IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MARC PAUL,	)	
	)	C.A. No. 6570-VCP
Plaintiff,	)	
	)	
v.	)	
	)	
CHINA MEDIAEXPRESS HOLDINGS, INC., a Delaware corporation,	)	
	)	
Defendant.	)	
	)	

MEMORANDUM OPINION

Submitted: October 11, 2011
Decided: January 5, 2012

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PARSONS, Vice Chancellor.

This is an action to inspect the books and records of a corporation under 8 *Del. C.* § 220. A shareholder brought this action after a series of reports and events, including the resignation of the company's independent auditor, raised suspicions that the company had engaged in fraud and falsified its financial statements. The company opposes the shareholder's demand on the ground that the shareholder has not established a proper purpose to inspect its books and records. Furthermore, the company argues that this action should be stayed pending resolution of a motion to stay these and other proceedings that is pending in a related federal court action.

For the reasons stated in this Memorandum Opinion, I find that the shareholder has established proper purposes to inspect the books and records of the company. Those purposes are to investigate (1) fraud and mismanagement and (2) the ability of the board to act independently and in good faith. Therefore, I grant the shareholder's demand as to the documents discussed in this Memorandum Opinion, but only to the extent the documents are necessary for one of his proper purposes. I also deny the company's request to stay this action.

I. BACKGROUND

A. The Parties

Plaintiff, Marc Paul, is a resident of Tennessee and a shareholder of Defendant, China MediaExpress Holdings, Inc. ("CME" or the "Company"). Paul acquired stock in CME through personal online brokerage accounts he maintains for himself and his family.

Defendant, CME, is a Delaware corporation with its principal place of business in Hong Kong, China. CME is engaged in the business of television advertising on inter-city and airport express buses in China. Until recently, CME was publicly listed on the NASDAQ Stock Market. CME obtained its listing on NASDAQ through a merger with TM Entertainment and Media, Inc. ("TM Entertainment") in 2009.

B. Facts

This action arises from various allegations of fraud and mismanagement made against CME beginning in January 2011. Around that time, Citron Research, a financial analyst firm, released a report alleging that CME was engaging in fraudulent accounting practices and that most of CME's business could be a fraud.[1] The next week, two shortsellers, Bronte Capital and Muddy Waters LLC, released reports making similar allegations that CME's financial statements and operations were fraudulent.[2] Zheng Cheng, CME's Chairman, CEO, and President, responded to the allegations on February 7, 2011, denying any fraud and accusing the shortsellers of acting in concert to promote their own objective of driving down the Company's stock price.[3]

On March 2, 2011, Muddy Waters released a follow-up report further elaborating on its basis for believing that CME was a fraud and that CME's management was

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1 PX 3. This reference is to one of Plaintiff's trial exhibits which was admitted in connection with the trial held on October 11, 2011.

2 PX 4, 5.

3 PX 31.

engaged in a cover-up.[4] Then, on March 11, the Company's independent auditor, Deloitte Touche Tohmatsu ("DTT") formally resigned. In a press release following DTT's resignation, CME acknowledged that DTT had stated in its resignation letter that it was "no longer able to rely on the representations of management," that certain issues raised in the audit should be addressed through an independent investigation, and that the issues may have adverse implications for prior periods' financial reports.[5] That same day, the Company requested that NASDAQ temporarily suspend trading in its stock.[6]

Following the resignation of DTT, CME's situation quickly degenerated. Jacky Lam, a director and the Company's CFO, resigned on March 13, 2011, citing concerns over senior management's failure to respond properly to information which he had "learned in the past few days" following the resignation of DTT.[7] Dorothy Dong, another CME director, resigned shortly after Lam, citing similar concerns over senior management's response to accounting irregularities related to DTT's resignation.[8]

On April 4, 2011, NASDAQ notified the Company that it was suspending trading in the Company's stock effective April 12. Shortly thereafter, another director, Marco Kung, resigned from the board, citing concerns over senior management's response to

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4 PX 6.

