

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IAN BEISER, )  
 )  
 Plaintiff, )  
 )  
 v. ) C.A. No. 3893-VCL  
 )  
 PMC-SIERRA, INC., )  
 a Delaware corporation, )  
 )  
 Defendant. )

**MEMORANDUM OPINION AND ORDER**

**Submitted: December 16, 2008**

**Decided: February 26, 2009**

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LAMB, Vice Chancellor.

The plaintiff in this action seeks the production of certain books and records of the defendant pursuant to 8 *Del. C.* § 220. The plaintiff in this case is also the lead plaintiff in a related federal lawsuit (the “Federal Action”) in which discovery has been stayed pursuant to the Private Securities Litigation Reform Act of 1995 (“PSLRA”). For the reasons set forth herein, the court holds that a plaintiff does not plead a proper purpose in a Section 220 action when the only end use for the requested documents that may be inferred is to assist in the prosecution of a federal action where discovery is stayed under the PSLRA. Because the plaintiff here has not adequately pleaded any other intended use for the requested documents, this action will be dismissed.

## I.

### A. The Parties

Ian Beiser, the plaintiff in this action, has been a shareholder of the sole defendant, PMC-Sierra, Inc., continuously since April of 1999. PMC is a Delaware corporation with its principal executive offices located in Santa Clara, California.

### B. Facts

The following facts, which must be treated as true for the purpose of this motion to dismiss, are drawn from the well-pleaded allegations of the complaint

and the exhibits attached thereto.<sup>1</sup> In this section, the court has also drawn from and taken judicial notice of facts in the docket and orders of the Federal Action where Beiser is the lead plaintiff.<sup>2</sup>

On August 29, 2006, Beiser filed his original derivative complaint against PMC in the United States District Court for the Northern District of California based primarily on allegedly improper stock option backdating by PMC.<sup>3</sup> On October 16, 2006, a second derivative action against PMC was filed in the same court.<sup>4</sup> The federal court consolidated the two cases into the resulting Federal Action on December 6, 2006. Thereafter, the federal court appointed Beiser as the lead plaintiff and Beiser filed a consolidated verified complaint on January 29, 2007.

On March 15, 2007, PMC moved to dismiss the Federal Action. On August 22, 2007, the federal court entered an order dismissing the complaint based on Beiser's failure to adequately plead demand futility. The order of dismissal gave

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<sup>1</sup> *In re Tyson Foods, Inc.*, 919 A.2d 563, 571 (Del. Ch. 2007).

<sup>2</sup> The facts this court has drawn from the docket and orders of the related federal case are publicly available and not subject to reasonable dispute. *Nelson v. Emerson*, 2008 WL 1961150, at \*2 (Del. Ch. May 6, 2008) (drawing facts from "documents filed in the related federal court proceedings" in a motion to dismiss); *Orloff v. Schulman*, 2005 WL 3272355, at \*12 (Del. Ch. Nov. 23, 2005) (taking judicial notice, in the context of a motion to dismiss, of the petition and approval of a lease assignment in companion bankruptcy litigation); *In re Wheelabrator Techs., Inc. S'holders Litig.*, 1992 WL 212595, at \* 12 (Del. Ch. Sept. 1, 1992) (holding that the court may take judicial notice of certain publicly filed documents on a motion to dismiss).

<sup>3</sup> Compl. ¶ 11; *In re PMC-Sierra, Inc. Deriv. Litig.*, Case No. 5:06-CV-05330-RS (N.D. Cal.).

<sup>4</sup> *Barone v. Bailey, et al.*, Case No. 5:06-CV-06473-RS) (N.D. Cal.).

Beiser leave to amend his complaint, and Beiser filed his first amended consolidated complaint on October 2, 2007. On November 6, 2007, PMC moved to dismiss Beiser's amended complaint. Again, the federal court ruled that Beiser had failed to adequately plead demand futility and dismissed the first amended complaint on May 8, 2008 with leave to amend "one final time."<sup>5</sup>

In its May 8, 2008 order, the federal court noted that the discovery stay imposed by the PLSRA applied in the Federal Action and that discovery would not be allowed until Beiser filed a complaint that meets the applicable pleading standards. The federal court also denied Beiser's motions to compel, which sought documents similar to those sought in this Section 220 action.

