing." *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1146 (Del.Supr. 1990). The statute does not contain language that can be read to require an evidentiary showing in order to obtain relief under 8 Del.C. §220(c). The District of Columbia

Circuit Court of Appeals held that under Delaware common law a stockholder establishes the right to relief when he shows, "by sufficiently particular allegations, a proper purpose." *Fleisher Development Corp. v. Home Owners Warranty Corp.*, 856 F.2d 1529, 1536 (D.C. Cir. 1988). Neither the word "evidence," nor the word "wrongdoing" appears in 8 Del.C. §220. The statute was meant to make it easier for a stockholder to enforce his common law right of inspection. Plaintiff submits that imposition of a new burden, i.e., a requirement that the person seeking documents introduce evidence of wrongdoing, is not permitted by its language or purpose. See, *Hoesch v. National Railroad Passenger Corp.*, 677 A.2d 29, 32 n.5 (Del.Supr. 1996).

A proper purpose is defined by §220 to mean "...a purpose reasonably related to such person's interest as a stockholder ... ." It has been established that seeking to determine if waste, breach of loyalty and self-dealing have occurred is related to a person's interest as a shareholder and is a proper purpose. *Nodana Petroleum Corp. v. State*, 123 A.2d 243 (Del. Supr. 1956) *Saito v. McVessen HBOC, Inc.*, 806 A.2d 113 (Del. Supr. 2002); *Khanna v. Covad Communications Group, Inc.*, 2004 WL 187274 (Del. Ch. 2004).

This Court has pointed to public documents as being a source of details of corporate acts to justify court application. *Rales v. Blasband, supra*, 634 A.2d at 934 n.10; *Grimes v. Donald*, 675 A.2d 12307 (Del. Supr. 1996); *Scattered Corp. v. Chicago Stock Exchange*,

*Inc.*, 701 A.2d 70 (Del. Supr. 1997). A stockholder should therefore only be required to justify and corroborate the carefully detailed petition by reference to public documents or other material.

Plaintiff, a long standing shareholder of defendant, met his burden through public documents, logic and analysis. He pointed to the public documents and the resulting analysis therein. Plaintiff carefully and specifically alleged and demonstrated by references to defendant's publicly filed documents that defendant had three officers, Messrs. Seidenberg, Lee and Babbio, each of whom received approximately equal pay for the years 2000-2002. The total was \$205 million for the three years, or approximately \$20 million plus per year each. While these annual amounts might seem modest in comparison with the pay of more highly compensated CEOs, there are unusual circumstances at bar. First, it is nearly unheard of that other officers in the company are paid what the CEO is paid. The reason is that the CEO bears the highest hands-on responsibility for the success of the company. A triumvirate does appear in Shakespeare's play, *Julius Caesar*, so it can happen at least in theater, but we submit that it invites close examination in real life.

Second, Ivan Seidenberg was the CEO when his company acquired the companies at which Messrs. Babbio and Lee were, respectively, the CEOs. Corporate mergers are expected to achieve economies of scale, especially at the CEO level. It is reasonably conceivable,

we suggest, that the pay of Messrs. Babbio and Lee were meant to ease for them the loss of CEO status at their former companies, and not for what they would do for Verizon.

Third, the bulk of their pay came in stock option awards. Their original contracts did not provide for stock options, but their contracts were amended shortly before the shareholders approved bonus plans that enabled the three recipients to obtain such large awards upon directors' decisions. The stock options were valued by using the factors Verizon had listed in other public filings for valuing its stock options. Curiously, Verizon never disclosed in any public filing or in the lower court the amount it valued these options. It is unthinkable that the board granted these options without having had an economic evaluation done to guide them in deciding how many options to grant.

It may be noted that Verizon was a company that had not achieved good financial results. Its stock price had been declining.

Under a rational basis test, we submit that there are reasonably conceivable facts to support a rational basis to investigate waste, mismanagement, and breach of duties of loyalty at Verizon.

In sum, it is respectfully submitted that all a shareholder of a public company should need to justify a carefully delineated limited request are detailed allegations, corroborated by reference

to public documents, and an analysis thereof or other written material. Indeed, this Court has often noted public sources "as a justifiable source". *Rales* at 934, n.10. To require more of a private shareholder - who is after all an owner of the Company whose records he is seeking - would be unfair. The shareholder does not have access to evidence contained in corporate records.

To require the shareholder to await the outcome of governmental investigations, governmental lawsuits, class action litigations or the publicity of such events, or the Company's public confession of misconduct, or a whistle blower, which by then may be too late to right any of the wrongs that may have occurred, see, *Seinfeld v. Barrett*, 2006 WL 890909 at \*4 (D. Del. 2006), is inconsistent with the Court's admonition to "use the tools at hand". Making the shareholder wait for these events is also inconsistent with shareholder rights. Adopting the rule urged by plaintiff would, in the end, conserve litigation costs and judicial resources. Only appropriate derivative suits would be commenced and the merits addressed more quickly. <sup>(1)</sup>

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1. The foregoing rule is also consistent with the rules of other jurisdictions having similar rules regarding inspection as in Delaware. See *Soreno Hotel Co. v. State*, 107 Fla. 195 (1932); *State Ex rel. Fussell v. McClendan*, 109 So.2d 783 (Fla. Dist. Ct. App. 1959); *Orlando v. Reliance Homestead Ass'n La.*, 1027 (La. 1931); *North Oakland County Bd. Of Realtors v. Realcomp, Inc.*, 226 Mich. App. 54, 55 (Mich. Ct. of App. 1997); *Parsons v.*

II. §220 REQUIRES THAT THE SHAREHOLDER MAKING A REQUEST FOR CORPORATE INFORMATION NEED ONLY HAVE A "PROPER PURPOSE."

QUESTION:

B) If the standard in question "A" would not be appropriate, is there any reduced burden of proof under Section 220 that would improve stockholders' ability to obtain the "tools" to pursue derivative claims without disrupting corporations' orderly conduct of business and without inappropriately interfering with corporate decision-making? If so, articulate the reduced burden of proof. If not, explain why not.

Plaintiff submits that in answer to B) as limited in A), there should be no burden of proof upon a shareholder of a public company. The only burden upon the shareholder of a public company should be that of presenting the concerns and reasons in a detailed petition and corroboration thereof by reference to the public filings, media disclosures and the reports of the public company and, of course, paying the reasonable costs incurred by the Company to provide the requested books and records. That position is supported by the authorities cited in answer to Question A) above.

It must be remembered that the threshold established by §220 is that the stockholder must have a "proper purpose." The measure of this standard should not be whether he has sufficient proof to establish a *prima facie* case, but instead whether or

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*Jefferson-Pilot Corporation*, 426 SE 2d 685 (N.Car. Supr. Ct. 1993).

not the shareholder's request is a *bona fide* one. Such a rule obviates the issues as to how much evidence of wrongdoing, or possibilities of wrongdoing is required, and such a rule enables §220 to become the envisioned summary proceeding rather than an additional battleground in stockholder litigation.

Moreover, such a rule would be consistent with standards of notice pleading for Ch. Ct. Rule 12(b)(6) and the reasonable doubt standard of Ch. Ct. Rule 23.1. Plaintiff submits that the court should adopt no standard for 8 *Del.C.* §220 that is more stringent than the pleading requirements of the stockholder's derivative complaint itself. A plaintiff need not plead evidence, nor must he produce evidence to defeat a motion to dismiss, and it should not be necessary at the preliminary stage, for the application under 8 *Del.C.* §220.

**CONCLUSION**

For the foregoing reasons, Plaintiff submits that the statutory standard for §220 requests should be as set forth above.

