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Re: Shamrock Activist Value Fund, L.P. v. iPass Inc.
C.A. No. 2462-N
Date Submitted: December 12, 2006

Dear Counsel:

Plaintiff Shamrock Activist Value Fund, L.P. ("Shamrock") holds stock in Defendant iPass Inc., a Delaware corporation (the "Company"), and brings this action under § 220 of the Delaware General Corporation Law to gain access to certain of the Company's books and records relating to a merger between the Company and GoRemote Internet Communications, Inc. ("GoRemote") that was announced on December 12, 2005, and consummated on February 15, 2006 (the "Merger").

Shamrock is disappointed with the results of the Merger. On September 27, 2006, it delivered a demand letter pursuant to § 220, in proper form, which identified the books and records which it sought to inspect.[1] Shamrock's purported purpose was to investigate potential mismanagement of the Company. It pointed out that management had projected that several benefits from the Merger would be achieved within a short period of time but that those results had not been realized. In addition, Shamrock asserted that the Company's management had failed to develop a comprehensive plan for the integration of GoRemote with the Company following the Merger. In response, the Company, contending that Shamrock had not set forth a proper purpose for any inspection of its books and records, rejected the demand on October 4, 2006.[2] Shortly thereafter, this action was filed. The Company now moves for its dismissal under Court of Chancery Rule 12(b)(6).

In considering a motion to dismiss under Court of Chancery Rule 12(b)(6) for failure of the complaint to state a claim, the Court takes the well-pleaded allegations of the complaint as true and affords the plaintiff the benefit of all

[1] Compl. ¶ 4 & Ex. A.
[2] Compl. Ex. B.

reasonable inferences that can be drawn from those allegations.[3] The Court, however, must "accept only those reasonable inferences that logically flow from the face of the complaint and is not required to accept every strained interpretation of the allegations proposed by the plaintiff."[4]

Delaware law, by 8 *Del. C.* § 220, confers upon the stockholder a statutory right to inspect the books and records of the corporation. The statutory right, however, is conditioned upon the stockholder's identifying a proper purpose for the inspection.[5] A "proper purpose" is any purpose "reasonably related to such person's interest as a stockholder."[6] "[A] stockholder's desire to investigate a wrongdoing or mismanagement is a 'proper purpose.'"[7]

> Stockholders may use information about corporate mismanagement, waste or wrongdoing in several ways. For example, they may: institute derivative litigation; seek an audience with the board of directors to discuss proposed reform or, failing in that, they may

[3] *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 727 (Del. Ch. 1999).
[4] *In re General Motors Corp. (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (internal quotations omitted).
[5] *See, e.g., Highland Select Equity Fund, L.P. v. Motient Corp.*, 906 A.2d 156, 164 (Del. Ch. 2006).
[6] 8 *Del. C.* § 220(b).
[7] *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) (citation omitted).

> prepare a stockholder resolution for the next annual meeting, or mount a proxy fight to elect new directors.[8]

The stockholder, to meet its burden under § 220 with respect to demonstrating the proper purpose of investigating mismanagement, must 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 . . ."[9] Neither "mere suspicion" of wrongdoing or mismanagement, however, nor an interest in investigating "general mismanagement, without more" is sufficient.[10]

Shamrock's allegations of mismanagement focus on two projections proffered by the Company's management in support of the Merger: (1) substantial cost savings would result immediately following the Merger and (2) the Merger would be accretive in the first full quarter of combined operations. Shamrock,

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[8] *Id*. at 119-20 (quoting *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 117 (Del. 2002) (internal punctuation omitted)). Thus, it is important to remember that § 220 serves significant functions beyond those of arming potential fiduciary duty plaintiffs who have been encouraged to hone their claims with one of the "tools at hand" provided by § 220. *See, e.g.*, *Beam v. Stewart*, 845 A.2d 1040, 1056 & n.51 (Del. 2004).

[9] *Seinfeld*, 909 A.2d at 123. Although characterized by the parties as a dispute about a "proper purpose," the more precise question is whether the facts alleged by Shamrock, taken as true, can be cobbled together to support an inference of possible mismanagement. *Cf. Polygon Global Opportunities Master Fund v. West Corp.*, 2006 WL 2947486, at *3 (Del. Ch. Oct. 12, 2006).

[10] *Seinfeld*, 909 A.2d at 122-23.

alleging that neither of these projections was met, states that its purpose for seeking inspection of the Company's books and records is to:

> investigate possible mismanagement, misrepresentation by management of cost savings associated with the merger with GoRemote, misrepresentation by management of an integration plan with respect to the merger with GoRemote, waste of corporate assets, and lack of due care and appropriate due diligence by the Company's Directors and senior management when evaluating the proposed merger with GoRemote.[11]

According to Shamrock, the divergence between projections and results is evidence of mismanagement: either management failed to make its projections responsibly or management failed to implement the Merger competently. Credible evidence of mismanagement, however, requires more than a divergence between forward-looking statements and subsequent results. Predictions of the consequences of implementing corporate decisions (*i.e.*, the taking of risk)[12] and the failure of those predictions to materialize do not, without more, share a logical

[11] Compl. ¶ 4 & Ex. A.