5 PX 33.

6 *Id.*

7 PX 15.

8 *Id.*

issues related to DTT's resignation.[9] Following Kung's resignation, the Company announced that it was not in compliance with NASDAQ Rule 5605(c)(2)(A), which requires that a listed company's audit committee be comprised of at least three independent board members.[10] On May 2, 2011, the Audit Committee of the board retained the DLA Piper law firm to conduct an internal investigation of the concerns raised by DTT.[11] NASDAQ delisted CME's shares on May 19.[12]

1. The federal proceedings

As a result of the events unfolding at CME during the spring of 2011, Starr Investments Cayman II, Inc. ("Starr"), a CME investor, filed a complaint against CME, DTT, Cheng, and Lam in the United States District Court for the District of Delaware on March 18, 2011 (the "Federal Action").[13] In its complaint, Starr alleges various violations of state law and federal securities laws, including: (1) violation of § 10(b) of the Exchange Act and Rule 10b-5; (2) violation of § 20(a) of the Exchange Act against Cheng and Lam; (3) common law fraud; (4) breach of fiduciary duty against Cheng and Lam; (5) aiding and abetting a breach of fiduciary duty against DTT; and (6) negligent

9 PX 21.

10 NASDAQ Rule 5605(c)(2)(A).

11 PX 37.

12 PX 38.

13 *Starr Invs. Cayman II, Inc. v. China MediaExpress Hldgs., Inc.*, No. 11-CV-0023-SLR (D. Del. filed Mar. 18, 2011).

misrepresentation.[14] The federal defendants moved to dismiss that case on June 13, 2011, three days before Plaintiff filed his Complaint in this action. In response to the federal defendants' motion to dismiss, Starr filed an amended complaint in the Federal Action on July 5. On September 30, the federal defendants moved to dismiss Starr's amended complaint. Pursuant to the Private Securities Litigation Reform Act ("PSLRA"), discovery in the Federal Action is stayed pending the district court's resolution of the federal defendants' motion to dismiss.[15]

C. Procedural History

On or about May 17, 2011, while the Federal Action was proceeding, Paul served CME with a written demand for inspection of the books and records of the Company pursuant to 8 *Del. C.* § 220. CME did not respond to the demand. As a result, Paul filed the Complaint in this action on June 16. CME answered the Complaint on July 6, and a trial date was set for October 11, 2011.

On September 27, 2011, CME moved in the Federal Action to stay discovery in this action pursuant to the Securities Litigation Uniform Standards Act ("SLUSA").[16]

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14 PX 9.

15 15 U.S.C. § 78u-4(b)(3)(B) ("In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.").

16 15 U.S.C § 78u-4(b)(3)(D) ("Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.").

Then, at a pretrial teleconference on October 4, less than a week before the scheduled trial in this action, CME requested a continuance of the trial date until after the district court has decided the SLUSA motion. Due to the imminent trial date, the limited scope of the trial, and CME's failure to raise the issue of a continuance or stay more promptly in this Court, I denied CME's request.[17] At trial, however, both parties were given the opportunity to address CME's related request that this Court defer ruling on Paul's § 220 demand pending the district court's decision. The district court has not yet ruled on the SLUSA motion.

D. Parties' Contentions

In this books and records action under 8 *Del. C.* § 220, Plaintiff asserts two purposes for his request to inspect the books and records of CME. They are: (1) to investigate "possible mismanagement and breaches of fiduciary duties by the directors and officers of the Company, including, but not limited to, mismanagement and breaches of fiduciary duties in connection with the Company's lack of oversight and possible participation in fraudulent conduct involving the Company's customer contracts, revenues and net income"; and (2) to "determin[e] whether the Company's directors are independent and have acted, and are capable of acting, in good faith with respect to the Company's potential misconduct."[18]

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[17] Oct. 4, 2011 Hr'g Tr. 12-13.

[18] Plaintiff's Complaint alleges that he also sought to value his shares of CME stock, but Paul withdrew that claim at trial. Oct. 11, 2011 Trial Tr. ("Tr.") 55-56.

CME opposes Paul's inspection demands on the basis that he has failed to state a proper purpose.[19] CME also argues that, in any case, these proceedings should be stayed pending resolution of the SLUSA motion in the Federal Action.

II. ANALYSIS

A. 8 *Del. C.* § 220

It is well-established that "[s]tockholders of Delaware corporations enjoy a qualified common law and statutory right to inspect the corporation's books and records."[20] Under the common law, "[i]nspection rights were recognized . . . because, '[a]s a matter of self-protection, the stockholder was entitled to know how his agents were conducting the affairs of the corporation of which he or she was a part owner.'"[21] This common law right was codified in Delaware under 8 *Del. C.* § 220, which provides in pertinent part that:

> Any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose, and to make copies and extracts from: (1) The corporation's stock ledger, a list of its stockholders, and its other books and records . . . .[22]

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19 Originally, Defendant also objected to Paul's demand because the brokerage statements he provided to the Company as proof of stock ownership were illegible. At trial, however, Paul presented legible copies of the statements and credibly testified to his ownership of CME stock. Thus, to the extent CME continues to press its ownership defense, I reject it as contrary to the evidence.