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UNREPORTED DECISIONS

*Khanna v. Covad Communications Group, Inc.*,  
2004 WL 187274 (Del. Ch. 2004) . . . . . Exhibit A

*Seinfeld v. Barrett*,  
2006 WL 890909 at 4 (D. Del. 2006) . . . . . Exhibit B

# EXHIBIT A

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 UNPUBLISHED OPINION. CHECK COURT  
 RULES BEFORE CITING.

Court of Chancery of Delaware.

KHANNA

v.

COVAD COMMUNICATIONS GROUP, INC.

No. 20481-NC.

Submitted Dec. 15, 2003.

Decided Jan. 23, 2004.

Dear Counsel:

NOBLE, J.

\*1 This is an action brought under 8 *Del. C.* § 220 by Petitioner Dhruv Khanna ("Khanna") to inspect certain books and records of Respondent Covad Communications Group, Inc. ("Covad"), a Delaware corporation. Khanna is the largest individual holder of Covad's common stock and is a former general counsel and executive vice president. He claims to have sought inspection of Covad's books and records to advance his investigation into an alleged pattern of self-dealing by several members of Covad's board. Many, if not most, of the events which hold Khanna's interest occurred during his tenure as general counsel. This is the Court's decision following trial.

I.

On June 10, 2003, Khanna made demand (the "Demand") upon Covad to inspect certain corporate records.<sup>FN1</sup> He set forth the following purposes for his demand:

FN1. Joint Exhibit ("JX") 1.

The purposes of this demand are: (1) to enable [Khanna] to investigate whether the Company's directors (a) breached their fiduciary duties in connection with the investigation of [his]

allegations of wrongdoing, as well as in connection with the underlying transactions themselves or (b) otherwise acted unlawfully to the detriment of shareholders; and (2) to enable [Khanna] to evaluate whether a valid basis exists to bring a shareholder action to challenge the transactions, Board member actions or elections or otherwise seek shareholder redress.

Khanna listed the documents which he sought to inspect:

1. all Company Board of Directors' (the "Board" or the "Board of Directors") minutes and resolutions from May 1, 2002 to the present, including minutes and resolutions from any and all Board committees or subcommittees;
2. all Company Board of Directors' minutes and resolutions authorizing, ratifying or otherwise approving (a) the Company's investment in Certive, Inc. on or about November 1999, (b) the Company's acquisition of BlueStar Communications Group, Inc. ("BlueStar") on or about September 2000, (c) the Company's post-BlueStar acquisition pay-out of additional shares of the Company to former BlueStar shareholders based on these shareholder's earn-out rights on or about April 2001, or (d) the Company's settlement with DishnetDSL on or about February 2002;
3. all Company Board of Directors' minutes and resolutions authorizing, ratifying or otherwise approving (a) the founding of Certive Inc. by Mr. Charles McMinn, (b) Mr. Richard Shapero's joining the Board of Directors of BlueStar Communications Group, Inc. (c) Mr. Frank Marshall or Mr. Dan Lynch joining the Board of Advisors of Certive, Inc., or (d) Mr. Charles McMinn joining the Board of Directors of DishnetDSL;
4. all documents provided to, considered by, or generated by any committed or subcommittee (however denominated) of the Board or of the Board's audit committee in 2002 or thereafter, including any law firm(s) or other agents hired by such committee(s) or subcommittee(s) (hereinafter individually or collectively, "Special Investigative

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Committee”) to investigate allegations that certain directors and executive officers of the Company had breached their fiduciary duties and/or otherwise engaged in allegedly unlawful or otherwise wrongful conduct while acting on behalf of the Company;

\*2 5. all documents provided to, considered by, or generated by the Special Investigative Committee to investigate any alleged improprieties in the manner by which the Company or its officers or agents handled the investigation conducted by or the investigative report(s) prepared by Gary Scholick in 2002 concerning a former executive officer;

6. all documents constituting, reflecting or evidencing any form of directive from the Board or a Board committee or subcommittee defining the purposes, scope of work, or tasks of the Special Investigative Committee (including any retention letters signed by the Special Investigative Committee retaining any agents or law firms), or modifying any such purposes, scope of work or tasks;

7. all documents presented to the Company's Board of Directors or any committee or subcommittee thereof relating to the findings and investigation of the Special Investigative Committee;

8. all documents reviewed or considered by the Special Investigative Committee in concluding that the allegations of wrongdoing “were without merit and that it would not be in the best interests of the Company to commence litigation based upon these allegations,” as represented in the Company's Form 10-K filed with the Securities and Exchange Commission on or about March 20, 2003;

9. all documents reviewed or considered by the Board of Directors, or any member or members thereof, in concluding that Dhruv Khanna should be terminated as an employee of the Company, as represented in the Company's Form 10-K filed with the Securities and Exchange Commission on or about March 20, 2003;

10. all documents constituting, reflecting or evidencing communications between or among current or former members of the Board of Directors, executive officers or senior employees (directors and above) of the Company, including, but not limited to, all electronic mail communications, relating to (a) the allegations that certain members of the Board and certain executive

officers had breached their fiduciary duties, (b) the Board's investigation of these allegations, (c) the addition of Richard Jalkut to the investigating group of directors into the allegations, (d) the removal of the investigation into the allegations from the umbrella of the Audit Committee to the umbrella of the full Board, (e) the resignation of Chuck Haas as an officer and employee of the Company, (f) the retirement of Frank Marshall as a director of the Company, (g) the departure of Mr. Robert Knowling from the Company on or about October 2000, (h) the return of Mr. McMinn as Chairman of the Board, or the appointment of Mr. Frank Marshall as the interim CEO on or about October 2000, (i) the hiring of Mr. Hoffman as CEO of the Company on or about June 2001, (j) the performance of Mr. Hoffman as CEO of the Company since June 2001, (k) the public statements of Mr. Hoffman concerning the Company's financial performance and projections, (l) the public statements of the Company concerning the percentage of its total revenue that is derived from its direct sales channel, (m) the Confidentiality Agreement signed between Mr. Charles Hoffman and Dhruv Khanna on or about July 11, 2002 and extending on or about July 23, 2002, (n) amending or modifying the Proxy Statement issued by the Company on or about June 7, 2002, or postponing the Annual Meeting held on July 25, 2002, or (o) correspondence sent by or on behalf of Dhruv Khanna to the Board, or any committee or subcommittee, member, or agent or representative thereof;

\*3 11. all documents constituting, evidencing, or reflecting communications between and among the Company (including its individual directors and officers) and its external auditors concerning the substance of or the need to disclose to the public Dhruv Khanna's allegations in 2002 and 2003;

12. all documents relating to or reflecting the retention of outside counsel to advise the Company on the content of its public disclosures from June 2002 through the present and the non-involvement or abandonment of other outside counsel on this issue;

13. all documents relating to or reflecting any investigation conducted by or on behalf of the Company or its Board or a committee or subcommittee thereof into representations made to

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the auditors by executive officers of the Company during the years 2000-2003, inclusive;

14. all documents constituting, reflecting or evidencing the Company's or the Board's document retention policies or the communications between or among current or former members of the Board, executive officers and senior employees (directors and above) of the Company concerning the retention or destruction of documents since June 1, 2000.

Covad, through its counsel, on June 18, 2003, denied, in large measure, Khanna's request and offered several reasons for its position, which may be summarized as follows: (1) his articulated purposes were a sham because he was seeking redress, or otherwise to retaliate, for his termination from Covad through future employment litigation; FN2 (2) Khanna could not meet his burden to demonstrate that corporate wrongdoing had probably occurred; (3) his purposes were vague and overly broad; (4) his purposes were both a sham and an exercise in futility because he would not have standing to act as a derivative plaintiff in any action against Covad's directors; (5) the requested documents were not reasonably related to his asserted purposes; and (6) many of the documents were privileged.<sup>FN3</sup> Covad challenged Khanna's motives by claiming that Khanna sought access to its books and records to advance claims arising out of his dismissal as general counsel, an action which Khanna has asserted was, in part, the product of discrimination based on national origin and an effort to punish him for "whistle blowing."