Beiser filed a second amended consolidated complaint on May 28, 2008, and on June 25, 2008 PMC moved to dismiss that complaint for failure to plead demand futility, among other things. The federal court then stayed those proceedings to allow Beiser to pursue this action.

On April 15, 2008, shortly before the federal court's decision dismissing his first amended complaint, Beiser sent a letter to PMC's counsel requesting the opportunity to inspect the company's books and records.<sup>6</sup> PMC responded that it

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<sup>5</sup> Compl. Ex. B at 5.

<sup>6</sup> In its papers, PMC argued that Beiser should have served the company's registered agent and that the broad power of attorney did not specifically provide Beiser's counsel with the authority to make demand. At oral argument on the motion to dismiss in this case, Beiser's counsel represented that they had cured the purported deficiencies on December 2, 2008 and provided the court with a copy of that demand. The court is satisfied that Beiser's revised demand satisfies the requirements of 8 *Del. C.* § 220.

would not allow the requested inspection. On May 8, 2008, in its order granting PMC's second motion to dismiss, the federal court noted that "[w]hatever rights plaintiffs may have under Delaware law to seek corporate records are matters that plaintiffs must pursue, if at all, in the Delaware courts."<sup>7</sup>

Beiser filed his complaint in this action on July 15, 2008, seeking the inspection of certain of PMC's books and records pursuant to 8 *Del. C.* § 220. PMC has moved to dismiss the complaint claiming, *inter alia*, that Beiser does not have the requisite "proper purpose" to inspect the company's books and records. Oral argument was held on the motion to dismiss on December 11, 2008.

## II.

PMC moves to dismiss the complaint in this case pursuant to Delaware Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted. If "it appears with reasonable certainty that the plaintiff cannot prevail on any set of facts that can be inferred from the pleadings" the court will grant the defendant's motion.<sup>8</sup> For the purpose of this motion, the court will, as it must, grant the plaintiff all reasonable inferences that may be drawn from the complaint.<sup>9</sup> However, the court "is required to accept only those reasonable inferences that

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<sup>7</sup> Compl. Ex. B at 7.

<sup>8</sup> *Romero v. Career Educ. Corp.*, 2005 WL 1798042, at \*2 (Del. Ch. July 19, 2005); *accord Malpiede v. Townson*, 780 A.2d 1075, 1082-83 (Del. 2001).

<sup>9</sup> *Malpiede*, 780 A.2d at 1083.

logically flow from the face of the complaint and is not required to accept every strained interpretation of the allegations proposed by the plaintiff.”<sup>10</sup> Moreover, “[c]onclusory allegations unsupported by facts contained in a complaint . . . will not be accepted as true.”<sup>11</sup>

### III.

#### A. Does Beiser Have A Proper Purpose?

Section 220 requires that the plaintiff have a proper purpose for his books and records request. According to the statute, a “proper purpose” is “a purpose reasonably related to [the plaintiff’s] interest as a stockholder.”<sup>12</sup> Ultimately, at trial the plaintiff must prove by a preponderance of the evidence “that his primary purpose as to each category of the [d]emand is proper.”<sup>13</sup>

Besier claims that he seeks PMC’s books and records for the purposes of:

(i) investigating possible mismanagement and breaches of fiduciary duties; (ii) investigating violations of law by the officers and directors of [PMC] in connection with [PMC’s] stock option granting practices and procedures and internal controls; and (iii) determining whether [PMC’s] officers and directors are independent and/or disinterested and whether they have acted in good faith.<sup>14</sup>

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<sup>10</sup> *In re Gen. Motors (Hughes) S’holder Litig.*, 897 A.2d 162, 168 (Del. 2006).

<sup>11</sup> *Orman v. Cullman*, 794 A.2d 5, 15 (Del. Ch. 2002) (citing *Solomon v. Pathe Commc’n Corp.*, 672 A.2d 35, 38 (Del. 1996)).

<sup>12</sup> 8 *Del. C.* § 220(b).

<sup>13</sup> *Khanna v. Covad Commc’ns Group, Inc.*, 2004 WL 187274, at \*5-\*6 (Del. Ch. Jan. 23, 2004) (citing *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1031-33 (Del. 1996)).

<sup>14</sup> Compl. Ex A at 2.