20 *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 116 (Del. 2002).

21 *Id.* (quoting *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 467 (Del. 1995).

22 8 *Del. C.* § 220(b).

Therefore, in asserting the right to inspect the books and records of a company, a shareholder must prove that he (1) is a stockholder of the company, (2) has made a written demand on the company, and (3) has a proper purpose for making the demand.

Here, it is undisputed that Plaintiff is a shareholder of CME and has made a valid written demand. The Company, however, resists Paul's demand on the ground that he does not have a proper purpose. Accordingly, I begin by addressing Plaintiff's alleged purposes.

1. Proper purpose

Where, as here, a shareholder seeks to inspect the books and records of a company other than the stock ledger or list of stockholders, the burden of proof is on the shareholder to demonstrate a proper purpose for inspection by a preponderance of the evidence.[23] "Proper purpose," under Delaware law, means a purpose reasonably related to such person's interest as a stockholder.[24] As this Court noted in *Melzer v. CNET Networks, Inc.*, "[t]here is no shortage of proper purposes under Delaware law."[25] To plead a proper purpose successfully, however, the purpose asserted by the shareholder should be intended to "further[] the interest of all stockholders and should increase stockholder return."[26]

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23 *Id.*; *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006).

24 *Seinfeld*, 909 A.2d at 121.

25 934 A.2d 912, 917 (Del. Ch. 2007).

26 *Seinfeld*, 909 A.2d at 121.

2. Investigating waste and mismanagement

It is well-established that a shareholder's investigation of wrongdoing or mismanagement at a company is a "proper purpose" for a § 220 action.[27] To meet its burden of proving a proper purpose, however, a shareholder must make more than mere conclusory statements that waste and mismanagement have occurred or are occurring.[28] Instead, the shareholder must present some credible basis "through documents, logic, testimony or otherwise" from which the Court can infer wrongdoing.[29] Moreover, although shareholders have the burden of coming forward with specific and credible allegations sufficient to warrant a suspicion of waste and mismanagement, they are "not required to prove by a preponderance of the evidence that waste and [mis]management are actually occurring."[30] Instead, shareholders only need to show a credible basis from which the Court can infer that there are reasonable grounds to suspect mismanagement

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27 *Melzer*, 934 A.2d at 917.

28 *See City of Westland Police & Fire Ret. Sys. v. Axcelis Techs., Inc.*, 1 A.3d 281, 290 (Del. 2010) ("Inspection under § 220 is not automatic upon a statement of a proper purpose.") (citing *Pershing Square, L.P. v. Ceridian Corp.*, 923 A.2d 810, 818 (Del. Ch. 2007)); *Melzer*, 934 A.2d at 917 n.19 ("Section 220 makes inspection available only for shareholders with a 'proper purpose.' If a shareholder could satisfy this burden by conclusorily repeating words previously used to describe a proper purpose, the requirement would be rendered meaningless, and well settled canons of statutory construction prevent such absurd results.").

29 *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *8 (Del. Ch. Aug. 30, 2004).

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

that would warrant further investigation.[31] This showing "may ultimately fall well short of demonstrating that anything wrong occurred."[32]

Here, Plaintiff sufficiently has alleged a credible basis to warrant suspicion of waste and mismanagement at CME. In the Complaint, Paul alleges as proof of wrongdoing: (1) numerous third-party media reports alleging fraudulent conduct by CME's officers and directors; (2) the NASDAQ Stock Market's halting of trading in, and subsequent delisting of, CME shares; (3) the resignation of the Company's independent auditor; (4) the noisy resignations of three board members in the last year, including the Company's CFO, citing concerns about senior management and the Company's accounting practices; and (5) CME's initiation of its own internal investigation.

Each of these items arguably provides a credible basis from which the Court could infer that CME's officers and directors may have mismanaged the Company or engaged in wrongdoing in breach of their fiduciary duties. Collectively, these allegations and the evidence supporting them convince me that Paul has presented a credible basis for suspecting wrongdoing. The resignation of DTT, for example, implicates problems with CME's financial reporting and CME's ability or willingness to respond to those

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31 *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 567-69 (Del. 1997).