FN2. In June 2002, Khanna was removed from his position as Covad's general counsel and placed on leave. Covad terminated Khanna at the end of 2002.

FN3. JX 2. Covad offered to produce limited portions of board minutes if Khanna agreed not to use them in any employment-related litigation.

## II.

Khanna filed this action on August 11, 2003. He sought access to the same books and records as set forth in the Demand. On September 25, 2003, purportedly worried that his substantive claims against Covad's directors for breach of their fiduciary duties might become time barred, he brought a class and derivative action (the "Derivative Action") against the directors of Covad and against Covad as a nominal defendant.<sup>FN4</sup> In that action, Khanna alleges, for his derivative claims, that Covad's directors breached their duty of loyalty in approving four transactions in which certain directors were interested and, for his class claims, that Covad failed to make necessary and appropriate disclosures to its shareholders.

FN4. *Khanna v. McMinn*, C.A. No. 20545 (Del. Ch.).

## III.

\*4 The issues for the Court's resolution are whether:

1. By filing the Derivative Action, Khanna has waived his right to pursue, or is otherwise precluded from pursuing, this books and records action.<sup>FN5</sup>

FN5. This issue was initially presented by Covad's motion to dismiss, the briefing of which was completed three days before trial and, although argument of that motion was held on the morning of trial, its resolution was reserved until the Court's post-trial decision.

2. Khanna has a primary purpose arising out of his standing as a shareholder or, instead, his principal motivation is to advance his personal employment-related claims against Covad and its directors.

3. Khanna has sufficiently demonstrated the potential for corporate wrongdoing to support his purpose for seeking inspection.

4. If Khanna cannot qualify to be a representative plaintiff in the Derivative Action, he should be

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permitted to pursue this action.

5. The documents, or some of them, sought by Khanna are protected from inspection by the attorney-client privilege or the work product doctrine.

6. The Demand is too broad in its scope and certain documents requested are not properly the subject of a Section 220 action.<sup>FN6</sup>

FN6. The Demand was in writing and under oath, stated a purpose, and was directed to Covad's principal place of business.

#### IV.

##### 1. *The Derivative Action as terminating Khanna's rights under Section 220.*

Covad contends that this Section 220 action should be dismissed because (1) Khanna's filing of the Derivative Action demonstrates that he no longer needs to inspect the corporation's books and records because his counsel must have been confident with the information available to them in order to file his complaint without running afoul of Court of Chancery Rule 11; and (2) otherwise, Khanna would be pursuing "backdoor" discovery during the pendency of the Derivative Action.<sup>FN7</sup> I conclude that Covad has not set forth adequate grounds in support of its application for dismissal of this action.

FN7. The defendants in the Derivative Action have moved to dismiss.

Covad premises both of its arguments on fundamental principles. First, by filing the Derivative Action, Khanna's counsel, by virtue of Court of Chancery Rule 11, certified that they had sufficient information to justify proceeding with the Derivative Action. Thus, Covad argues, no production under Section 220 should be necessary. Second, "derivative plaintiffs are not entitled to discovery to assist their compliance with Rule 23.1."

FN8. Covad argues that granting Khanna the opportunity to inspect its books and records through Section 220 after the filing of the Derivative Action would be tantamount to allowing discovery during the pendency of the motion to dismiss.

FN8. *Rales v. Blasband*, 634 A.2d 927, 934 n.10 (Del.1993); see also *Scattered Corp. v. Chi. Stock Exch., Inc.*, 701 A.2d 70, 78 (Del.1997).

Covad overlooks the simple reality that the overlap of the Section 220 action and the Derivative Action is attributable to Covad's failure to comply with its obligations under Section 220 when the Demand was made.<sup>FN9</sup> By failing to produce timely the requested documents, Covad created the conditions about which it now complains. Covad's suggestion that a shareholder's rights under Section 220 lapse when the substantive litigation is filed would, if accepted, encourage corporations to shirk their Section 220 duties and to engage in dilatory conduct in the hopes that the passage of time and the need for the potential plaintiff to move forward with his litigation would allow them to avoid their obligations altogether. If Covad was wrong when it rejected Khanna's Section 220 demand, it cannot now obtain vindication simply because Khanna concluded that the derivative and class claims would suffer if he did not file his substantive action.<sup>FN10</sup> Moreover, merely because Khanna's counsel concluded that they had sufficient information to file a complaint does not preclude the possibility, or even the likelihood, that additional information to which Khanna may otherwise be entitled, would bolster his response to a motion under Court of Chancery Rules 12(b)(6) or 23.1. Survival of a motion to dismiss, of course, requires more than the defense of a motion under Court of Chancery Rule 11.

FN9. For this aspect of this letter opinion, I assume that Khanna has otherwise submitted a proper demand under Section 220.

FN10. Covad questions that the running of

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the statute of limitations caused Khanna to move forward with the Derivative Action. It points out that two of the challenged transactions occurred well over three years, the applicable period if the question is controlled by 10 *Del. C.* § 8106, before the filing of the Derivative Action and that the other two transactions occurred substantially less than three years before. While Khanna's articulated reason for the timing of the filing of the Derivative Action is, at best, somewhat puzzling, the issue is not why Khanna filed when he did or whether he had to file when he did but, instead, whether Khanna should be forced to face the choice of filing or waiting for the appropriate production under Section 220 which had been delayed because of Covad's failure to produce the documents which he was entitled to inspect under Section 220.

\*5 The cases relied upon by Covad do not require the opposite conclusion. In *Taubenfeld JT v. Marriott International, Inc.*,<sup>FN11</sup> the Section 220 demand was made roughly five months after the defendants in the substantive action had moved for dismissal. Such an open effort to circumvent the prevailing view that discovery should not be allowed during the pendency of a motion to dismiss a derivative action is far different from the facts here. In this case, Khanna made his request to inspect the records far enough in advance of his filing of the Derivative Action that it was reasonable to have expected that he would have obtained the appropriate documents before commencing the substantive litigation.

FN11. 2003 WL 22682323 (Del. Ch. Oct. 28, 2003).

Similarly, in *Parfi Holding, A.B. v. Mirror Image Internet, Inc.*,<sup>FN12</sup> the Court concluded that a Section 220 demand in the midst of related litigation would be underly burdensome. Again, the burden here, if any, only occurred because, assuming again that Khanna has a proper Section 220 demand, Covad chose not to meet its statutory

obligations to one of its shareholders.

FN12. C.A. No. 18457 (Del. Ch. Mar. 23, 2001) (bench ruling).

Accordingly, Covad's motion to dismiss the action because Khanna subsequently filed the Derivative Action is denied.<sup>FN13</sup>

FN13. Covad posits that significant harm could arise from the relatively contemporaneous filing of a Section 220 action and the related substantive action. It should be a sufficient answer that when and if that problem arises, it will be addressed. The Court obviously has, whether in the Section 220 action or in the substantive action, the power to take such steps as are necessary to protect a party from the abuse of the judicial process, if such an action is warranted. Covad correctly points out that Khanna could have moved more quickly to present his Section 220 demand and then to have filed this action more promptly. However, his demand was sufficiently far in advance of the filing of the Derivative Action that it did not impose any undue burden on Covad and it does not relieve Covad of its statutory obligations.

## 2. *The propriety of Khanna's purpose.*

Khanna must demonstrate that his primary purpose as to each category of the Demand is proper.<sup>FN14</sup> "A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder."<sup>FN15</sup> Khanna's articulated purpose of investigating self-dealing by members of Covad's board is undoubtedly a proper purpose.<sup>FN16</sup> However, because Khanna was dismissed from his position as Covad's general counsel and has threatened to take action in response to that dismissal, Covad challenges the truthfulness of Khanna's articulated purpose and argues that many of his requests are not to serve any corporate or shareholder purpose but, instead, are to assist his employment-related claims.

