

Supreme Judicial Court

FOR THE COMMONWEALTH OF MASSACHUSETTS

No. SJC-12101

FRED CHITWOOD,
Plaintiff-Appellant,

v.

VERTEX PHARMACEUTICALS, INC.,
Defendant-Appellee.

ON APPEAL FROM AN ORDER OF THE SUPERIOR COURT FOR
SUFFOLK COUNTY, BUSINESS LITIGATION SESSION

**BRIEF OF AMICUS CURIAE NEW ENGLAND LEGAL FOUNDATION
IN SUPPORT OF THE DEFENDANT-APPELLEE**

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae New England Legal Foundation ("NELF") states, pursuant to S.J.C. Rule 1:21, that it is a 26 U.S.C. § 501(c)(3) nonprofit, public interest law foundation, incorporated in Massachusetts in 1977, with its headquarters in Boston. NELF does not issue stock or any other form of securities and does not have any parent corporation. NELF is governed by a self-perpetuating Board of Directors, the members of which serve solely in their personal capacities.

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ISSUE PRESENTED

On September 16, 2016, the Court issued an announcement in this case seeking amicus briefs on the following issue:

Where G. L. c. 156D, § 16.02, entitles a shareholder of a corporation to inspect and copy corporate records if the shareholder meets certain requirements, what must the shareholder show to meet the requirement that his demand to inspect and copy records be "for a proper purpose" pursuant to § 16.02(c)(1).

Accordingly, NELF will discuss the standard of proof that should be required for a shareholder to establish a "proper purpose" to inspect a corporation's confidential books and records. NELF will then apply that standard of proof to the particular circumstances of this case, in which independent directors of a corporation's board of directors, who constituted a majority of the board, voted unanimously to refuse a shareholder's litigation demand, and the "demand refused" shareholder then sought to inspect the board's books and records pertaining to that refusal.

INTEREST OF AMICUS CURIAE

NELF is a nonprofit, public interest law firm, incorporated in Massachusetts in 1977 and

headquartered in Boston. NELF's membership consists of corporations, law firms, individuals, and others who believe in its mission of promoting balanced economic growth in New England, protecting the free enterprise system, and defending economic rights. NELF's members and supporters include a cross-section of large and small businesses and other organizations from all parts of the Commonwealth, New England, and the United States.

NELF is committed to a reasonable interpretation of statutes that regulate issues of internal corporate governance. NELF is also committed to honoring the business judgment rule, codified at G. L. c. 156D, § 7.44(a), which protects a corporation's good-faith and independent decision to refuse a shareholder's litigation demand after conducting a reasonable inquiry. Accordingly, a "demand refused" shareholder, such as the plaintiff in this case, should not be allowed to inspect corporate documents pertaining to that refusal unless he can produce some evidence that the corporation's decisionmaking process was wrongful and therefore does not warrant protection under the business judgment rule.

NELF has appeared regularly as amicus curiae before this Court in many other cases that have raised issues of general concern for businesses in Massachusetts.¹ Accordingly, amicus believes that its brief in this case could assist the Court in deciding the issue presented in the Court's September 16, 2016 amicus announcement.²

ARGUMENT

I. TO ESTABLISH A "PROPER PURPOSE" TO INSPECT A CORPORATION'S CONFIDENTIAL BOOKS AND RECORDS, A SHAREHOLDER SHOULD BE REQUIRED TO PRODUCE SOME EVIDENCE OF ALLEGED CORPORATE WRONGDOING THAT JUSTIFIES ACCESS TO SUCH DOCUMENTS.

The real question presented in this case is, when independent directors of a corporation's board of directors, who constitute a majority of the board,

¹ See, e.g., *Gyulakian v. Lexus of Watertown*, 475 Mass. 290 (2016); *Verdrager v. Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, P.C.*, 474 Mass. 382 (2016); *Vale v. Valchuis*, 471 Mass. 495 (2015); *Meshna v. Scrivanos*, 471 Mass. 169 (2015); *Glovsky v. Roche Bros. Supermarkets, Inc.*, 469 Mass. 752 (2014); *Martin v. Simmons Prop.s, LLC*, 467 Mass. 1 (2014); *McInnes v. LPL Fin., LLC*, 466 Mass. 256 (2013); *Flagg v. AliMed, Inc.*, 466 Mass. 23 (2013); *Machado v. System4 LLC*, 465 Mass. 508 (2013); *Feeney v. Dell Inc.*, 465 Mass. 470 (2013).

