IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

LOUISIANA MUNICIPAL POLICE EMPLOYEES' RETIREMENT SYSTEM,	)	
Plaintiff,	)	
v.	)	*Civil Action No. 7314-VCG*
LENNAR CORPORATION,	)	
Defendant.	)	

MEMORANDUM OPINION

Date Submitted: September 17, 2012
Date Decided: October 5, 2012

Jay W. Eisenhofer, and John C. Kairis of GRANT & EISENHOFER P.A., Wilmington, Delaware; Attorneys for Plaintiff.

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GLASSCOCK, Vice Chancellor

Two news articles report that a corporation is included in an industry-wide investigation by government agencies concerning compliance with the Fair Labor Standards Act ("FLSA").[1] Is that fact, together with the existence of a handful of old employee lawsuits alleging corporate violations of the FLSA, sufficient to support a books-and-records demand to investigate a potential *Caremark* claim? Under the facts below, I conclude that the answer is no.

This matter involves a demand by the Louisiana Municipal Police Employees Retirement System ("LAMPERS") for books and records from Lennar Corp. ("Lennar") pursuant to Section 220 of the Delaware General Corporation Law ("DGCL").[2] LAMPERS, a Lennar stockholder, seeks to investigate possible mismanagement at Lennar—specifically, Lennar's compliance with labor, tax, and immigration law.[3] LAMPERS bases its suspicions on a collection of lawsuits brought between 2007 and early 2009 by former Lennar employees against the company as well as two articles published in the *Wall Street Journal* in September, 2011. The articles revealed that the Department of Labor was conducting a nationwide investigation of the labor practices of numerous home-building companies, including Lennar. Lennar responds that this evidence is insufficient as a matter of law to support a Section 220 demand and has moved for summary

[1] Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (2006).
[2] 8 *Del C.* § 220.
[3] Compl. 1.

judgment under Rule 56.[4] Neither party disputes any issue of material fact in this case. Accordingly, the only issue for me to decide is whether the evidence LAMPERS has provided constitutes "some credible basis" from which I could infer that further investigation is warranted to explore possible mismanagement at Lennar.[5] For the reasons below, I find that LAMPERS' evidence is insufficient to support its demand, and I therefore grant Lennar's motion.

I. BACKGROUND

The facts in this case are relatively straightforward. Between 2007 and 2009, eight plaintiffs alleged that Lennar wrongfully misclassified them as exempt from the FLSA so as to avoid paying overtime.[6] The last such lawsuit was filed February 24, 2009, and all of the lawsuits eventually settled.[7] LAMPERS points to no other relevant legal action against Lennar besides these eight lawsuits.

On September 8, 2011 the *Wall Street Journal* ("*Journal*") published an article revealing that the U.S. Department of Labor ("DOL") was investigating several of the country's biggest home builders, including Lennar, as part of a nationwide effort to enforce compliance with the FLSA.[8] On September 17, the

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[4] Del. Ch. Ct. R. 56.
[5] *See Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 568 (Del. 1997).
[6] Compl. ¶ 9.
[7] *Id.*
[8] *Id.* ¶ 6. *See also* Pl.'s Br. Opp. Def.'s Mot. Summ. J. 4 ("The misclassification of employees . . . presents a serious problem for . . . the entire economy. . . . The [Department of Labor's] Misclassification Initiative, launched under the auspices of Vice President Biden's Middle Class Task Force, is making great strides in combating this pervasive issue.").

Journal published a follow-up article explaining that state-level labor regulators and the IRS were joining the DOL's investigation.[9] The Plaintiffs point out that in its 2011 10-K Lennar has acknowledged that any failure of Lennar's employees or subcontractors to comply with state and federal labor law could cause financial and reputational harm to the company.[10]

Shortly after the *Journal* published these articles, LAMPERS sent its demand letter to Lennar requesting board minutes and other documents related to Lennar's compliance—and Lennar's subcontractors' compliance—with federal and state labor, tax, and immigration laws.[11] LAMPERS' demand letter relied solely on the *Journal* articles and did not mention the earlier employee lawsuits as a basis for its demand.[12] LAMPERS also requested information about Lennar's directors, ostensibly to assess demand futility.[13] Lennar rejected LAMPERS' demand, saying that it believed that the evidence that LAMPERS relied on did not constitute "a credible basis for thinking there has been wrongdoing."[14] LAMPERS subsequently filed this action, relying on both the settled lawsuits and the DOL investigation as evidence of possible wrongdoing.

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[9] *Id.* ¶ 7.
[10] *Id.* ¶ 11.
[11] *Id.* ¶ 14.
[12] Pl.'s Br. Opp. Def.'s Mot. Summ. J. 14.
[13] Compl. ¶ 16. Because of my decision here, I need not reach the issue of whether these requests were overly broad.
[14] *Id.* ¶ 19.