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The mere existence of potential individual (as contrasted with shareholder) claims against the corporation or its officers and directors does not necessarily defeat inspection rights under Section 220. On the other hand, the existence of such potential personal claims provides a basis for further inquiry into the shareholder's purpose. Khanna has defused these concerns, to an extent, however, with his commitment "not to use any documents produced in response to his Section 220 request in any potential litigation against Covad on wrongful termination grounds."<sup>FN17</sup> Thus, I find, with the support of Khanna's commitment that documents produced in response to any order entered in this action will not be used, unless obtained through the course of discovery in other actions, that Khanna's primary purpose in making a demand under Section 220 is the advancement of his shareholder-based claims and, thus, is a primary proper purpose.<sup>FN18</sup>

FN14. *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1031-33 (Del.1996).

FN15. 8 Del. C. § 220(b).

FN16. See *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 116 (Del.2002); Donald J. Wolfe, Jr. & Michael A. Pittenger, Corporate and Commercial Practice in the Delaware Court of Chancery § 8-6[e] at 8-76 (2003) (hereinafter "Wolfe & Pittenger").

FN17. Pl.'s Post-Trial Br. at 9.

FN18. Investigation of corporate wrongdoing to facilitate pursuit of shareholder litigation, of course, is not the only "proper purpose."

[S]tockholders may use information about corporate mismanagement in other ways, as well. They may seek an audience with the board to discuss proposed reforms or, failing in that, they may prepare a stockholder resolution for the next annual meeting, or mount a proxy fight to elect

new directors.

*Saito v. McKesson HBOC, Inc.*, 806 A.2d at 117. Although Khanna's demand letter makes passing reference to a purpose of "otherwise seek[ing] shareholder redress," he has not relied upon that purpose during the course of this action.

That Khanna has a proper primary purpose for his Section 220 demand does not necessarily lead to the conclusion that all of the books and records which he seeks to inspect are reasonably related to his proper purpose. Thus, the Court must assess and, if appropriate, limit the scope of his demands in light of his articulated proper purpose.

Khanna also seeks to advance a claim based on Covad's alleged failure to make necessary and timely disclosures regarding the substance of his allegations, his "whistle blowing" efforts, and their consequences. Developing adequate information to evaluate a disclosure claim, as a general matter, is an appropriate purpose for a Section 220 demand.

### 3. The sufficiency of Khanna's allegations of corporate wrongdoing.

\*6 In order to obtain access to a corporation's books and records for the purpose of investigating corporate wrongdoing, the shareholder must "demonstrate by a preponderance of the evidence 'some credible basis from which the court can infer that waste or mismanagement may have occurred.'" <sup>FN19</sup>

The stockholder, however, is not under any obligation to prove by preponderance of the evidence that any wrongful conduct actually occurred. <sup>FN20</sup> Khanna seeks documents regarding four challenged transactions. <sup>FN21</sup> He has shown for each of the transactions a credible basis for inferring that wrongful conduct may have occurred because of self-dealing benefiting certain members of Covad's board of directors in transactions that ultimately proved materially adverse to Covad's financial interests.

FN19. *Carapico v. Phila. Stock Exch., Inc.*,

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791 A.2d 787, 792 (Del. Ch.2000)  
 (quoting *Thomas & Betts Corp.*, 681 A.2d  
 at 1031).

FN20. *Sec. First Corp. v. U.S. Diecasting  
 and Dev. Co.*, 687 A.2d 563, 568  
 (Del.1997).

FN21. Khanna alleges wrongdoing in four  
 transactions which may be briefly  
 summarized:

(1) *Certive*. The Chairman of Covad's  
 board formed an entity known as Certive,  
 Inc. to provide services within the general  
 scope of Covad's business without first  
 affording Covad the opportunity to  
 evaluate that business opportunity.  
 Thereafter, the Chairman induced Covad  
 to invest in Certive. Other members of  
 Covad's board held financial interests in  
 Certive or were dependent upon the  
 Chairman.

(2) *BlueStar 1*. Covad acquired BlueStar  
 Communications Group, Inc., a  
 less-than-successful competitor of Covad,  
 at an inflated price because several  
 members of Covad's board owned, directly  
 or indirectly, a substantial interest in  
 BlueStar. Moreover, the fairness opinion  
 obtained by Covad was submitted by a  
 firm that also was owed in excess of \$25  
 million by BlueStar, an indebtedness that  
 Covad assumed through the acquisition  
 process.

(3) *BlueStar 2*. The BlueStar stockholders  
 were entitled to additional shares of Covad  
 if, after the acquisition, the BlueStar  
 business unit met certain operating targets.  
 Although BlueStar unit failed to meet  
 those objectives, Covad awarded the  
 former BlueStar shareholders with a  
 significant portion of the  
 performance-based additional stock.  
 Roughly half of the additional stock was  
 distributed to Covad directors.

(4) *DishNet*. Covad acquired an equity  
 interest in DishNet for \$23 million.  
 Disputes arose, and a settlement was  
 reached in which Covad relinquished its

interest in DishNet for \$3 million, thus  
 absorbing a \$20 million loss. Covad's  
 Chairman was deeply involved with  
 DishNet and, thus, was in a conflicted  
 position because of his interests in both of  
 the feuding entities.

Covad responds to Khanna's efforts to establish a  
 sufficient likelihood of corporate wrongdoing by  
 seeking to prove that he could not prevail on his  
 claims. For example, it argues that various  
 transactions were approved by a majority of  
 directors whose independence and disinterestedness  
 are not fairly questioned by Khanna. Instead of  
 contesting whether Khanna has a credible basis for  
 believing that corporate wrongdoing occurred,  
 Covad attempts to debate whether Khanna will  
 ultimately prevail.<sup>FN22</sup>

FN22. For example, Covad argues that the  
 BlueStar 2 compromise was a reasonable  
 effort to minimize litigation risk.

A Section 220 action is not the proper forum for  
 litigating a breach of fiduciary duty case. All that  
 the Section 220 plaintiff must show is a credible  
 basis for claiming that "there are legitimate issues  
 of wrongdoing." Here, Khanna has shown that each  
 of the transactions was initiated to assist some  
 Covad directors to their personal material benefit  
 and that the transactions carried serious adverse  
 consequences of a degree that could be perceived as  
 the product of mismanagement or flawed, and  
 possibly conflicted, judgment. To engage in the  
 detailed analysis-an analysis possibly less plaintiff  
 friendly than one that would be carried under Court  
 of Chancery Rules 23.1 or 12(b)(6) because, in part,  
 the facts might be those provided by the corporate  
 insiders-would defeat the purposes of this summary  
 proceeding and the underlying policy guidance that  
 potential plaintiffs use the procedures of Section 220  
 to determine if a case exists for the shareholder to  
 pursue.<sup>FN23</sup> The shareholder seeking to  
 investigate corporate wrongdoing, if Covad's  
 analytical approach were adopted, would first be  
 required to survive the functional equivalent of a  
 merits-based dismissal motion in the substantive  
 action.<sup>FN24</sup> While the analysis to be undertaken in

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considering those motions is, of course, important, the Section 220 action is not the proper forum for that analysis.<sup>FN25</sup>

FN23. *See, e.g., Guttman v. Huang*, 823 A.2d 492, 504 (Del. Ch.2003).

FN24. “[A] bare allegation of curiosity or suspicion will not suffice. This is not to say that the plaintiff is obligated to prove the existence of wrongdoing to secure inspection of relevant corporate books and records under Section 220, however. Both the stated purpose and the underlying need for information necessarily derive from an absence of conclusive facts, and such a standard would beg the ultimate question at issue.” *Wolfe & Pittenger*, § 8-6[e] at 8-76.