² Neither the defendant nor its counsel, nor any individual or entity aside from amicus, has authored this brief in whole or in part, or has made any monetary contribution to its preparation or submission. See *Aspinall v. Philip Morris Co.s*, 442 Mass. 381, 385 n.8 (2004) (discussing Mass. R. App. P. 17).

have exercised their business judgment by voting unanimously to refuse a shareholder's litigation demand, how can the shareholder establish the statutorily required "proper purpose" to inspect the board's confidential documents pertaining to that refusal? See G. L. c. 156D, § 16.02(c)(1) ("books-and-records provision").³

³ The books-and-records provision states, in relevant part:

(c) A shareholder may inspect and copy the records described in subsection (b) [such as minutes of board meetings and records of actions taken by a board committee] only if:

(1) his demand is made in good faith and for a proper purpose;

(2) he describes with reasonable particularity his purpose and the records he desires to inspect;

(3) the records are directly connected with his purpose; and

(4) the corporation shall not have determined in good faith that disclosure of the records sought would adversely affect the corporation in the conduct of its business or, in the case of a public corporation, constitute material non-public information at the time when the shareholder's notice of demand to inspect and copy is received by the corporation.

G. L. c. 156D, § 16.02(c)(1)-(4).

To answer this question, NELF will first discuss the standard of proof that should be required for a shareholder to establish a "proper purpose" generally, based on the immediate statutory context of this language and on legislative commentary explaining the shareholder's many proof requirements under the books-and-records provision.⁴ NELF will then apply the "proper purpose" requirement to the particular circumstances of this case--a "demand refused" shareholder who wishes to inspect confidential corporate documents pertaining to that refusal.

The shareholder in this case, plaintiff Fred Chitwood, made a litigation demand on the Board of Directors of the defendant corporation, Vertex Pharmaceuticals, Inc. ("Vertex"). Appellee's Brief, Addendum ("ADD.") 5. The Board appointed a Special Committee, composed of two independent directors, to investigate the matter and submit its findings and

⁴ See Comment to G. L. c. 156D, § 1.50 ("Interpretation of Chapter") ("It is the intention of the drafters that the Comments elaborate and shed light on the provisions of the Act in order to assist practitioners and courts to better interpret and apply the Act. *The Comments are an important component in an understanding of the corporate law of Massachusetts.*") (emphasis added).

recommendations to the Board. ADD. 4-5. The Board also retained a law firm as independent counsel to assist the Special Committee in its efforts. ADD. 5.

After investigating the issue thoroughly, the Special Committee submitted its findings and recommendations to the Board. ADD. 6. By a unanimous vote, the Board's independent directors, who constituted a majority of the Board, accepted the Special Committee's findings and recommendations and then voted to refuse Chitwood's litigation demand. *Id.* See also Defendant's Brief, at 3. Vertex provided Chitwood's counsel with a written summary of the Special Committee's investigation and findings. ADD. 6-7.

In response, Chitwood's law firm made written demand on Vertex to inspect all books and records pertaining to the Special Committee's investigation and report. ADD. 7. Vertex rejected Chitwood's books-and-records demand, asserting that he had not shown a proper purpose and that the demand was overbroad. ADD. 8.

After conducting a bench trial, the Superior Court denied Chitwood's books-and-records demand. ADD. 10. The lower court concluded that Chitwood

failed to establish the necessary proper purpose, essentially because he failed to show that Vertex's refusal of his litigation demand was wrongful. ADD. 9-10. In particular, the lower court found that Vertex "appoint[ed] a Special Committee of two independent directors with unrestricted power to investigate [Chitwood's] allegations. That committee's findings were summarized in great detail for the plaintiff, *who offered no evidence at trial calling into question the independence of the Special Committee or the diligence of its efforts.*" ADD. 10 (emphasis added).