32 *Khanna v. Covad Commc'ns Gp., Inc.*, 2004 WL 187274, at *6 n.25 (Del. Ch. Jan. 23, 2004); *see also Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006) ("Although the threshold for a stockholder in a section 220 proceeding is not insubstantial, the 'credible basis' standard sets the lowest possible burden of proof. The only way to reduce the burden of proof further would be to eliminate any requirement that a stockholder show *some evidence* of possible wrongdoing.").

problems. The NASDAQ delisting similarly raises concerns about CME's financial reporting and corporate governance. Each of the resigning directors also expressed concerns about senior management, and the internal investigation by the Company itself tends to corroborate the existence of reasonable suspicion that raises concerns that wrongdoing or mismanagement may have occurred.

The only challenge the Company makes to the sufficiency of this evidence is that the third-party media reports, particularly the reports by Citron Research, Bronte Capital, and Muddy Waters LLC, are hearsay and that the authors of those reports were conflicted and unreliable because they stood to benefit from a decline in CME's share price. CME further argues that the reports made DTT and the directors "skittish," causing them to resign, and created a "self-fulfilling prophecy" that resulted in CME's current situation.[33]

Delaware law, however, "d[oes] not endorse a categorical rule of law . . . that 'hearsay statements not offered for their truth fail as a matter of law to meet Section 220's evidentiary requirements.'"[34] Instead, if the Court determines that such evidence is sufficiently reliable, "it may be considered in determining whether a credible basis exists to conclude that waste or mismanagement may have occurred . . . ."[35] Here, the events that occurred after the publication of the challenged reports, such as the resignation of the CME directors, reinforce the shortsellers' claims. Therefore, without addressing whether

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33 Tr. 57-58.

34 *Marmon v. Arbinet Thexchange, Inc.*, 2004 WL 936512, at *4 (Del. Ch. Apr. 28, 2004).

35 *Id.*

those reports ultimately may be used to prove the truth of the allegations of fraud that later may be brought against the Company, I find that, when considered in light of the other evidence upon which Paul relies, the reports do provide a credible basis upon which to infer that waste and mismanagement may have occurred at CME.

3. Determining whether the Company's directors are independent and capable of acting in good faith

As an alternative purpose, Paul demands inspection to determine whether CME's directors are independent and capable of acting in good faith with respect to the Company's potential misconduct.[36] Paul acknowledged at trial that he seeks to investigate the independence of the directors in anticipation of alleging demand futility if he later decides to bring a derivative action on behalf of the Company.[37] As the Supreme Court has recognized:

> Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements of Court of Chancery Rule 23.1. . . . By first prosecuting a Section 220 action to inspect books and

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[36] Once a shareholder establishes a proper purpose under § 220, the right to relief will not be defeated by the fact that the stockholder may have secondary purposes that are improper. *See CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 792 (Del. 1982) ("[O]nce a proper purpose has been established, any secondary purpose or ulterior motive of the stockholder becomes irrelevant."). Nevertheless, the nature of the proper purpose(s) established by a § 220 plaintiff is important because the scope of the inspection authorized by this Court must be tailored to the plaintiff's stated purposes. *See Marathon P'rs, L.P. v. M&F Worldwide Corp.*, 2004 WL 1728604, at *4 (Del. Ch. July 30, 2004) ("If a court orders inspection of books and records or stocklists, the court has wide discretion in determining the proper scope of inspection in relation to the stockholder's purpose.").

[37] Tr. 65-66.

> records, the stockholder-plaintiff may be able to uncover particularized facts that would establish demand excusal in a subsequent derivative suit.[38]

CME contends that Paul does not have a proper purpose to investigate class action or derivative claims because he continued to buy shares of CME stock after the release of negative third-party reports and, therefore, cannot claim "reliance for any federal securities-law claims or proximate cause in connection with any derivative disclosure claims."[39] As a result, the Company asserts, Paul's claims are atypical and he is unlikely to qualify as a representative plaintiff.

Defendant misunderstands the relevant law on this point. Paul need not prove that he would qualify as a representative plaintiff in a later class or derivative action to show a proper purpose under § 220. Instead, what matters in proving a proper purpose under § 220 is that he would have standing to bring either direct or derivative claims against CME following the requested inspection.[40] Because, as CME acknowledges,[41] Paul was a CME shareholder at all times relevant to the alleged fraud, he presumably will have

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38 *King v. VeriFone Hldgs., Inc.*, 12 A.3d 1140, 1145-46 (Del. 2011) (footnotes omitted).