FN25. In general and particularly with respect to DishNet, Khanna may ultimately fall well short of demonstrating that anything wrong occurred. His allegations do, however, supply a credible basis to support his right as a shareholder to investigate further the conduct leading to a substantial corporate loss in a matter in which the Chairman had a substantial and conflicted interest.

In summary, the question is not whether Covad can raise substantial doubt about the viability of Khanna's claims of wrongdoing. It is sufficient if he provides a credible basis for believing that wrongdoing may have occurred. On the record before me, I am satisfied that he has done so with respect to the four challenged transactions.<sup>FN26</sup>

FN26. With respect to the Certive transaction, Covad has represented, Def.'s Post-Trial Mem. at 11, that certain directors of Covad had not, at the time of that transaction, become involved with Certive. Thus, Covad asks for leave to reopen the record for the introduction of that evidence. I deny that application

because (1) Covad had full opportunity to present this evidence at trial; (2) in light of the Court's concerns about litigating fiduciary duty claims in a Section 220 action, the result might not change; and (3) at issue here is a shareholder's access to the records of the corporation, a potential burden on the corporation of substantially less impact than a liability determination against either the corporation or, as would be more likely in this context, its directors.

#### 4. *Khanna as representative plaintiff.*

\*7 Covad next argues that Khanna's extensive involvement with it should preclude him from acting as a representative plaintiff. For example, Khanna, as Covad's general counsel, was necessarily involved to some extent with the allegedly self-dealing transactions and likely possesses privileged information. Whether a shareholder will file a complaint or whether that shareholder will be a proper representative plaintiff are not questions that determine a shareholder's rights under Section 220. The appropriate place for determining the adequacy of a representative plaintiff is in the action in which the shareholder aspires to that status.

#### 5. *Khanna's inspection of documents subject to the attorney-client privilege or the work product doctrine.*

According to Covad, many of the categories defined by Khanna contain documents subject either to the attorney-client privilege or the work product doctrine. In general, in an action under Section 220, non-opinion work product may be inspected if the party seeking discovery “shows it has a *substantial need* for the materials and it cannot acquire a substantial equivalent without *undue hardship*.”<sup>FN27</sup> Access to opinion work product may be obtained only if “the requesting party shows it is directed to the pivotal issue in the current litigation and the need for the information is compelling.”<sup>FN28</sup> Finally, the attorney-client privilege may be avoided by a Section 220 plaintiff who can demonstrate “ ‘good cause’ why the privilege

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should not attach.” FN29

FN27. *Saito v. McKesson HBOC, Inc.*, 2002 WL 31657622, at \*11 (Del. Ch. Nov. 13, 2002), *aff'd*, 808 A.2d 970 (Del.2003).

FN28. *Id.* at \*12.

FN29. *Deutsch v. Cogan*, 580 A.2d 100, 107 (Del. Ch.1990). In order to ascertain the existence of “good cause,” the Court will look to the following relevant factors of those identified in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir.1970): “(i) the number of shares owned by the shareholder and the percentage of stock they represent; (ii) the assertion of a colorable claim; (iii) the necessity of the information and its unavailability from other sources; (iv) whether the stockholders identified the information sought and is not merely fishing for the information; and (v) whether the communication is advice concerning the litigation itself.” *Grimes v. DSC Communications Corp.*, 724 A.2d 561, 568 (Del. Ch.1998).

Khanna, however, has not sought to circumvent either the attorney-client privilege or the work product doctrine and, certainly, has not made any necessary showing. Accordingly, any of the inspection directed through this action is first subject to the attorney-client privilege and the work product doctrine.<sup>FN30</sup> Unfortunately, no privilege log has been compiled and the potentially privileged documents have not been identified. Accordingly, any dispute regarding whether a particular document is protected from disclosure by either the attorney-client privilege or the work product doctrine cannot be addressed unless and until it arises.

FN30. Thus, the Court is not called upon to consider whether the relative weight of one of the *Garner* factors-“whether the communication is advice regarding the

litigation itself”-should be given greater weight because of the pendency of the Derivative Action.

#### 6. Consideration of the various categories of the Demand.

A stockholder's right to inspect a corporation's books and records under Section 220 does not open the door to the wide ranging discovery that would be available in support of litigation.... A stockholder who demands inspection for a proper purpose should be given access to all of the documents in the corporation's possession, custody or control, that are necessary to satisfy that proper purpose. Thus, where a § 220 claim is based on alleged corporate wrongdoing, and assuming the allegation is meritorious, the stockholder should be given *enough information to effectively address the problem*, either through derivative litigation or through direct contact with the corporation's directors and/or stockholders.<sup>FN31</sup>

FN31. *Saito*, 806 A.2d at 114-15 (emphasis added); *see Carapico*, 791 A.2d at 793.

\*8 “[O]nly those records that are ‘essential and sufficient’ to the shareholder's purpose will be included in the court-ordered inspection,”<sup>FN32</sup> and Khanna bears the burden of satisfying that standard.<sup>FN33</sup>

FN32. *Helmsman Mgmt. Servs., Inc. v. A & S Consultants, Inc.*, 525 A.2d 160, 167 (Del. Ch.1987); *see also Dobler v. Montgomery Cellular Holding Co., Inc.*, 2001 WL 1334182, at \*5 (Del. Ch. Oct. 19, 2001).

FN33. Indeed, if Section 220 afforded a shareholder the full panoply of discovery rights, the goal of avoiding the costs and burdens of unnecessary discovery reflected in the policy of staying discovery while derivative and class actions are tested by

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motions to dismiss would be frustrated.

Thus, a review of each category of documents sought by Khanna follows:

*Demand No. 1*

Through this category, Khanna seeks board minutes and resolutions after his termination. It is necessary to his proper purpose to ascertain if the board, after his termination, fully addressed the various issues surrounding his allegations of corporate wrongdoing.

*Demand No. 2*

Minutes and resolutions approving the challenged transactions are prime examples of documents to which a shareholder in a Section 220 action is entitled. Covad represents that all documents in this category have been produced to Khanna. If that is the case, this request is moot. Otherwise, it is an appropriate request.

*Demand No. 3*

The documents in this category are also appropriate for inspection. Again, Covad represents that they have been produced and, if so, the request is moot.

*Demand No. 4*

It is "sufficient" and "essential" to Khanna's appreciation of the potential for wrongful conduct to be able to inspect the various documents within this category, which generally addresses corporate consideration of his allegations, although it may be that many, or even most, of them are privileged.

*Demand No. 5*

The documents in this category are appropriately produced to the extent that they relate to the challenged transactions. However, to the extent that

they address the reasons for Khanna's termination, they are not sufficiently related to his proper purpose as a shareholder but, instead, are directly and primarily related to his personal status as a former employee; the scope of this demand is accordingly limited.

*Demand No. 6*

The terms and conditions under which the special committee operated to investigate Khanna's claims constitute an appropriate topic for him in his shareholder capacity because the integrity of the special committee's actions may have an impact on the validity of any action that he has filed or might intend to file in his capacity as shareholder.

*Demand No. 7*

Covad contests the appropriateness of this category by asserting that the special committee made all ultimate decisions and, thus, there was no "recommendation" to the board. From that premise, it argues that no responsive documents exist. Again, to the extent that such materials are not privileged, the conclusions of the special committee as to Khanna's allegations of wrongdoing would be appropriate for his stockholder inquiry.

*Demand No. 8*

The documents requested in this category presumably would largely be included in the inspection afforded in previous categories because one would assume that the special committee would have reviewed those documents which are responsive to Khanna's request regarding the challenged transactions. To the extent that there are any responsive documents which are not privileged and which are not otherwise addressed by the previous categories, they are to be produced.