Delaware courts have often held that investigating possible wrongdoing by a company's officers and directors is a "proper purpose" under Section 220.<sup>15</sup> At the pleading stage, however, a plaintiff must do more than merely "state, in a conclusory manner, a generally accepted proper purpose. [A plaintiff] must state a reason for the purpose, i.e., what it will do with the information, or an end to which that investigation may lead."<sup>16</sup> Here, Beiser has failed to plead any proper end to the purposes he sets forth, nor has the court been able to infer any proper purpose from the pleadings.

Generally the end, in cases such as this, is to determine whether sufficient evidence exists to support the filing of a derivative lawsuit. The Delaware courts have consistently encouraged plaintiffs to utilize Section 220 *before* filing a derivative action.<sup>17</sup> Doing so may prevent "expensive and time-consuming procedural machinations that too often occur in derivative litigation."<sup>18</sup> Here, Beiser could have filed his Section 220 action before August 29, 2006, the date he

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<sup>15</sup> See, e.g., *Romero*, 2005 WL 1798042, at \*2.

<sup>16</sup> *W. Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 646 (Del. Ch. 2006).

<sup>17</sup> See, e.g., *Freund v. Lucent Techs., Inc.*, 2003 WL 139766, at \*4 (Del. Ch. Jan. 9, 2003) (citing *Grimes v. Donald*, 673 A.2d 1207, 1218 (Del. 1993); *Scattered Corp. v. Chicago Stock Exchange*, 701 A.2d 70, 78 (Del. 1997)).

<sup>18</sup> *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 279 n.5 (Del. Ch. 2003). Recognizing the strain Section 220 actions can place on a company if filed after the plaintiff initiates a related action, Vice Chancellor Strine noted that "[i]t's wholly unrealistic and burdensome for plaintiffs to believe that you can invoke compulsory litigation machinery . . . and then turn around and use 220 [to obtain books and records]. It is a whipsaw on the company and it's unduly burdensome, and it's a whipsaw on the processes of dispute resolution." *Parfi Holding, AB, v. Mirror Image Internet, Inc.*, C.A. No. 18457, tr. at 6 (Del. Ch. Mar. 23, 2001) (TRANSCRIPT).

filed his initial federal complaint. Instead Beiser waited over 20 months, until April 15, 2008, by which time PMC had already expended considerable resources in defense of the Federal Action. Though the dilatory nature of Beiser's filing of the Section 220 action is not, in and of itself, fatal to his case, the timing does make it more difficult for Beiser to plead a proper purpose because the most obvious end use (to aid in filing a subsequent action) is no longer available.<sup>19</sup>

Where no proper end is evident, to satisfy the "proper purpose" requirement the plaintiff must clearly plead how he might use the evidence.<sup>20</sup> Here, the only reasonable use for the evidence is to aid Beiser in the Federal Action through discovery that has been foreclosed by the PSLRA. As discussed below, this is not a proper purpose under Section 220.

#### B. The PSLRA And The SLUSA

The PSLRA was enacted in an effort to reduce abusive litigation practices in certain federal lawsuits and automatically stays discovery upon the defendant's filing of a motion to dismiss.<sup>21</sup> The Securities Litigation Uniform Standards Act of 1998 (the "SLUSA"), enacted by Congress three years after the PSLRA to prevent

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<sup>19</sup> See, e.g., *Melzer v. CNET Networks, Inc.*, 934 A.2d 912, 920 (Del. Ch. 2007) (granting the Section 220 demand and stating that the "[p]laintiffs should have access to books and records . . . in order to allow them to explore a potential lapse in the good faith of the CNET board that would excuse demand in the California derivative suit").

<sup>20</sup> *W. Coast Mgmt.*, 914 A.2d at 646.

<sup>21</sup> *Cohen v. El Paso Corp.*, 2004 WL 2340046, at \*3 (Del. Ch. Oct. 18, 2004) (citing 15 U.S.C. § 77z-1(b)(1); H.R. Conf. Rep. No.104-369 (1995)); see also 15 U.S.C. § 78v-4(b)(3)(B).



plaintiffs from fleeing to state court to obtain discovery, allows a federal court to “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 [the PSLRA].”<sup>22</sup>