39 Def.'s Pre-Trial Br. 9.

40 *Cf. Polygon Global Opportunities Master Fund v. W. Corp.*, 2006 WL 2947486, at *5 (Del. Ch. Oct. 21, 2006) (finding that a plaintiff lacked a proper purpose because it would not have standing to pursue derivative or direct claims of wrongdoing following a § 220 inspection).

41 Def.'s Pre-Trial Br. 9.

standing to bring direct or derivative claims against CME. Therefore, Paul also has demonstrated the existence of a proper purpose to investigate demand futility.

B. Scope of Demand

Inspection under § 220 is not discovery, but rather is a limited form of document production narrowly tailored to the express purposes of the shareholder requesting access to the company's books and records.[42] Even where a shareholder has made a sufficient showing to satisfy the demand requirements of § 220, the right to inspection is not absolute; instead, "it is a qualified right depending on the facts presented."[43] In ordering the production of documents under § 220, the Court "has wide discretion in determining the proper scope of inspection in relation to the stockholder's purpose."[44] As this Court held in *Marathon Partners, L.P. v. M&F Worldwide Corp.*, "[t]he scope of inspection should be circumscribed with precision and limited to those documents that are necessary, essential and sufficient to the stockholder's purpose."[45] Moreover, where the shareholder is seeking the more intrusive inspection of books and records, as opposed to

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42 *See Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 117 n.10 (Del. 2002) ("Plaintiffs 'bear the burden of showing a proper purpose and [must] make specific and discrete identification, with rifled precision . . . [to] establish that each category of books and records is essential to the accomplishment of their articulated purpose . . . .'") (quoting *Brehm v. Eisner*, 746 A.2d 244, 266-67 (Del. 2000)).

43 *Compaq Computer Corp. v. Horton*, 631 A.2d 1, 4 (Del. 1993).

44 *Marathon P'rs, L.P. v. M&F Worldwide Corp.*, 2004 WL 1728604, at *4 (Del. Ch. July 30, 2004).

45 *Id.*; *see also Saito*, 806 A.2d at 116 ("The scope of a stockholder's inspection, however, is limited to those books and records that are necessary and essential to accomplish the stated, proper purpose.").

shareholder lists or stock ledgers, "the level of judicial scrutiny is enhanced and the scope of relief more carefully tailored."[46]

Here, because I find that Paul has stated proper purposes to investigate wrongdoing and mismanagement, as well as demand futility, he is entitled to inspect the books and records of CME that are necessary, essential, and sufficient to further those purposes. Paul's demand includes a detailed list of the documents he seeks to inspect. Therefore, I next examine that list in light of the proper purposes Paul has stated.

1. Requested documents

Paul seeks to inspect the following documents:

> (1) Any valuation of the Company in connection with the merger (*i.e.*, reverse merger) with TM Entertainment and Media, Inc.;
>
> (2) Any documentation supporting the following contentions set forth in Chairman, CEO and President Zheng Cheng's letter to "Shareholders and Friends" dated February 7, 2011, [(PX 32), including] . . .
>
> a. Any materials provided to the United States Patent Office or any patent office in any other country, including the People's Republic of China, relating to the Company's acquisition of a patent for the media player used by the Company, referenced in [PX 32], at page 4;
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> b. Any contracts entered into with Beijing A-er-sha Passenger Transaction Co. Ltd. and Beijing Xiang Long A-er-sha Passenger Transportation Co. Ltd., referenced in the Response Letter, at page 4;

[46] Donald J. Wolfe & Michael A. Pittenger, Corporate and Commercial Practice in the Delaware Court of Chancery § 8.06(e)(1).

c. The contract that was purportedly entered into by the Company with Apple Inc.'s alleged authorized distributor, the Eading Group, in December 2010, referenced in [PX 32], at page 4;

(3) Copies of each version of the "media kit" used by Company employees;