*Demand Nos. 9, 11 and 12*

\*9 A common theme flows through these three

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demands. Khanna seeks to understand why more (or accurate) information about his termination and whistle blowing efforts was not disclosed to the shareholders. Khanna has not shown that documents which might provide those reasons are essential for his purposes. He does not contend that he does not know (i) the facts involving his personal conduct; (ii) the substance of the allegations which he made; or (iii) the substance and timing of the public disclosures which Covad made. Yet, that is "enough information to effectively address the problem." In short, Khanna's search for documents which may explain why Covad made the disclosures as it did is beyond the scope of this Section 220 application. <sup>FN34</sup>

FN34. I also note that Covad, as to Demand Nos. 11 and 12, maintains that there are no responsive documents. Def.'s Post-Trial Mem. at 18-19.

#### *Demand No. 10*

The scope of this request is overly broad. A Section 220 action is not a substitute for discovery under the rules of civil procedure. <sup>FN35</sup> For instance, Request 10(o) which seeks correspondence sent by or on behalf of Khanna to the board or any representative thereof is an example of documents for which Khanna has not shown any necessity and which he should be aware of in any event. Moreover, to require the production of all communications, including e-mails, among directors and officers of Covad, under these circumstances, would be excessive. The appropriate documents, *i.e.*, necessary for purposes reasonably related to his status as stockholder, consist of those documents which are not the documents of individuals but, instead, are those which are held by the corporation. Furthermore, Khanna has shown no need for documents in the following categories of Demand No. 10:(e), (f), (g), (j), (m). Subject to these limitations, inspection of the documents in this category is appropriate.

FN35. *Saito*, 806 A.2d at 117 n.10.

#### *Demand No. 13*

This inquiry is so broad that its apparent purpose cannot be ascertained and cannot clearly be tied to those areas of wrongdoing which Khanna has challenged. The scope of this request will be approved as narrowed to one involving documents held by Covad which reflect representations made to its auditors by its executive officers regarding the four challenged transactions for the years 2000-03, inclusive.

#### *Demand No. 14*

A document retention policy is necessary for a shareholder to appreciate this completeness, in a historical sense, of the documents which are produced to him. Thus, the document retention policy will alert the shareholder as to whether there may have been other documents which would have been responsive to his request but which have been destroyed in the ordinary course of business. Khanna will be allowed to inspect the document retention policy.

#### V.

Khanna, subject to the limitations set forth above, has demonstrated his entitlement to inspect certain books and records of Covad. Counsel are directed to confer promptly and submit a form of order to implement this decision.

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# EXHIBIT B

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Briefs and Other Related Documents  
 Only the Westlaw citation is currently available.  
 United States District Court, D. Delaware.  
 Frank R. SEINFELD, Plaintiff,

v.

Craig R. BARRETT, Charlene Barshefsky, E. John  
 P. Browne, D. James Guzy, Reed E. Hundt, Paul S.  
 Otellini, David S. Pottruck, Jane E. Shaw, John L.  
 Thornton, David B. Yoffie, Andrew S. Grove, and  
 Intel Corporation, Defendants.  
 No. Civ.A. 05-298-JJF.

March 31, 2006.

Francis G.X. Pileggi, of Fox Rothchild, LLP,  
 Wilmington, Delaware, for Plaintiff.  
 Stephen C. Norman, of Potter Anderson & Corroon,  
 LLP, Wilmington, Delaware, for Defendants.

*MEMORANDUM OPINION*

FARNAN, J.

\*1 Pending before the Court is Defendants' Motion To Dismiss Based Upon Failure To Comply With Rule 23.1 (D.I.15), Defendants' Motion To Dismiss For Lack Of Jurisdiction Over The Subject Matter (D.I.19), and Plaintiff's Motion For Summary Judgment (D.I.5). For the reasons discussed, all Motions will be denied.

**Background**

This derivative lawsuit relates to a Proxy Statement, issued by Defendants in March 2005, which discussed four proposals to be voted on by Intel Corporation's ("Intel") shareholders: the reelection of ten of the eleven board members, the approval a public accounting firm for the year, amendments to and extension of the 2004 Equity Incentive Plan, and amendments to and extension of the Executive Officer Incentive Program ("EOIP"). Plaintiff alleges that the Proxy Statement provided that if the

shareholders approved the bonuses listed under the EOIP, the bonuses would be tax deductible; if the shareholders did not approve, however, the same bonuses would be given but they would not be deductible.

On May 16, 2005, Plaintiff filed his Complaint, alleging that Defendants violated Section 14(a) of the Securities Exchange Act of 1934 (and Rule 14a-9 promulgated thereunder) and breached their fiduciary duties under Delaware law. Specifically, Plaintiff alleges that Defendants made false or misleading statements in the Proxy Statement by representing to the shareholders that the company would receive a tax deduction if the EOIP were approved. According to Plaintiff, there would be no deduction, regardless of whether the shareholders approved the EOIP, because the tax code does not allow a deduction where the same benefits will be given to the executive officers even if the shareholders do not approve the plan. Plaintiff further alleges that the Proxy Statement was false or misleading because material terms were omitted, specifically, the variables used and the amount of the bonuses for 2005.

On June 7, 2005, Plaintiff filed its Motion For Summary Judgment (D.I.5). Defendants filed their motions to dismiss (D.I.15, 19) on June 27, 2005.

**Parties' Contentions**

By their first Motion (D.I.15), Defendants contend that Plaintiff violated Federal Rule of Civil Procedure 23.1 and Delaware state law by failing to make a demand on the Board prior to filing this lawsuit. By their second Motion (D.I.19), Defendants contend that the Court lacks subject matter jurisdiction because the claims are not ripe for review. Specifically, Defendants contend that the claims will not be ripe for review until payments are made under the 2005 EOIP, a tax deduction has been claimed, or the IRS rules that the deductions

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would be improper. Finally Defendants contend that the Court should not grant Plaintiff's motion for summary judgment because "[t]here are multiple issues of fact affecting multiple elements of plaintiff's claims" and because Plaintiff is not entitled to judgment as a matter of law. (D.I. 26 at 2).

In response, Plaintiff contends that demand would have been futile due to the Directors' interest and lack of business judgment. Plaintiff further contends that the claims are ripe for review because the claims arose when the allegedly false or misleading statements were made to shareholders. Finally, Plaintiff requests that the Court grant summary judgment on all of its claims because he contends that there are no issues of fact and he is entitled to judgment as a matter of law.

#### Discussion

##### I. Whether Plaintiff Failed To Comply With Rule 23.1 And Delaware State Law By Failing To Make A Demand On The Board of Directors

\*2 Federal Rule of Civil Procedure 23.1 requires a plaintiff to "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors ... and the reasons for the plaintiff's failure to obtain the action or for not making the effort." *Fed.R.Civ.P.* 23.1. Rule 23.1 only goes to the adequacy of a plaintiff's pleadings, however; "[t]he substantive requirements of demand are a matter of state law." *Blasband v. Rales*, 971 F.2d 1034, 1047 (3d Cir.1992).

Under Delaware law, "the entire question of demand futility is inextricably bound to issues of business judgment and the standards of that doctrine's applicability." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del.1984) (overruled on other grounds). As a result, in considering whether demand would have been futile, [t]he trial court is confronted with two related but distinct questions: (1) whether threshold presumptions of director disinterest or independence are rebutted by well-pleaded facts;

and, if not, (2) whether the complaint pleads particularized facts sufficient to create a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment.

*Levine v. Smith*, 591 A.2d 194, 205 (Del.1990) (overruled on other grounds). These two inquiries are disjunctive, meaning that if either prong is met, demand is excused. *In re J.P. Morgan Chase & Co. S'holder Litig.*, No. 531-N, 2005 Del. Ch. LEXIS 51, at \*28 (Del. Ch. Apr. 29, 2005).