In reaching its decision, the Superior Court relied on another Superior Court decision interpreting the "proper purpose" requirement. ADD. 9. That court held that a shareholder must "present[] *some evidence* that establishes a *credible basis* from which a court can infer the existence of legitimate issues as to such conduct warranting further investigation." *Id.* (emphasis added) (quoting *Gent v. Teradyne*, 2010 WL 5071862, at *6, 27 Mass. L. Rptr. 517 (2010) (Fabricant, J.)).

As the Superior Court in this case aptly summarized the shareholder's burden of proof, "the

plaintiff must present some *evidence* of wrongdoing," ADD. 9, to be permitted access to a corporation's confidential books and records that may substantiate the alleged wrongdoing. This interpretation is amply supported by the immediate statutory context of the "proper purpose" requirement, and by the Legislature's comments discussing the books-and-records provision generally. See *In re Custody of Victoria*, 473 Mass. 64, 73 (2015) ("[W]e consider the specific language of a statute in connection with the statute as a whole and in consideration of the *surrounding text*, structure, and purpose of the Massachusetts act.") (emphasis added).

Notably, the Legislature has surrounded the "proper purpose" requirement with many other stringent requirements in the books-and-records provision, all of which the shareholder must meet to be allowed access to confidential corporate documents. See § 16.02(c)(1)-(4), quoted in n.3, above. And the Legislature itself has explained that these many statutory requirements are intended "to *avoid harassment under the guise of inspection*" Comment 3 to G. L. c. 156D, § 16.02 (emphasis added).

In particular, the Legislature has required the shareholder to show a proper purpose "in good faith," to "describe[] with reasonable particularity his purpose and the records he desires to inspect," and to show that "the records are directly connected with his purpose" G. L. c. 156D, 16.02 (c)(1)-(3). (See n.3, above.) The Legislature has also allowed the corporation to oppose the books-and-records demand if the corporation has "determined in good faith that disclosure of the records sought would adversely affect the corporation in the conduct of its business" G. L. c. 156D, § 16.02(c)(4).

In sum, the Legislature has required the shareholder to establish a "proper purpose," among other statutory requirements, to ensure that he is not merely harassing the corporation and instead has a legitimate, articulable basis for gaining access to the corporation's confidential documents. As the Legislature has further explained, "§ 16.02(c) . . . attempts to elicit more meaningful statements of purpose than would be served by a statement, for example, that the shareholder [merely] wishes . . . to determine whether any improper transactions have

occurred. . . .” Comment 3 to § 16.02 (emphasis added).

The Legislature has thus made it clear that “[i]nspection under [the books-and-records provision] 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.” *Paul v. China MediaExpress Holdings, Inc.*, No. CIV.A. 6570-VCP, 2012 WL 28818, at *6 (Del. Ch. Jan. 5, 2012) (discussing Delaware law) (emphasis added).

Accordingly, in light of the Legislature’s express concern “to avoid harassment under the guise of inspection,” and its express intent “to elicit more meaningful statements of purpose,” (Comment 3 to § 16.02), a shareholder should be required to substantiate his books-and-records request with some preliminary evidence of potential corporate wrongdoing. Only this standard of proof could fulfill the Legislature’s purpose of preventing a shareholder from engaging in an unjustified fishing expedition into the corporation’s confidential records, and hence its discretionary decisionmaking. *See Paul*, 2012 WL 28818, at *6 (“[W]here the shareholder is seeking the

more intrusive inspection of books and records, as opposed to shareholder lists or stock ledgers, the level of judicial scrutiny is enhanced and the scope of relief more carefully tailored.") (emphasis added). Consequently, a shareholder's unsupported assertion, as in this case, that the requested documents *might* uncover corporate misconduct should not suffice to establish a proper purpose for a books-and-records request.

In sum, to establish a proper purpose under § 16.02(c)(1), the shareholder should be required to "present some *evidence* of wrongdoing," ADD. 9, to be allowed access to confidential corporate documents that may substantiate the alleged wrongdoing.

II. AS APPLIED IN THIS CASE, A SHAREHOLDER SHOULD BE REQUIRED TO PRODUCE SOME EVIDENCE THAT THE CORPORATION REFUSED HIS LITIGATION DEMAND IN BAD FAITH, FAILED TO CONDUCT A REASONABLE INQUIRY, OR LACKED THE NECESSARY INDEPENDENCE TO WARRANT PROTECTION UNDER THE BUSINESS JUDGMENT RULE.

