

I.

The plaintiff, Meir Freund, is a stockholder of the defendant, Lucent Technologies, Inc., a Delaware corporation (“Lucent”). Freund brought this action pursuant to 8 *Del.* C. § 220 to compel a more complete inspection of certain of Lucent’s books and records. After the conclusion of discovery, Freund moved for summary judgment. For the reasons, and subject to the limitations, described below, an order will be entered permitting the inspection.

II.

Lucent is a publicly held corporation that manufactures, designs and develops telecommunication systems. Freund is the record holder of 4,000 shares of Lucent stock. Lucent was spun-off from AT&T and an initial public offering of Lucent’s stock was held in 1996. As a result, Lucent’s common stock became one of the most widely held securities in the world. From the time of its IPO until 1999 Lucent’s stock price steadily increased, reaching a high of around \$80 per share in December of 1999. Shortly after that high, however, the price began to fall. At the time Freund wrote his letter demanding the right to inspect certain of Lucent’s books and records on March 1, 2001, Lucent common stock was trading at around \$12 per share. More recently, Lucent shares are trading below \$1 .00.

Beginning in January 2000, Lucent issued a series of press releases announcing that it would not meet previously announced sales and earnings

targets. Later the same year, Lucent announced a substantial restatement of fourth quarter 2000 revenues (Lucent's fiscal year ends September 30) by \$689 million, and related profits by \$425 million. In substantial part, this financial restatement resulted from the reversal of sales that, apparently, were improperly recognized.

In response to Lucent's financial restatement, the Securities and Exchange Commission initiated a formal investigation into possible fraudulent accounting practices at Lucent. Moreover, a series of lawsuits were filed against Lucent, raising allegations, among other things, of securities fraud, mismanagement and retaliatory firing of an employee for "whistle blowing."

On December 22, 2000, Freund filed a securities class action complaint against Lucent, and two of its former CEOs, Henry Schacht and Richard McGinn, in the United States District Court for the District of New Jersey. In that complaint, Freund alleged that the defendants had violated the federal securities laws by engaging "in a continuous course of conduct to report false and misleading financial results for the Company in the fourth fiscal quarter of 2000, ending September 30, 2000." This case was later consolidated into related litigation pending in that same court. Freund initiated discovery in his action but voluntarily dismissed his complaint on March 30, 2001, before any discovery was obtained.

He did so because he learned that he would not be named lead plaintiff and that “there [was] nothing else for [him] to do in that case.. ..”¹

On March 1, 2001, Freund sent Lucent a demand letter requesting 18 categories of documents pursuant to 8 *Del. C. § 220*.² Freund stated that his purpose for requesting those documents was to determine whether the company had been subjected to waste and mismanagement, whether it had adequate controls in place, and whether senior management and the board of directors had been implementing those controls diligently. Freund further stated that his belief that mismanagement was occurring was based on the company’s revisions of its financial statements, its repeated failures to meet previously announced income and revenue targets, the filing of shareholder (and other) lawsuits, press reports that senior officials of the company had accused the company of improper accounting practices, and the existence of a formal SEC investigation into Lucent.

Lucent responded to Freund’s demand letter by stating it was prepared to allow him to inspect certain books and records. On April 4, 2001, after Freund had signed a suitable confidentiality agreement, Lucent produced some documents, but

¹ Freund Dep. at 73.

² Freund’s demand is summarized, *infra*, at pages 12-17.

withheld others that were responsive to the demand. According to Freund, Lucent's production did not fully satisfy any of the categories in his demand.

After further correspondence, Freund commenced the current action on May 17, 2001. Thereafter, Freund did nothing to prosecute his case for nearly eight months. In the meantime, a number of derivative complaints alleging misconduct similar to that described in Freund's Section 220 demand letter were filed in this court and ultimately consolidated into *In re Lucent Technologies, Inc. Derivative Litigation*, C.A. No. 18698-NC. Finally, at a status conference held by the court on March 5, 2002, in this case, Freund proposed that this matter be resolved on summary judgment, and Lucent did not object.

Freund states that his purposes for requesting the books and records is to investigate the following: (1) whether Lucent's management and board of directors has engaged in waste and mismanagement; (2) whether Lucent lacked adequate financial and accounting controls; and (3) whether management and the board failed to implement existing controls diligently.