Both federal and Delaware courts have held that Congress did not intend to preempt Section 220 actions through the enactment of the PSLRA and the SLUSA.<sup>23</sup> Delaware courts have, however, anticipated that Section 220 actions might be used to circumvent the PSLRA and allowed the Section 220 action to proceed, in the face of a PSLRA mandated stay of discovery, only where (1) the plaintiff was not currently involved in the federal action, (2) the plaintiff’s counsel was not currently involved in the federal action, and (3) the plaintiff agreed to enter a confidentiality agreement preventing him from sharing the information obtained with the plaintiff or counsel in the federal action.<sup>24</sup> In *Cohen*, this court stated that it would not permit a Section 220 action to proceed if it were brought in bad faith to circumvent the PSLRA, but noted that bad faith was not suggested there because of the three safeguards mentioned above.<sup>25</sup> None of these safeguards are present in

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<sup>22</sup> 15 U.S.C. § 77z-1(b)(4); 15 U.S.C. § 78u-4(b)(3)(D).

<sup>23</sup> See, e.g., *Cohen*, 2004 WL 2340046, at \*3; *Kaufman v. Computer Assocs. Int’l*, 2005 WL 3470589, at \*3 (Del. Ch. Dec. 21, 2005); *City of Austin Police Ret. Sys. v. ITT Educ. Ser., Inc.*, 2005 WL 280345, at \*3-\*10 (S.D. Ind. Feb. 2, 2005).

<sup>24</sup> *Cohen*, 2004 WL 2340046, at \*2; *Romero*, 2005 WL 1798042, at \*4.

<sup>25</sup> 2004 WL 2340046, at \*2. Even with the safeguards present, the federal court in the related case utilized the SLUSA and issued a one-line opinion staying the Section 220 action directly after this court’s decision allowing it to proceed. This court honored the stay. See *City of*

this case. Beiser is the lead plaintiff in the related Federal Action and is represented by the same counsel as in this action. Additionally, Beiser and his counsel have failed to stipulate that documents gathered in the Section 220 action would not be used in the Federal Action. Quite the contrary, it is evident that the purpose of the Section 220 action is to obtain documents for use in the Federal Action.<sup>26</sup> Beiser filed this action only after the court in the Federal Action denied his request to lift the stay under the PSLRA, and he seeks documents that he is not permitted to obtain under the PSLRA.<sup>27</sup>

The court recognizes that a stockholder's rights under Section 220 are independent from its rights to assert any of the underlying claims, but such

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*Austin*, 2005 WL 280345, at \*8 (citing *Wyatt v. El Paso Corp.*, No. H-02-2717 (S.D. Tex. Dec. 8, 2004)).

<sup>26</sup> In his papers, Beiser repeatedly relies on the federal court's finding of "good cause" to issue a stay in the Federal Action. In the same order, however, the federal court, without expressing an opinion on the matter, recognized that "the [Delaware] court may well deny [Beiser's] request to view PMC's books and records." *In re PMC-Sierra*, No. C. 06-05330 RS, Order Granting Plaintiff's Motion to Stay, at 2, August 13, 2008. The federal court further clarified that its order should not be taken as tacit approval of the books and records request, stating: "I don't think anything in my order should be interpreted pro or con in some interpretation of what the Delaware courts should or should not do." *In re PMC-Sierra, Inc. Derivative Litig.*, No. C. 06-05330 RS, tr. at 6, October 30, 2008. *Melzer*, a case upon which Beiser relies heavily, is inapposite. 934 A.2d 912. There, the federal judge expressly suggested that the plaintiff initiate a Section 220 action and even listed four categories of documents that would be advisable for the plaintiff to seek in Delaware. Moreover, unlike the case here, foreclosure of discovery by the PSLRA was not an issue raised in the *Melzer* opinion.

<sup>27</sup> Beiser contends that the PSLRA does not apply to the Federal Action because the PSLRA does not apply to individual or derivative suits. PMC challenges Beiser's contention. Without expressing an opinion on whether the PSLRA applies in the Federal Action, the court finds it sufficient for the purposes of this action that the federal court has found that the PSLRA applies and has expressly denied the lifting of the automatic stay of discovery.

independence does not obviate the need for a proper purpose.<sup>28</sup> Here, Beiser's only purpose appears to circumvent the mandates of the PSLRA. Attempting to obtain discovery for use in a case where such discovery is clearly prevented by federal law, without more, will not satisfy the "proper purpose" requirement of Section 220.

#### IV.

For the foregoing reasons, the complaint is DISMISSED WITH PREJUDICE. IT IS SO ORDERED.

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<sup>28</sup> *W. Coast Mgmt.*, 914 A.2d at 646.