

Possibility of Wrongdoing Constitutes Proper Purpose in Section 220 Proceeding

Tuesday, December 18, 2018

In *Barnes v. Sprouts Farmers Market, Inc.*, Jennifer Barnes, a stockholder of Sprouts Farmers Market, Inc. (“**Stockholder**”), sought to inspect the books and records of Sprouts Farmers Market, Inc. (the “**Company**”) in order to investigate potential breaches of duty, corporate mismanagement, wrongdoing, and unjust enrichment by the Company’s fiduciaries. Section 220 of the Delaware General Corporation Law permits stockholders of a Delaware corporation to inspect a company’s books and records for any proper purpose. Such purpose need only be reasonably related to the person’s interest as a stockholder, and the stockholder need only show “some evidence to suggest a credible basis from which a court can infer” the related conduct.

Stockholder suggested that the Company’s directors and officers committed wrongdoing by failing to address the impact of ongoing produce deflation on the Company leading up to the sale of Company stock in an offering in March 2015. The offering documents, which were filed in early March 2015, did not address the produce deflation experienced by the Company beginning in mid-February 2015. However, on a conference call a few days after the filing, the Company’s Chief Executive Officer and Chief Financial Officer pointed to produce deflation as a factor in the Company’s lower gross profit margins in the first quarter of 2015. Produce deflation was similarly sighted in connection with the Company’s second quarter numbers. Stockholder pointed to the conference call statements in March 2015, arguing that the statements evidenced knowledge of the trend in produce deflation at the same time the Company failed to include such information in its offering documents. In its defense, the Company submitted that, although it recognized produce deflation in early March 2015, Stockholder’s characterization amounts to review of the events in hindsight and fails to demonstrate real-time recognition of a larger trend of produce deflation.

The Master emphasized that Section 220 proceedings are not a trial on the merits and the Court did not consider whether wrongdoing actually occurred. Instead, the Master parsed Stockholder’s and the Company’s arguments into two categories: “premature merits-based defenses” and claims “which strike at the evidence and logic . . . offer[ed] as a basis for inferring possible wrongdoing.” Suggesting simply that the Company’s arguments did not undermine the possibility of Stockholder’s claims, the Master’s report emphasized that Stockholder’s ability to provide “*some evidence* from which [the Master] *can infer* that wrongdoing *possibly* occurred” was enough to meet the applicable standard. While the Company attacked the substance of Stockholder’s arguments, the ability of the Master to follow Stockholder’s suggestion (rather than the validity thereof) sufficed to meet the standard required under Section 220.

[Barnes v. Sprouts Farmers Market, Inc.](#)

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