II. ANALYSIS

Section 220 of Delaware General Corporation Law allows stockholders of companies incorporated in Delaware to inspect the books and records of the company if the stockholders' demand complies with the statute's form and manner requirements[15] and if the stockholders demonstrate "any proper purpose" for the demand.[16] The statute defines proper purpose as "a purpose reasonably related to such person's interest as a stockholder."[17] Once a plaintiff has identified a proper purpose, it has the burden to "show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation."[18] This is a low standard. Indeed, "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."[19]

LAMPERS, therefore, must (1) identify a proper purpose for its demand, and (2) support that demand with a "credible basis" from which I can conclude an investigation is warranted.

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[15] Lennar does not dispute LAMPERS' compliance with the form and manner requirements of Section 220. *See* Def.'s Br. Supp. Mot. Summ. J. 1.
[16] 8 *Del. C.* § 220(b).
[17] *Id.*
[18] *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006).
[19] *Id.*

A. Proper Purpose

The Delaware Supreme Court has recognized that an investigation of corporate mismanagement, waste, or wrongdoing is a proper purpose for a Section 220 inspection.[20] However, stockholders are only permitted to investigate those issues that affect their interests as stockholders.[21] In other words, if a stockholder seeks to use Section 220 to investigate corporate wrongdoing for which there is no remedy, or if the stockholder would not have standing to seek a remedy, then that stockholder has not stated a proper purpose.

LAMPERS's purpose for bringing the demand is not to investigate the past wrongdoing that may have given rise to the litigation in 2007-2009. LAMPERS concedes that it lacks standing to prosecute such an investigation and that the only purpose for which it seeks books and records from Lennar is to investigate *ongoing* mismanagement concerning compliance with labor law. Because ongoing wrongdoing affects LAMPERS's interests as a current stockholder, I conclude that LAMPERS has stated a proper purpose for investigation under Section 220. I now turn to whether the evidence that LAMPERS has provided gives me a credible basis from which I can infer the possibility of current wrongdoing.

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[20] *Id.* at 121.

[21] *See Graulich v. Dell Inc.*, 2011 WL 1843813, at *7 (Del. Ch. May 16, 2011) (holding that the plaintiff's Section 220 demand for books and records failed because it was made for the purpose of initiating a derivative suit which the plaintiff lacked standing to bring and which would have been barred by the statute of limitations and claim preclusion).

B. Credible Basis

While investigating mismanagement is undoubtedly a proper purpose under Section 220, this Court has repeatedly stated that "a mere statement of a purpose to investigate possible general mismanagement, without more, will not entitle a shareholder to broad § 220 inspection relief. There must be some evidence of possible mismanagement as would warrant further investigation of the matter."[22] To permit stockholders to demand corporate books and records based on the "mere suspicion" of wrongdoing would "invite mischief" and expose companies to "indiscriminate fishing expeditions."[23] This means that "a stockholder making a Section 220 demand does not have to prove mismanagement actually occurred, but must make a credible showing, through documents, logic, testimony or otherwise, that there are legitimate issues of wrongdoing."[24] This requirement strikes an appropriate balance between encouraging productive Section 220 actions where there is a reasonable likelihood of wrongdoing while preventing inspections without a factual basis from draining corporate resources.[25]

LAMPERS fails to clear the low hurdle that this Court has set for Section 220 plaintiffs, because neither the former lawsuits against Lennar nor the articles

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[22] *Helmsman Mgmt. Servs., Inc. v. A & S Consults., Inc.*, 525 A.2d 160, 165-66 (Del. Ch. 1987).
[23] *Seinfeld*, 909A.2d at 122.
[24] *Norfolk Cnty. Ret. Sys. v. Jos. A. Bank Clothiers, Inc.*, 2009 WL 353746, at *6 (Del. Ch. Feb. 12, 2009) *aff'd*, 977 A.2d 899 (Del. 2009) (citations omitted).
[25] *Seinfeld*, 909A.2d at 122-23.

from the *Journal* constitute credible evidence that Lennar is currently engaged in the worker misclassification that LAMPERS seeks to investigate.

1. Prior Litigation against Lennar.

LAMPERS cites one case, *Romero v. Career Education Corp.*, where previous litigation served as the basis for a Section 220 demand.[26] However, *Romero* does not stand for the proposition that past litigation against a company may support an inference that the company has allowed that conduct to persist to the present day. The plaintiff in *Romero* sought to investigate possible breaches of fiduciary duty in connection with specific conduct that was itself the subject of several federal securities class-action lawsuits filed against the defendant. [27] Here, LAMPERS explicitly disclaimed any argument that it seeks to investigate the specific wrongful conduct (the pre-2009 misclassification of employees to avoid paying overtime) alleged in the old lawsuits. Instead, LAMPERS argues that the lawsuits (in connection with the DOL investigation, which I will discuss shortly) provide a credible basis from which I may infer that misclassification continues today. However, the Court in *Romero* did not make such a speculative inference as LAMPERS asks me to make here.

This Court has in fact rejected the argument that past lawsuits against a company constitute credible evidence of similar ongoing malfeasance. Then-

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[26] *Romero v. Career Educ. Corp.*, 2005 WL 1798042 (Del. Ch. Jul. 19, 2005).
[27] *Id.* at *1.