(4) Books and records constituting any contracts or evidencing any business relationship between the Company and any of the following:

a. Shanghai Ba-Shi (Group) Industrial Co. Ltd;
b. Shanghai Zi-xing Passenger Transportation Co. Ltd;
c. Tianjin Long Distance Transportation Co., Ltd;
d. Tianjin A-er-sha Passenger Transportation Co., Ltd;
e. Tianjin Jin-yu Transportation Co., Ltd.
f. Beijing Yin-jian Transportation Co., Ltd, 5th Branch;
g. Fujian San-fu Express Passenger Transportation Co., Ltd;
h. Fujian Min-shen-fa Express Passenger Transportation Co., Ltd;
i. Xin-guo-xian Group (Jiangsu) Transportation Co., Ltd;
j. Changzou Highway Transportation Co., Ltd;
k. Jiangsu Yanfu Highway Transportation Group Co., Ltd;
l. Jiangsu Yanfu Highway Transportation Group Dongtai Branch;
m. Jiangsu Kuailu Yanchen Vehicle Transportation Co., Ltd.;
n. The Coca Cola Company;
o. Lenovo Group Limited;
p. Toyota Motor Corporation;
q. Master Kong;
r. China Mobile; and
s. Fujian Fenzhong;

(5) The resignation letter from Deloitte Touche Tohmatsu ("Deloitte"), or its affiliated subsidiary, in connection with Deloitte's resignation as the Company's independent auditor; and

(6) All memoranda, presentations, reports, correspondence, email, minutes, recordings, consents, agendas, resolutions, summaries,

> analyses, transcripts, notes, and board or committee packages created by, distributed to, or reviewed by or on behalf of CME's Board of Directors . . . or any committee thereof, concerning the subjects referenced in items 1-5 above.[47]

In addition, Paul demands the right to inspect all books and records requested in his demand letter that are within the legal possession, custody, or control of the Company, including, but not limited to, such books and records that are within the possession, custody, or control of the Company's subsidiaries and outside legal counsel, special counsel, accountants, or consultants.[48]

2. Permitted documents

At first blush, there would appear to be only one issue regarding the scope of the documents Paul demands in this action: the parties dispute whether Demand One is directed to a proper purpose. A controversy does exist as to that question and, as explained in Part II.B.3 *infra*, I have determined to deny that demand. In addition, the interplay between this action and the Federal Action and various considerations made relevant by the PSLRA and SLUSA require this Court to examine Paul's other demands more closely. Indeed, CME has argued in the Federal Action that Paul's demands seek "inspection of a wide range of [CME's] books and records" and would be unduly burdensome, especially because CME's operations and virtually all of its business are

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47 PX 39 at 1-3.

48 *Id.* at 3.

conducted in China.[49] Although CME did not make such an argument in this case, I have examined closely each of Paul's demands in view of the standards applicable in this summary proceeding under 8 *Del. C.* § 220.

Paul is entitled to production of all documents requested under Demands Two, Three, and Five (and their subparts) above. The documents requested under Demand Two directly relate to CME's claimed business relationships, intellectual property, and customer contracts. The existence, or nonexistence, of these contracts and documents would affect directly the Company's revenue and net income. Likewise, Demand Five, DTT's resignation letter, also directly relates to alleged wrongdoing and fraudulent accounting practices by CME. Finally, Demand Three, the media kits used by the Company, relate to representations made by the Company about its business relationships and profitability. All of these documents could impact the veracity of CME's financial reporting and would help confirm or repudiate Paul's suspicions of fraud and wrongdoing at the Company. Therefore, Paul is entitled to inspection of these documents.

Paul is also entitled to production of documents constituting any contracts between CME and the entities listed in Demand Four. Paul is not, however, entitled to production of documents "evidencing any business relationship between the Company" and the more than twenty entities listed in Demand Four. The latter clause is simply too broad for a § 220 demand, especially where there is reason for caution based on a co-pending motion

[49] Def.'s Pre-Trial Br. Ex. A at 11. Notably, CME attempts to bolster its argument in the Federal Action by conflating this litigation with Starr's Derivative Action.

for a stay under SLUSA. Paul made no showing that production of such an ill-defined group of documents is necessary to either of his proper purposes.

3. Denied documents

I deny Paul's request to inspect any valuations of CME in relation to its 2009 merger with TM Entertainment. At trial, Paul withdrew his request to inspect CME's books and records for the purpose of valuing his single CME share.[50] Although Paul argued that the valuations from the merger were also relevant to investigating possible wrongdoing and demand futility, that argument is not persuasive. Paul has not requested any documents in relation to the merger that appear likely to show wrongdoing or a lack of independence on the part of the board. Similarly, his vague and general assertion that there were problems with "a number of reverse mergers involving foreign corporations and the lack of transparency" is unavailing. Paul has not made any specific factual allegations that provide a credible basis for suspecting fraud in the TM Entertainment merger. Moreover, to the extent the alleged fraud in this case dates back to 2009, Paul will have the opportunity to investigate that fraud through the documents I already have authorized for inspection.

