

Court of Chancery Holds That Shareholder Satisfied Burden of Proof under Section 220 to Show Credible Basis to Infer That Company Misled Shareholders Regarding Biggest Client

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In *Elow v. Express Scripts Holding Company*, C.A. No.12721-VCMR and *Khandhar v. Express Scripts Holding Company*, C.A. No. 12734-VCMR (Del. Ch. May 31, 2017), the Court of Chancery held that plaintiff shareholder Clifford Elow’s (“Elow”) demand to inspect certain books and records of Express Scripts Holding Company (the “Company”) met all statutory requirements and stated a proper purpose, while plaintiff (and purported shareholder) Amitkumar Khandhar’s (“Khandhar”) demand did not. Thus, the Court granted Elow’s Section 220 demand subject to a confidentiality agreement and denied Khandhar’s demand.

Anthem, Inc. (“Anthem”) and the Company were parties to a ten-year contract in which the Company would provide pharmacy benefit management services to certain Anthem health plans, subject to a periodic pricing review every three years to ensure that Anthem was receiving “competitive benchmark pricing.” The Company and Anthem were able to reach an agreement after Anthem’s first periodic pricing review in 2012; however, the 2015 negotiations were unsuccessful. The failed renegotiations led Anthem to file suit in March of 2016, alleging that the Company acted in bad faith and materially breached the agreement by failing to negotiate in good faith.

While the 2015 negotiations were falling apart, Company executives made multiple public statements about the relationship of the parties, referring to their relationship as “strong” and stating that they were confident about retention. As such, in May of 2016, the investors filed a class action lawsuit against the Company, alleging that it violated federal securities laws by telling investors the relationship with Anthem was strong and accounting for the renewal of the agreement in publicly-filed financial statements because Company management knew their relationship with Anthem was severely damaged, had received two formal notices of breach, and had received a demand from Anthem of a \$15 billion pricing concession.

On July 28, Khandhar made a demand on the Company to inspect its books and records, which was denied on August 9. Khandhar responded by letter and was similarly denied on September 7. Khandhar filed the above suit on September 8, 2016. On August 24, Elow made a similar demand on the Company, which was also denied. Elow filed the above suit on September 6, 2016.

The Company claimed that Khandhar’s demand was improper and did not meet the form and manner requirements of Section 220 because he failed to prove beneficial ownership of stock before initiating litigation. The Court agreed for two reasons: first, because the stock purchase plan Khandhar produced as proof of ownership did not contain his name; second, because this purported proof of ownership was not provided prior to litigation. Therefore, the Court rejected Khandhar’s demand.

In challenging Elow’s inspection demand, the Company argued that Elow had not stated a proper purpose under Section 220. Elow’s stated purpose was to investigate whether officers and directors breached their fiduciary duties by (1) allowing the Company to breach its contractual obligations to Anthem, (2) failing to prevent the



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Company's breaches despite a known duty to act, and (3) communicating dishonestly with the stockholders regarding the agreement and customer retention. The Court held that the pleading in the Anthem actions coupled with the statements of the Company's management were enough to establish a credible basis to infer possible mismanagement, and that the demand therefore stated a proper purpose.

The Company also challenged the broad scope of Elow's demand and asked that any production be incorporated by reference into any future derivative complaint. The Court held that Elow had only shown that board or committee packages (including agendas, minutes, or presentations) relating to the Anthem relationship dated from January 1, 2015 until the present were essential for purposes of the Section 220 demand. Further, the Court granted the Company's request to apply the incorporation-by-reference doctrine in order to prevent potential cherry-picking of documents in any subsequent derivative complaint. The Court entered judgment in Elow's favor and granted his Section 220 demand subject to a confidentiality order and the incorporation-by-reference doctrine.

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