Lucent claims that Freund's stated purpose for inspection is not his *bona fide* purpose and that he does not have a "proper purpose" under Delaware law. Lucent asserts that Freund's purpose is improper because it seeks to use Section 220 to obtain documents for his counsel or other parties in other pending litigation against Lucent. Lucent also maintains that Freund's request is overbroad because the

books and records that Freund seeks are not necessary and essential to his stated purpose.

III.

This court will award summary judgment when there are no material issues of fact in dispute and the moving party is entitled to judgment as a matter of law.³ In evaluating the record, the court will view the facts in a light most favorable to the nonmoving party, accepting as true uncontroverted facts from the record.⁴ A motion for summary judgment will be granted only if there are no material issues of fact and the movant is entitled to judgment as a matter of law. Usually, the moving party bears the burden of proof in showing that there are no questions of material fact; however, the moving party can discharge this burden by showing that there is an absence of evidence to support the nonmoving party's case?

A stockholder's exercise of the right to inspect books and records beyond stock lists and related information depends upon strict compliance with the requirements of Section 220, which provides:

Where the stockholder seeks to inspect the corporation's books and records, other than its stock ledger or list of stockholders, such stockholder shall first establish (1) that such stockholder has complied with this section respecting the form and manner of making demand

³ Ch. Ct. R. 56 (c); *Fleer Corp. v. Topps Sewing Gum, Inc.*, 539 A.2d 1060, 1061-62 (Del. 1988).

⁴ *Battista v. Chrysler Corp.*, 454 A. 2d 286,290 (Del. Super. 1982).

⁵ *Celotex Corp. v. Catrett*, 477 U.S. 317,323 (1986).

for inspection for such documents; and (2) that the inspection such stockholder seeks is for a proper **purpose**.⁶

Here, it is undisputed that Freund was a record holder of Lucent common stock at all times relevant to this proceeding and that he has complied with section 220's form and manner requirements in delivering his initial request for inspection. Nor is there any dispute that his request was, in part, denied by Lucent. Nevertheless, there is a dispute about Freund's purpose in seeking inspection and the scope of his inspection rights. The court will now turn to those questions.

A. Is Freund's Purpose Proper?

In determining whether a stockholder is entitled to inspect corporate books and records, courts examine the propriety of the stockholder's primary purpose in seeking such **inspection**.⁷ Since Freund would bear the burden at trial in proving that his purpose was proper, he must show on this motion for summary judgment that there is no genuine issue of material fact as to the propriety of his purpose. Freund asserts that his purpose is to investigate waste and mismanagement by Lucent's management and board of directors. Thus, to meet his burden, he must

⁶ 8 *Del. C.* § 220(c).

⁷ *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1031 & n.2 (Del. 1996); *CM & M Group, Inc. v. Carroll*, 453 A.2d 788,792 (Del. 1982).

show “some credible basis from which the court can infer that waste or mismanagement may have occurred.”*

“It is well established that investigation of mismanagement is a proper purpose for a Section 220 books and records inspection.” Moreover, “[a] purpose of investigating the misconduct identified in [an] SEC order” is “sufficiently concrete.”⁸ Freund here points to the SEC’s formal investigation into Lucent’s accounting practices. In addition, he notes Lucent’s revisions of its financial statements for fiscal year 2000, as well as the commencement of litigation by other shareholders of Lucent following the precipitous decline in the value of Lucent’s stock. This record adequately supplies “some credible basis” to support an inference of waste or mismanagement at Lucent.

Lucent argues that because Freund was able to file his federal securities law suit in compliance with applicable pleading requirements under federal law, he must, perforce, already possess all the information he needs to determine whether or not waste and mismanagement has occurred. For this proposition, Lucent relies on a transcript decision of this *court* in ***Parfi Holding, AB v. Mirror Image Internet, Inc.***, in which Vice Chancellor **Strine** concluded that investigating corporate

⁸ *Thomas & Betts Corp.*, 681 A.2d at 103 1.

⁹ *Security First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 536, 567 (Del. 1997).