Under the first prong, "directorial interest exists whenever divided loyalties are present, or where the director stands to receive a personal financial benefit from the transaction not equally shared by the shareholders." *Blasband*, 971 F.2d at 1048. A director lacks independence when a director's decision is based on extraneous influences, rather than the merits of the transaction. *Id.* In order for a court to find that demand is futile due to director interest or a lack of independence, a majority of the board - of directors, or one-half of an evenly-numbered board, must be interested or lack independence. *Beam v. Stewart*, 845 A.2d 1040, 1046 n. 8 (Del.2004).

If the first prong is not satisfied, there is a presumption that the board's actions were the product of a valid exercise of business judgment. *Id.* at 1049. Thus, to satisfy the second prong, a plaintiff must plead sufficient particularized facts to "raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision." *In re J.P. Morgan Chase & Co.*, 2005 Del. Ch. LEXIS 51, at \*39 (quoting *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 286 (Del. Ch.2003)) (citations omitted).

The Court concludes that Plaintiff has failed to plead particularized facts sufficient to overcome the presumption of director disinterest and independence. Plaintiff states that "[t]he entire board is neither disinterested nor independent since every member of the board is liable for violation of § 14(a) of the Exchange Act, Rule 14a-9, and Schedule 14A." (D.I. 1 at 3). The mere threat of personal liability for approving a board action,

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however, does not lead to the conclusion that a director is interested or lacks independence. *Aronson*, 473 A.2d at 815. Furthermore, Plaintiff has not alleged any other facts demonstrating that a majority of the Board is interested, nor has he refuted Defendants' contention that the Board of ten members contains, at most, three interested members. (D.I. 16 at 3-4) ("Of Intel's ten current Directors, only one is an officer of the company, and only two are eligible to participate in the 2005 EOIP.").

\*3 While Plaintiff has failed to demonstrate that the directors are interested or lack independence, the Court concludes that Plaintiff has pleaded facts sufficient to raise a reason to doubt that the action was taken honestly and in good faith. In his Complaint, Plaintiff alleges that Defendants made a false or misleading statement when they promised tax deductions to shareholders in return for their approval of the EOIP, when, in fact, no tax deduction would result under 26 CFR 1.162-27(e)(4)(I). Plaintiff further alleges that Defendants misled shareholders when they omitted material terms, namely the variables used and the amount of the bonuses for 2005. These allegations could raise issues as to the honesty and good faith of the Directors. Accordingly, the Court concludes that demand on the Board would be futile, and the Court will, therefore, deny Defendants' Motion To Dismiss Based Upon Failure To Comply With Rule 23.1 (D.I.15).

## II. Whether The Court Should Dismiss Plaintiff's Complaint For Lack Of Jurisdiction Over The Subject Matter

Having concluded that demand would be futile, the Court must determine whether the Court has subject matter jurisdiction over Plaintiff's claims.

Article III, Section 2 of the United States Constitution requires the existence of a justiciable case or controversy before a federal court may exercise jurisdiction over a matter. *Presbytery of New Jersey of the Orthodox Presbyterian Church v. Florio*, 40 F.3d 1454, 1462 (3d Cir.1994). "One aspect of justiciability is ripeness which

determines when a proper party may bring an action." *Philadelphia Fed'n of Teachers v. Ridge*, 150 F.3d 319, 323 (3d Cir.1998) (quoting *Travelers Ins. Co. v. Obusek*, 72 F.3d 1148, 1154 (3d Cir.1995)) (citations omitted).

The United States Supreme Court has established a two-part inquiry for determining whether a case is ripe for review. Under this two-part inquiry, a court must look to (1) "the fitness of the issues for judicial decision and [ (2) ] the hardship to the parties of withholding court consideration." *Abbott Labs. v. Gardner*, 387 U.S. 136, 149 (1967). Under the fitness inquiry, a court will consider whether the issues are legal or factual, whether the disputed action is final, whether the claim involves contingent events, and the adversarial nature of the parties' relationship. *Ridge*, 150 F.3d at 323. Under the hardship inquiry, a court looks to "whether the challenged action creates a 'direct and immediate' dilemma for the parties, such that the lack of pre-enforcement review will put the plaintiffs to costly choices." *Id.*

The Court concludes that this case is ripe for review. First, the case is fit for judicial review. The parties are adverse; Plaintiff is a shareholder suing derivatively for false statements allegedly made by Defendants to shareholders. Additionally, the claim does not involve contingent or uncertain events, nor is the claim bound up in the facts. Defendants contend that the case will not be ripe for review until after there are payments under the 2005 EOIP, a tax deduction has been claimed, or the IRS rules that the deductions would be improper. The Court concludes, however, that if Section 14(a) and Rule 14a-9 were violated, they were violated by the making of the allegedly false and misleading statements in order to solicit shareholder approval. *See General Elec. Co. v. Cathcart*, 980 F.2d 927, 932 (3d Cir.1992). There is no additional requirement that a defendant do anything beyond making the false statement.

\*4 Second, the Court finds there would be a great hardship to Plaintiff if the Court withholds consideration. The most significant hardship may be the expiration of the statute of limitations. The statute of limitations on claims filed pursuant

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Section 14(a) expires "one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation." *Westinghouse Elec. Corp. v. Franklin*, 993 F.2d 349, 353 (3d Cir.1993). If the Court delays this action until a tax deduction is claimed or is rejected by the IRS, the statute of limitations may run, and Plaintiff would be unable to assert his claim. Additionally, the Court finds Plaintiff will be harmed if the Court withholds consideration, because the payments, approved by the shareholders due to the allegedly false or misleading statements, will be made in 2006.

Because this case is fit for judicial review and there will be a hardship to Plaintiff if the Court withholds consideration, the Court will deny Defendants' Motion To Dismiss For Lack Of Jurisdiction Over The Subject Matter (D.I.19).

### III. Whether The Court Should Grant Plaintiff's Motion For Summary Judgment

Having concluded that Plaintiff did not fail to comply with Rule 23.1 and that the Court does not lack jurisdiction over the subject matter, the Court turns to Plaintiff's Motion For Summary Judgment (D.I.5).

#### A. Legal Standard

Pursuant to Rule 56(c) of the Federal Rules of Civil Procedure, a party is entitled to summary judgment if a court determines from its examination of "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. *Fed.R.Civ.P.* 56(c). In determining whether there are triable issues of material fact, a court must review all of the evidence and construe all inferences in the light most favorable to the non-moving party. *Goodman v. Mead Johnson & Co.*, 534 F.2d 566, 573 (3d Cir.1976). However, a court should not make credibility determinations or weigh the evidence. *Reeves v. Sanderson Plumbing Prods., Inc.*, 530

U.S. 133, 150 (2000).

To defeat a motion for summary judgment, the non-moving party must "do more than simply show that there is some metaphysical doubt as to the material facts. In the language of the Rule, the non-moving party must come forward with 'specific facts showing that there is a genuine issue for trial.'" *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986) (citations omitted). However, the mere existence of some evidence in support of the nonmovant will not be sufficient to support a denial of a motion for summary judgment; there must be enough evidence to enable a jury to reasonably find for the nonmovant on that issue. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986).