Chancellor Chandler stated in *Graulich v. Dell Inc.* that even though the "'credible basis' standard has been interpreted as a low one . . . simply saying that the company has already been subject to lawsuits, with nothing else, does not cut it."[28] Though the plaintiff's demand letter in *Graulich* was vague, then-Chancellor Chandler rejected the possibility that the plaintiff could successfully obtain documents under Section 220 by offering a prior lawsuit as evidence suggesting a *Caremark* claim for gross negligence by the board.[29]

The facts here well illustrate these lawsuits' low probative value for showing any current wrongdoing by Lennar. The lawsuits were all settled without any admission of wrongdoing by Lennar, and there have been no similar lawsuits filed since 2009. Furthermore, LAMPERS gave no indication in its brief or at oral argument whether the number of lawsuits brought against Lennar, eight, was disproportionate or unusual as compared to similar companies, or in light of the size of Lennar's business. Unsurprisingly, LAMPERS did not even mention the lawsuits in its initial demand letter to Lennar, instead waiting until this action was filed to claim that the lawsuits suggested ongoing wrongdoing. Accordingly, I conclude that the lawsuits do not provide a credible basis for concluding that Lennar is engaging in employee misclassification today.

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[28] *Graulich*, 2011 WL 1843813, at *5 n.49.
[29] *Id.* at *1 n.13.

2. The *Wall Street Journal* Articles

I now consider whether the news reports that LAMPERS relies on support an inference that Lennar is misclassifying employees. Coincidentally, this issue arose in a prior case involving LAMPERS making a § 220 demand based in part on a newspaper article. *Louisiana Municipal Police Employees' Retirement System v. Countrywide Financial Corp.* involved an attempt by LAMPERS to obtain books and records of Countrywide relating to possible options backdating that was described in an article in the *Los Angeles Times* ("*Times*").[30]

The Court in *Countrywide* implied that the news articles themselves were of limited probative value. In that case, the Court ultimately granted the Section 220 demand because LAMPERS corroborated the *Times* article with its own statistical analysis of Countrywide's stock price which suggested that Countrywide backdated or "springloaded" option grants.[31] However, the Court qualified its decision, saying that the decision "probes what would appear to be the outer limits of the minimal quantum of evidence a shareholder must adduce in order to demonstrate a credible basis to suspect corporate wrongdoing that would constitute

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[30] *La. Mun. Police Emps'. Ret. Sys. v. Countrywide Fin. Corp.*, 2007 WL 4373116, at *2 (Del. Ch. Dec. 6, 2007) ("Sometime in late June or early July 2006, LAMPERS' general counsel, R. Randall Roche ("Roche"), became aware of a Los Angeles Times article noting the consistently fortuitous timing of executive stock option grants at a number of companies, including Countrywide, and suggesting the possibility that grants may have been manipulated by those companies.").

[31] *Id.*

a proper purpose to inspect corporate books and records under 8 Del. C. § 220."[32] This disclaimer suggests that negative news articles alone are insufficient bases on which to justify a Section 220 demand.

In any event, the news articles that LAMPERS relies on in the instant case are particularly unconvincing as evidence of Lennar's alleged wrongdoing. The only possible suggestion in the *Journal* articles of wrongdoing by Lennar is (1) the existence of an investigation by the Department of Labor into worker misclassification, combined with (2) the assertion that Lennar is one of many companies being investigated. In other words, the articles describe actions by regulators, not wrongdoing by companies under investigation.

This stands in contrast to the news articles that were given little weight in *Countrywide*. In that case, the *Times* directly implicated Countrywide in wrongdoing. The lede for the first article read "[a] study by a shareholder advocacy firm suggests that Countrywide Financial Corp. and Occidental Petroleum Corp. have a knack for issuing favorable news releases shortly after they grant stock options to top executives."[33] By contrast, the articles here provide no reportorial suggestion, based on investigation, that Lennar is engaged in wrongdoing. Instead, the articles merely report that Lennar is one of many companies in many industries

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[32] *Id.* at *1.

[33] Kathy M. Kristof, *Good-News Link to Options Suggested*, L.A. Times, June 7, 2006, at C1.

caught up in the dragnet of a federal investigation. Such evidence does not support an inference of possible wrongdoing.

3. The Lawsuits and the Articles

The only remaining question is whether these two independently inadequate pieces of evidence—news reports of Department of Labor investigations on the one hand, and eight lawsuits alleging misconduct from 2007-2009 on the other hand—can together constitute "some evidence" of misconduct sufficient to support a Section 220 demand. I find that the probative value of each item is so negligible that combining them is of no consequence.

The lawsuits, which were settled without any admission of wrongdoing, suggest only that misconduct could have occurred in the past. The news articles suggest only an intensification of the Department of Labor's enforcement efforts. What LAMPERS lacks is some piece of objective evidence indicating that Lennar is engaging in worker misclassification *now*. The Plaintiff here has presented only a chain of inferences that never amount to more than speculation.

III. CONCLUSION

For the reasons above, Defendant Lennar Corp.'s Motion for Summary Judgment under Rule 56 is granted. The Defendants should provide an appropriate form of order.