Finally, Demand Six is objectionable in a couple of respects. First, Demand Six reads much more like a sweeping discovery request than a narrowly focused § 220 demand. This is apparent, for example, in its request for "all . . . emails [and] notes . . . created by, distributed to, or reviewed by or on behalf of CME's Board . . . or any

[50] Tr. 55-56. At the time of trial, a single CME share was worth approximately $0.30. Tr. 40.

committee thereof, concerning [well over two dozen subjects]." Second, the overbreadth and burdensomeness of Paul's request is exacerbated by his further request for all such books and records that are within the legal possession, custody, or control of the Company, its subsidiaries, or its agents, including outside legal counsel and accountants. Paul may be entitled to inspect certain documents that fall under the scope of Demand Six, but any such documents most likely would be among the documents the Court already has required CME to produce pursuant to Demands Two through Five. Accordingly, I deny Paul's request to inspect the documents called for in Demand Six in its entirety.

C. Confidentiality Agreement

Finally, when authorizing inspection under § 220, it is "entirely reasonable" to require the inspecting shareholder to enter into a confidentiality agreement as a prerequisite for inspection.[51] Here, Paul has agreed to execute a confidentiality agreement to protect the information obtained through this § 220 action from being shared with the federal plaintiffs.[52] Therefore, I condition Paul's right to receive documents pursuant to this Memorandum Opinion and any accompanying Order on his entering into such an agreement with CME and filing it for the Court's approval.

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[51] *Marathon P'rs, L.P. v. M&F Worldwide Corp.*, 2004 WL 1728604, at *4 (Del. Ch. July 30, 2004).

[52] Pl.'s Pre-Trial Br. 11; Tr. 12.

III. Whether the § 220 Action Should be Stayed Pending the Federal Court's Ruling on CME'S SLUSA Motion

In granting in part Paul's § 220 demand, I recognize that the district court may have authority to stay this action if it determines that such inspection would interfere with the automatic stay in the Federal Action. At least one federal court has held that § 220 actions are "discovery proceedings" for the purposes of SLUSA,[53] and that Act gives a federal court discretion to stay discovery proceedings in state courts if "necessary in aid of its jurisdiction, or to protect or effectuate its judgments."[54] Federal courts generally rely on three factors in deciding whether to stay a state action: (1) whether there is a risk that the federal plaintiffs will obtain the state plaintiff's discovery, and to what extent a confidentiality agreement and/or protective order with defendants can minimize that risk; (2) whether the underlying facts and legal claims in the state and federal actions overlap; and (3) the burden that the state court discovery proceedings will impose on the federal defendants.[55] In considering these factors, previous federal courts have invited "thoughtful and careful explanation[s]" from state courts regarding whether state actions

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53 *City of Austin v. ITT Educ. Servs., Inc.*, 2005 WL 280345, at *6 (S.D. Ind. Feb. 2, 2005).

54 15 U.S.C. § 78u-4(b)(3)(D).

55 *See In re Dot Hill Sys. Corp. Sec. Litig.*, 594 F. Supp. 2d 1150, 1165 (S.D. Cal. 2008); *In re Crompton Corp.*, 2005 WL 3797695, at *3 (D. Conn. Dec. 14, 2005); *In re Cardinal Health, Inc. Sec. Litig.*, 365 F. Supp. 2d 866, 872 (S.D. Ohio 2005).

should be stayed.[56] Therefore, I briefly discuss my reasons for concluding this action should not be stayed.

A. Risk of the Federal Plaintiffs Obtaining State Discovery

The dispositive question with regard to this element is "whether some form of relevant discovery is likely to reach the federal plaintiffs during the pendency of a motion to dismiss in federal court."[57] Relevant considerations include (1) the relationship between the plaintiffs in the state and federal cases and (2) the stage of the proceedings in the state action (*e.g.*, whether discovery hearings or even a public trial are likely to occur before the federal court has a chance to decide the motion).[58]

Paul, the Plaintiff in this action, is not a party to the Federal Action. He is an individual investor and CME has not alleged that he has any relationship with Starr.[59] Paul also has agreed to sign a confidentiality agreement that would restrict him from sharing information with the federal plaintiffs. Moreover, unlike in *In re Cardinal Health Inc. Securities Litigation*, [60] it is unlikely that further proceedings in this case will result in some form of discovery inadvertently reaching the federal plaintiffs.[61] In *In re*

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56 *City of Austin*, 2005 WL 280345, at *8.