#### B. Analysis

##### 1. Plaintiff's Claims Under Section 14(a) Of The Securities Exchange Act Of 1934

\*5 Plaintiff alleges that Defendants violated Section 14(a) of the Securities Exchange Act of 1934 by making false and misleading statements in the Proxy Statement. In order to prevail on his Section 14(a) claims, Plaintiff must prove that "(1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation itself, rather than a particular defect in the solicitation materials, was 'an essential link in the accomplishment of the transaction.'" *Cathcart*, 980 F.2d at 932.<sup>FN1</sup> The materiality of the misrepresentation or omission is determined by looking to whether "there is a substantial likelihood that a reasonable shareholder would find the fact significant in deciding how to vote." *Id.*

FN1. The parties dispute the existence and extent of a "state of mind" requirement. Plaintiff contends that a mental state is not required because he seeks only an injunction, or alternatively, that only negligence is required to prove a violation

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of Section 14(a). Defendants contend that actual knowledge is required under a safe harbor provision for forward-looking statements. The Court concludes that it need not reach the question of a state of mind requirement because the motion for summary judgment will be denied on other grounds.

a. Whether Plaintiff Is Entitled To Summary Judgment Under Section 14(a) For Defendants' Statement That Payments Under The EOIP Would Be Tax Deductible

The Proxy Statement provided that the purpose of the EOIP was to guarantee that compensation paid to executives over \$1,000,000 would be tax deductible under Section 162(m) of the Internal Revenue Code. Section 162(m) provides a deduction for performance-based compensation in excess of \$1,000,000, subject to several restrictions. D.I. 5, Ex. 2 at B-1; 26 U.S.C. § 162(m). This deduction is not available, however, if "the compensation would be paid regardless of whether the material terms are approved by shareholders." 26 C.F.R. § 1.162-27(e)(4)(i).

Plaintiff contends that the Proxy Statement contained a false or misleading statement because it represented that compensation paid under the EOIP would be tax deductible when it would not be, because the executives would allegedly receive the bonus regardless of whether the shareholders approved the proposal. The Proxy Statement provided in pertinent part:

If our stockholders do not approve the EOIP at the annual meeting, we will terminate the EOIP plan, and we will not pay any incentives under this plan for the 2005 performance year. However, we expect to make incentive payments to the executive officers in amounts similar to those that would have otherwise been paid under the EOIP; the difference is that we will lose a portion of the tax deductibility that would have otherwise been available to us. The Compensation Committee has not adopted a policy that all compensation paid must be tax-deductible and qualified under Section 162(m) of the Tax Code. If we cannot deduct incentives from our taxes, it will increase the overall cost of these

incentive payouts to us and thus to our stockholders through reduced net income.

(D.I. 5, Ex. B at 39).

In arguing that summary judgment should be granted, Plaintiff primarily relies on the Third Circuit's decision in *Shaev v. Saper*, 320 F.3d 373 (3d Cir.2003). In *Shaev*, the Proxy Statement at issue provided that the board of directors "may grant another bonus for fiscal year 2000, a portion of which may not be deductible under Section 162(m)" if the shareholders did not approve the executive compensation plan. (D.I. 5, Ex. 1 at 13). The Court, deciding a motion to dismiss, concluded that this statement "undermined the deductibility of the bonus even if the shareholders approved it." *Shaev*, 320 F.3d at 381. Accordingly, the plaintiff had adequately alleged that the defendants made a false statement by promising a tax deduction if the shareholders approved the executive compensation plan. *Id.* at 384-85.

\*6 The Court concludes that summary judgment is not appropriate at this juncture. First, materiality is a "mixed question of law and fact," *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 450 (1976), and cannot be decided as a matter of law unless the omission is "so obviously important to the shareholder's decision that reasonable minds cannot differ on the question of materiality and the underlying facts and inferences to be drawn from those facts are free from controversy." *Gould v. American Hawaiian Steamship Co.*, 535 F.2d 761, 771 (3d Cir.1976). The Court is unable to conclude as a matter of law that tax deductibility was so obviously important that reasonable minds could not differ on the question of materiality.<sup>FN2</sup>

FN2. Defendants argue that the statement is immaterial because the amount of the tax deduction is small in relation to Intel's revenues for 2005. This is not the standard. The Court must look to whether the statement was material to the shareholder in making its decision, not to whether the amount was material in the overall scheme of company profitability.

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Second, the Court concludes that *Shaev* is distinguishable from this case because the allegedly false statements in the Proxy Statement differ from those in *Shaev*. Furthermore, the Court cannot rely on *Shaev* to dispose of the issues here because *Shaev* involved a motion to dismiss and looked only to the adequacy of the plaintiff's pleadings. Here the Court is presented with a motion for summary judgment and, therefore, must look to the merits of the claims. Accordingly, the Court will deny Plaintiff's Motion For Summary Judgment on Plaintiff's claim that Defendants violated Section 14(a) by making a false statement pertaining to the tax deductibility of executive bonuses under the EOIP.

**b. Whether Plaintiff Is Entitled To Summary Judgment Under Section 14(a) For Alleged Omissions From The Proxy Statement**

Plaintiff's original claim was that Defendants violated Section 14(a) by omitting the three variables <sup>FN3</sup> used to determine the bonuses and the amount of the bonuses for 2005 from the Proxy Statement. In his reply brief, however, Plaintiff recognized that neither the EPS nor the amount of the bonuses for 2005 would be determined until the end of 2005. (D.I. 68 at 3-4). Thus, the Court will discuss Plaintiff's claim in light of the other omitted variables.

FN3. The three variables are the earnings per share ("EPS"), annual incentive baseline amounts, and annual factor for each executive officer. These three variables are used in a mathematical formula to determine the amount of the qualified executive officers' bonuses each year.

The Court concludes that summary judgment cannot be granted. As discussed above, materiality is a mixed question of law and fact. The Court is unable to conclude that the variables were so obviously important that reasonable minds could not differ on their materiality, particularly because the terms were defined and were provided for other years.

Additionally, the Code of Federal Regulations gives a non-exhaustive list of material terms including: the employees eligible to receive compensation; a description of the business criteria on which the performance goal is based; and either the maximum amount of compensation that could be paid to any employee or the formula used to calculate the amount of compensation to be paid to the employee if the performance goal is attained.

26 C.F.R. § 1.162-27(e)(4)(i). The Proxy Statement provides for each of these terms: the employees eligible to receive compensation are Intel's executive officers; the EOIP includes the formula for calculating the bonuses; and the maximum amount of compensation that can be provided to any employee is \$5,000,000. The Court cannot determine as a matter of law whether there were other material terms requiring inclusion. Accordingly, the Court will deny Plaintiff's Motion For Summary Judgment on Plaintiff's claim that Defendants violated Section 14(a) by omitting certain variables for the year 2005 from the Proxy Statement.

**2. Plaintiff's Claim For Breach Of Fiduciary Duty**

\*7 Plaintiff contends that the false and misleading statements also give rise to a claim for breach of fiduciary duty. "Under Delaware law, a board of directors is under a fiduciary duty to disclose fully and fairly all material information within the board's control when seeking shareholder action. This disclosure obligation clearly attaches to proxy statements." *State of Wisconsin Inv. Bd. v. Peerless Sys. Corp.*, No. 17657, 2000 Del. Ch. LEXIS 170, \*58 (Del. Ch. December 4, 2000) (citing *Stroud v. Grace*, 606 A.2d 75, 84 (Del.1992)). Because the Delaware Supreme Court has adopted the same standard for materiality as that established by the United States Supreme Court in *TSC Industries*, materiality is a mixed question of law and fact. *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del.1985). As discussed above, the Court concludes that a determination of materiality in this case is inappropriate for consideration on summary judgment. Accordingly, the Court will deny Plaintiff's Motion For Summary Judgment (D.I.5).

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Conclusion

For the reasons discussed, Plaintiff's Motion For Summary Judgment (D.I.5), Defendants' Motion To Dismiss Based Upon Failure To Comply With Rule 23.1 (D.I.15), and Defendants' Motion To Dismiss For Lack Jurisdiction Over The Subject Matter (D.I.19) will all be denied.

An appropriate Order will be entered.

*ORDER*

At Wilmington, the 31 day of March 2006, for the reasons set forth in the Memorandum Opinion issued this date;

IT IS HEREBY ORDERED that:

1. Plaintiff's Motion For Summary Judgment (D.I.5) is *DENIED*.
2. Defendants' Motion To Dismiss Based Upon Failure To Comply With Rule 23.1 (D.I.15) is *DENIED*.
3. Defendants' Motion To Dismiss For Lack of Subject Matter Jurisdiction (D.I.19) is *DENIED*.

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