¹⁰ *Carapico v. Philadelphia Stock Exchange, Inc.*, 791 A.2d 787,792 (Del. Ch. 2000).

mismanagement was not a proper primary purpose “in a situation where the [Section] 220 plaintiff has already made a decision—an informed decision to initiate two pieces of litigation against the company.” A review of that transcript ruling, however, shows that the real problem addressed by the court in that case was that the plaintiff’s trial testimony “forthrightly” admitting that he hoped to use the Section 220 action as a means of gathering discovery for use in his other **pending proceedings**—an arbitration in Sweden and a civil action in this court. The court observed that, once those other proceedings were commenced, “there [were] other processes under the law which are wholly sufficient to satisfy” the plaintiffs purpose in obtaining **discovery**.¹² The crucial difference here is that Freund dismissed his federal securities litigation nearly a year ago and has not initiated any other proceedings against Lucent. Thus, there is no reason to infer that he is prosecuting this demand in order to obtain evidence for use in some other pending proceeding.

For these reasons, the record fully supports the conclusion that Freund’s primary purpose in making his demand is to investigate corporate waste and

¹¹ Del. Ch., C.A. No. 18457, tr. at 6, Strine, V.C. (Mar. 23, 2001)(TRANSCRIPT).

¹² *Id.*

mismanagement. Of course, Freund's purpose must also not be adverse to the best interests of the **corporation**.¹³ The court will now examine that question.

B. Is Freund's Demand for Inspection Adverse to Lucent?

Lucent points out that it is still a "nominal defendant in a consolidated derivative action in this Court . . . that challenges the same alleged conduct that forms the basis of plaintiffs demand for **inspection**."¹⁴ "Under such circumstances," Lucent's argument goes, "where plaintiff's only stated purpose is to investigate alleged wrongdoing that is already the subject of a pending derivative action before this Court, plaintiffs demand for inspection of books and records is unnecessary, amounts to harassment of Lucent, and is adverse to the interests of the **Company**."¹⁵ There are several weaknesses with this argument. First, the Delaware Supreme Court has made it clear that the public policy of this State is to encourage stockholders to utilize Section 220 before filing a derivative action, as Freund is attempting to do here, in order to meet the heightened pleading requirements of Court of Chancery Rule 23.1 that are applicable to such actions? The fact that others, acting independently, have chosen to file derivative actions

¹³ *Thomas & Betts Corp.*, 681 A.2d at 1035.

¹⁴ Def. Br. at 9.

¹⁵ *Id.*

¹⁶ *Grimes v. Donald*, 673 A.2d 1207, 1218 (Del. 1993); *Scattered Corp. v. Chicago Stock Exchange*, 701 A.2d 70, 78 (Del. 1997).

without having first used the “tools at hand” should not prevent **Freund** from doing so.

Second, Lucent and the other defendants in the derivative case have moved to dismiss precisely on the ground that the complaint does not meet Rule 23.1’s pleading requirements. Thus, if Freund’s Section 220 action is dismissed and, afterward, the derivative complaint is dismissed for failure to allege demand excusal with particularity, there will be no derivative claimant left standing. While this result might simplify life for Lucent’s legal department, it is not necessarily consonant with the best interests of the corporation.

For all these reasons, the court is satisfied that Freund has met the requirement that he state a proper purpose. What is left to be decided is the scope of inspection to which he is entitled.

C. Scope of the Inspection

Lucent argues that the books and records that Freund seeks are not essential to his stated purpose, arguing that he has failed to identify with “rifled precision” the books and records necessary to satisfy his stated purpose.¹⁷ It is true, of course, that Section 220 does not give stockholders a right to conduct a broad fishing expedition. As this court recently observed:

¹⁷ *Brehm v. Eisner*, 746 A.2d 244,266 (Del. 2000).