The particular issue in this case is a shareholder's challenge, by way of the books-and-records provision, to the corporation's refusal of his litigation demand, as decided by a unanimous vote of independent directors who constituted a majority of the Board of Directors. Both this Court and the

Legislature have clearly restricted the "demand refused" shareholder, such as Chitwood, to challenging the integrity of the corporation's decisionmaking process, not the wisdom or merits of the decision itself. Specifically, "a plaintiff must allege facts that challenge the board's *good faith* or the *reasonableness of the board's investigation* of the plaintiff's demand." *Harhen v. Brown*, 431 Mass. 838, 845 (2000) (emphasis added). See also G. L. c. 156D, § 7.44(a) (requiring judicial deference to corporation's refusal of shareholder litigation demand if majority of independent directors "has determined in *good faith after conducting a reasonable inquiry* upon which its conclusions are based that the maintenance of the derivative proceeding is not in the best interests of the corporation") (emphasis added).

And so the "demand refused" shareholder who then makes a books-and-records demand should have to present some evidence that the corporation wrongfully refused his litigation demand. See *Malloch v. Town of Hanover*, 472 Mass. 783, 791 (2015) ("We interpret separate sections of statutes [in this case, §§ 7.44(a) and 16.02(c)(1) of chapter 156D,] as a

whole, to produce *internal consistency*, . . . and to give a *rational and workable* effect.”) (emphasis added) (citation and internal quotation marks omitted).

In particular, the shareholder should be required to make a preliminary showing that the corporation refused his litigation demand in bad faith, failed to conduct a reasonable inquiry, or lacked the independence necessary to warrant protection under the business judgment rule. “The business judgment rule affords protection to the business decisions of directors, including the decision to institute litigation, because directors are presumed to act in the best interests of the corporation.” *Harhen*, 431 Mass. at 845. See also Comment 2 to G. L. c. 156D, § 7.44 (“Standard to Be Applied”) (“If there is a majority of independent directors, the decision to dismiss, or to reject the demand, is, if made by directors, a business judgment to which the business judgment rule’s presumption of validity should apply.”).

Simply put, the demand-refused shareholder should be required to cast reasonable doubt on the integrity of the corporation’s decisionmaking process before

being allowed access to confidential corporate documents pertaining to that process. See Comment 2 to § 7.44 (“[T]o deprive the independent directors of the business judgment rule, the derivative plaintiff must plead and prove that the directors making the determination were not independent or did not act in good faith after reasonable inquiry”).

In this case however, Chitwood “offered no evidence at trial calling into question the independence of the [Board’s] Special Committee or the diligence of its efforts.” ADD. 10. Since Chitwood failed to produce any evidence impugning the integrity of Vertex’s refusal of his litigation demand, he cannot establish the necessary proper purpose to inspect Vertex’s confidential documents pertaining to that refusal. Accordingly, the lower court’s denial of Chitwood’s books-and-records request should be affirmed.

CONCLUSION

For the foregoing reasons, NELF respectfully requests that the Court affirm the judgment of the Superior Court.

Respectfully submitted,

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Dated: October 21, 2016

CERTIFICATE OF COMPLIANCE

Pursuant to Mass. R. App. P. 16(k), I hereby certify that this brief complies with the rules of court pertaining to the filing of an amicus brief, including, but not limited to, Mass. R. App. P. 17.

/s/ Ben Robbins

Ben Robbins

CERTIFICATE OF SERVICE

I, Ben Robbins, hereby certify that on this 21st day of October, 2016, I served the within brief by causing two copies to be delivered by priority mail to counsel for the Plaintiff: Mitchell J. Matorin, Matorin Law Office, LLC, 18 Grove Street, Suite 2, Wellesley, MA 02482; and to counsel for the Defendant: R. Todd Cronan, Goodwin Procter, LLP, 53 State Street, Exchange Place, Boston, MA 02109-2881.

Signed under penalties of perjury.

/s/ Ben Robbins

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