57 *In re Cardinal Health*, 365 F. Supp. 2d at 875.

58 *Id.*

59 *Cf. In re Crompton Corp.*, 2005 WL 3797695, at *2 (staying a state derivative action where counsel for the state and federal plaintiffs was the same).

60 365 F. Supp. 2d 866 (S.D. Ohio 2005).

61 *Id.* at 875.

Cardinal Health, the concurrent state action was a derivative suit that was approximately six months from trial. In light of the "advanced nature of the state court suit," the federal court granted a stay because the likelihood of "discovery hearings, discovery orders, and perhaps a public trial" increased the risk of public disclosures that would circumvent the automatic stay of the PSLRA.[62] Here, there is little or no risk of further discovery disputes or public proceedings. Therefore, it is unlikely that any form of "discovery" from this action will reach the federal plaintiffs, inadvertently or otherwise, during the pendency of the motion to dismiss the Federal Action.

B. Whether the State and Federal Actions have Overlapping Claims and Underlying Facts

The state and federal claims against CME relate to the same underlying facts, but they involve entirely different legal claims. A § 220 action is a proceeding by which a shareholder may inspect the books and records of a company in which he has an ownership interest. Although § 220 actions are often precursors to direct or derivative actions in state court for fraud or breaches of fiduciary duties,[63] the actual judgments entered in § 220 cases are much more limited in scope. In this case, for example, a judgment in favor of Paul would mean that he has proven stock ownership, a formal written demand, and a proper purpose. Consequently, there is minimal risk of

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62 *Id.*

63 *See City of Austin v. ITT Educ. Servs., Inc.*, 2005 WL 280345, at *11 (S.D. Ind. Feb. 2, 2005).

inconsistency between a judgment here and a ruling on the federal motion to dismiss.[64] Moreover, to the extent this action could be deemed to constitute the "embryonic stages" of a state derivative action, it still is unlikely that any judgment will issue from such a future derivative action before the district court has an opportunity to decide the motion to dismiss.[65]

C. The Burden of State Court Discovery on Defendants.

Finally, when deciding whether to stay a related state action, a federal court will consider whether the state action would create an unreasonable discovery burden for the federal defendant. Relevant concerns include (1) whether discovery in the federal and state actions will be duplicative and (2) whether the defendant will be required to litigate and resolve the same discovery disputes in two different courts, wasting judicial resources and imposing substantial costs on the defendant.[66]

Here, several of Paul's requests sought fairly limited production of targeted documents. To the extent certain other requests were not related to a proper purpose under § 220 or were overly broad, I denied the requests or limited their scope. Furthermore, in this action, CME will not be required to submit to any deposition discovery, will not have to answer interrogatories, and faces only a minimal risk of

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64 *Cf. In re Cardinal Health*, 365 F. Supp. 2d at 875-76 (finding that "the risk of inconsistent rulings would be unreasonably high given the similar subject matter, risking unnecessary tension between the courts").

65 *Id.* at 875.

66 *Id.* at 876.

further disputes over the scope of production.[67] Therefore, I do not expect complying with the production ordered in this action to be overly burdensome for CME.

IV. CONCLUSION

For the foregoing reasons, I grant Paul's § 220 demand to inspect the books and records of CME requested under Demands Two, Three, and Five of his demand letter, as listed *supra*, and under Demand Four, but only after the phrase "or evidencing any business relationship" is excised from that Demand. In all other respects, Paul's § 220 demand is denied. Furthermore, as a condition of his inspection, I direct Paul to enter into an appropriate confidentiality agreement with CME. Counsel for the parties promptly shall confer about a confidentiality agreement and submit a proposed form of such agreement to the Court within ten days of the date of this Memorandum Opinion.

IT IS SO ORDERED.

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[67] In this respect, the current situation is unlike that which existed in *In re Cardinal Health*, where the court observed that: "Defendants predict that Cardinal, its officers, and any implicated third parties would have to 'produce the same documents twice, respond to multiple sets of interrogatories, [and] defend and take the same depositions twice,' and also stress that both this Court and the state court 'would have to litigate, and resolve the same discovery disputes in two separate courts.'". *Id.*