Entitlement to inspection under § 220 for a stockholder demonstrating a proper purpose is ‘not open-ended; it is restricted to inspection of the books and records needed to perform the task.. ..’ Therefore the order allowing plaintiffs requested books and records inspection will be limited to those documents reasonably required to satisfy the purpose of the demand.’*

Moreover, while this court “has wide latitude in determining the proper scope of inspection, it is the responsibility of the trial court to tailor the inspection to the stockholder’s stated **purpose.**”¹⁹ Nevertheless, where a plaintiff has shown evidence of wide-ranging mismanagement or waste, a more wide-ranging inspection may be **justified.**²⁰

Freund has shown a proper purpose of investigating evidence of extensive waste and mismanagement at Lucent and should be afforded some leeway in the inspection he **seeks.**²¹ Nevertheless, Lucent argues that Freund has failed to make any effort to meet the burden of adducing specific evidence that any of the categories of documents requested are essential to his stated purpose. The court will address the proper scope of Freund’s requests in order.

¹⁸ *Carapico*, 791 A.2d at 792-93 (quoting *BBC Acquisition Corp. v. Durr-Fillauer Medical, Inc.*, 623 A.2d 85, 88 (Del. Ch. 1992)).

¹⁹ *Security First*, 687A.2d at 569.

²⁰ *Skoglund v. Ormand Industries, Inc.*, 372 A.2d 204,211 (Del. Ch. 1976); *Sahagen Satellite Technology Group, LLC v. Ellipso, Inc.*, 791 A.2d 794,798, n.16 (Del. Ch. 2000).

²¹ *Skoglund*, 372 A.2d at 211. *In Skoglund*, plaintiff was able to show the likelihood of systematic problems with management, thus, the court allowed plaintiff to conduct a “broad ranging investigation of mismanagement or waste.” *Id.* at 211.

Eighteen categories of documents remain in dispute between the parties.

The court analyzes these eighteen categories as follows:

Categories 1 and 5

1. Orders and other communications with the SEC concerning its investigation, as reported in the February 9, 2001 edition of the Wall Street Journal.

5. Copies of any presentations made by the company or its representatives to the SEC concerning fiscal year 2000 financial reporting.

Documents relating to the SEC formal order of investigation are reasonably required to satisfy Freund's stated purpose of investigating Lucent's alleged fraudulent accounting practices. Lucent's other objections to the inspection of these documents either have already been rejected, or are unpersuasive. For example, Lucent argues that the production of these documents will circumvent the discovery stay in the derivative action. However, that objection is easily resolved by conditioning the production in such a way as to prevent Freund or his counsel from sharing information discovered with anyone involved in the pending derivative litigation.

Categories 2-4

2. All reports, findings, conclusions reached by or on behalf of the company concerning its restatements of earnings for all or any part of fiscal year 2000.

3. All external auditing reports prepared by Pricewaterhouse Coopers concerning fiscal year 2000.²²

4. Any other reports concerning the condition or effectiveness of the company's internal controls or financial, accounting or information systems.

Lucent argues that Freund is not entitled to the documents requested in category 2 because its explanation for the restatement of earnings is already provided in the press releases and reports cited by Freund. Further, it argues that it has provided Freund with two documents related to this category and that no more documents exist. If there are no more documents that are responsive to this demand, so be it. However, to the extent that additional documents exist relating to the company's reports, findings or conclusions concerning its restatements for fiscal year 2000, Lucent must make them available for Freund to inspect.

Lucent argues that the requests in categories 3 and 4 should be limited to the fourth quarter of 2000 and that all such documents have been produced. Freund responds that the evidence demonstrates accounting problems earlier than the fourth quarter of 2000, and thus, he is entitled to all external audit reports concerning fiscal year 2000. Based on the record evidence constituting grounds to

²² Freund's initial request for the documents in this category also included reports from Cravath, Swaine & Moore, but, his reply brief states that "we will accept that there is no Cravath report" based on Lucent's representation that the Wall Street Journal was in error by stating that there was one. PI. Rep. Br. at 9.

inquire into a wide range of mismanagement, the court concludes that Freund is entitled to inspect documents relating to all of fiscal year 2000. Nevertheless, the request in category 4 is overly broad, since it is unlimited by time or particularized subject matter. The record reflects that Lucent has already produced reports concerning the effectiveness of Lucent's internal controls. Therefore, no further inspection is necessary in response to category 4 of the demand.

Category 6

6. The court records, depositions, documents and other materials filed by Nina Aversano in the New Jersey Superior Court.