[12] *See Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 193 (Del. Ch. 2006) ("[B]usiness failure is an ever present risk. The business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit. If the mere fact that a strategy turned out poorly is in itself sufficient to create an inference that the directors who approved it breached their fiduciary duties, the business judgment rule will have been denuded of much of its utility.").

nexus with mismanagement.[13] Something more must be tendered by the stockholder to bridge the gap between unfulfilled projections and mismanagement. Into that gap, Shamrock has tossed the allegation that the Company failed to adopt an integration plan in a timely and comprehensive fashion that would address the complexities of integrating the Company with GoRemote.[14] That allegation is the "something more" that, for purposes of a motion under Court of Chancery Rule 12(b)(6), provides the basis for an inference that mismanagement possibly occurred. The alleged failure to anticipate and to plan for the integration of the two companies precludes the Court from concluding, as a matter of law, that no reasonable inference could be drawn from the facts alleged so that Shamrock could

[13] As recognized in *Seinfeld*, it is important "to maintain a proper balance between the rights of shareholders to obtain information based upon credible allegations of corporate mismanagement and the rights of directors to manage the business of the corporation without undue interference from stockholders." *Seinfeld*, 909 A.2d at 122. As a general matter, construing "proper purpose" to include a divergence between projections and results, without more, would throw that balance askew. It is at least conceivable that there may be rare circumstances, clearly not present here, in which the projections are so extreme and the results so abysmal as to warrant further investigation.

[14] Shamrock, in its demand letter, which is attached to the Complaint, based its assertions regarding the Company's shortcomings in integrating of the Company and GoRemote on the following: "(i) the formulation of a plan for the restructuring announced on May 25, 2006, only after Shamrock wrote a letter to the Company in May 2006 asking about such a plan; (ii) as of August 2006, the GoRemote website directed 'dissatisfied iPass customers how to convert to GoRemote services,' and (iii) shortly after the closing of the Merger, John Thuma, the head of the supposed integration, left the Company." Compl. Ex. A.

not satisfy at trial the minimum evidentiary burden imposed upon a plaintiff in a § 220 action.[15]

The question, in the context of a motion to dismiss for failure to state a claim, is not whether the Court would draw Shamrock's inference linking the failed projections and the absence of a complete integration plan to mismanagement, as that concept is understood in that context of § 220. Instead, the Court is constrained to honor any reasonable inference that could be drawn in favor of Shamrock from the facts alleged. In short, the questions framed by the Company's motion to dismiss are better resolved following trial when the Court may draw its own inferences and will not, at that time, be required to draw inferences in favor of any particular party.[16]

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[15] *See Seinfeld*, 909 A.2d at 123 (observing that "the 'credible evidence' standard sets the lowest possible burden of proof."). The Company invited the Court to review the full scope of the various disclosures and financial results upon which Shamrock relied and to conclude, after comprehensive consideration, that Shamrock's characterizations are wrong. The Court, of course, is not limited to snippets unfairly pulled from a document, but, in this instance, even the broader review allowed cannot fully exclude Shamrock's interpretations.

[16] *See, e.g.*, *Romero v. Career Educ. Corp.*, 2005 WL 1798042, *2 (Del. Ch. July 19, 2005) ("In fact, quite to the contrary, this Court has held that the basis for a § 220 plaintiff's suspicions 'can best be addressed after the factual record is developed at trial.'" quoting *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *8 (Del. Ch. Aug. 30, 2004)).

Accordingly, for the foregoing reasons, the Court cannot now conclude "with reasonable certainty" that there is no set of facts "which could be proven [by Shamrock] to support the action."[17] Therefore, the Company's motion to dismiss must be denied.[18]

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC

[17] *Rabkin v. Phillip A. Hunt Chem. Co.*, 498 A.2d 1099, 1104 (Del. 1985).

[18] The Company's response (Compl. Ex. B) to Shamrock's demand letter set forth the following: "In light of Shamrock's recent activities, the Company believes that this demand has not been presented for a proper purpose; rather, it has been presented in order to threaten the Company with unnecessary burden and expense if the Company does not accede to Shamrock's other demands." For all the good that can come from a shareholder's inspection of corporate books and records, § 220, if not properly monitored by the Court, can become an effective and troubling tool for harassment and other mischief. Whether that is occurring in this action is, as acknowledged by the Company, beyond the scope of the Court's inquiry on a motion to dismiss.