The Aversano litigation is between Lucent and a former senior officer who allegedly warned **McGinn** that Lucent could not meet its profit targets. According to the press, the suit was brought under the New Jersey Whistle Blower statute. Lucent objected to this request principally on the ground that the material requested was publicly available at the courthouse in Middlesex County, New Jersey. At the hearing on the motion for summary judgment, the court directed Freund's counsel to go to there to inspect the public file. Freund's counsel reported to the court by letter dated December 2, 2002, that they had reviewed the public file in the New Jersey court and had located extracts of numerous depositions taken in the case, but not full transcripts or deposition exhibits. Their letter renewed their request for access to full transcripts and deposition exhibits.

The order to be entered on this motion will require Lucent to make those materials available.

Categories 7-11

7. - 9. Statements and descriptions of Lucent's (i) accounting compliance programs, and (ii) policies and procedures (a) for booking sales (including use of nonrecurring credits given to customers), and (b) concerning accounting treatment of software licensing agreements in effect during the Relevant period (October 1, 1999 to March 1, 2001).

10.-1 1. Statements and descriptions of Lucent's policies and procedures in effect during the Relevant Period for (i) preparing revenue "targets" or preparing and disclosing "financial guidance" or projections; and (ii) recognizing revenue, on sales to its distributors.

Lucent argues that Freund is not entitled to documents in categories 7 through 11 because he has not explained how a review of these company policies and procedures will help him understand whether or not management complied with them. This argument does not fairly meet the demand. Freund is entitled to know whether Lucent had policies and procedures in place to keep track of, and report on, its financial transactions in accordance with GAAP, as well as the other matters described. It is, of course, part of the responsibility of the board of directors and senior management to take reasonable steps to ensure that such procedures both exist and are followed properly.

Categories 12-15

12. Board or committee minutes discussing (a) Lucent's financial or accounting compliance programs, (b) its financial controls, (c) the SEC investigation, or (d) any restatement of financial results.

13– 15. Board or committee minutes discussing (a) any problems encountered or delays in the development of Lucent's OC-192 optical networking system; (b) any problems Lucent was having in its relationship with AT&T; and (c) the decline in demand for power switch product line.

The documents described in categories 12-15 should be made available to Freund, to the extent that they exist and have not already been produced. If, as Lucent states, there are no documents responsive to certain categories, it should so inform Freund.

Category 16

16. Documents concerning an alleged policy or strategy, reputedly adopted in September 1999 to ship products to customers notwithstanding design and technical problems.

Lucent's response to category 16 is that "there is no such policy and there are no such documents." In his deposition, Freund testified that he had no knowledge whether such an "alleged policy" actually existed. In the circumstances, Lucent will not be required to respond further to this category.

Categories 17-18

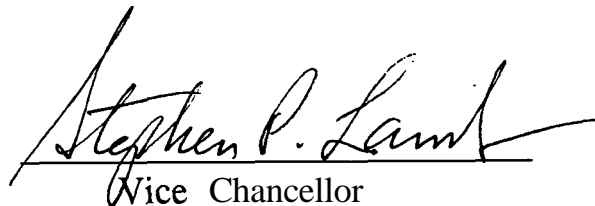
17. Policies and programs for the board, or any board committee, to monitor the progress of product development programs, manufacturing problems, and customer relationship problems.

18. Documents establishing or describing the responsibilities of the audit committee, or any other committee or group given oversight responsibility for the company's financial reporting, accounting, revenue recognition or other financial operations.

Lucent states that various board and committee minutes "concerning product development and manufacturing . . . have already been produced" to Freund. To the extent that separate policies or programs for the board or a board committee exist of the type described, Freund is entitled to see them. Moreover, he is entitled to inspect documents establishing or describing the responsibilities of the audit **committee**, or any similar committee of the board of directors.

IV.

For all of the foregoing reasons, the court will grant Freund's motion for summary judgment and will enter an Order granting the inspection demanded to the extent described in this opinion. Freund's counsel should submit an order on notice within 10 days. This order granting inspection will be conditioned upon Freund signing a suitable confidentiality agreement, if the existing agreement does not adequately protect Lucent's legitimate interests.


Vice Chancellor