IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SOUTHPAW CREDIT OPPORTUNITY MASTER FUND LP,	)	
Plaintiff,	)	
v.	)	C.A. No. 9542-ML
ADVANCED BATTERY TECHNOLOGIES, INC.	)	
Defendant.	)	

MASTER'S REPORT
(Post-Trial)

Date Submitted: December 17, 2014
Final Report: February 26, 2015

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Advanced Battery Technologies, Inc., pro se.

LEGROW, Master

This books and records case explores this Court's discretion to prescribe "limitations or conditions" on an inspection and order other "just and proper" relief relating to an inspection demand. In a nutshell, the plaintiff stockholder seeks to inspect the books and records of a publicly traded company that was delisted from the NASDAQ and has not complied with the disclosure obligations of a public company. The stockholder, however, does not want to be precluded from trading in the company's stock, and therefore asks this Court to require the defendant company to publicly disclose the books and records that are the subject of the demand. The company, on the other hand, argues that laws in China – where the company is based – preclude it from fully complying with the inspection demand and that, to the extent the company is required to produce books and records for inspection, the Court should impose a trading restriction on the plaintiff. Ultimately, I conclude that the stockholder is entitled to inspect some of the books and records demanded, that the company has not shown that the inspection is barred by China's laws or regulations, and that – at least under the circumstances of this case – a books and records inspection is not the appropriate mechanism to enforce either party's compliance with or obligations under federal law. I therefore recommend that the Court order the company to produce certain books and records for inspection, subject to a standard confidentiality agreement free from the unusual restrictions either party seeks. This is my post-trial final report in this action.

I. Background

These are the facts as I find them after trial. Plaintiff Southpaw Credit Opportunity Master Fund, LP ("Southpaw") is a hedge fund specializing in "distressed" securities. Beginning in early March 2014, Southpaw began purchasing stock of Defendant Advanced Battery Technologies, Inc. ("ABAT"). ABAT is a Delaware corporation, but its offices and operations are based exclusively in China.[1] Through an intermediate wholly-owned subsidiary, ABAT owns three operating subsidiaries that are incorporated and based in China: (1) Harbin ZhangQiang Power-Tech Co., Ltd. ("Harbin"), (2) Wuxi Agnell Autocycle Co., Ltd. ("Wuxi"), and (3) Dongguan Qiangqiang Amperex Technologies Co., Ltd. ("Dongguan"). Harbin and Dongguan primarily are focused on the manufacture and sale of certain batteries and battery cells, while Wuxi manufactures and distributes light electric vehicles.[2]

In May 2004, ABAT was listed on the OTC Bulletin Board and its common stock was registered under Section 12(g) of the Securities and Exchange Act of 1934 (the "Exchange Act"). In 2007, ABAT was approved for listing on the American Stock Exchange and in February 2008 it was approved for listing on the NASDAQ.[3] Until 2011, ABAT regularly filed public reports and disclosures in accordance with regulations established by the Securities and Exchange Commission ("SEC"). The Company filed its last quarterly report on August 5, 2011. ABAT was delisted from the NASDAQ in

[1] Joint Pre-Trial Order (hereinafter, "Pre-Tr. Order") ¶ II(2).
[2] Def.'s Pre-Trial Br. at 7.
[3] *Id.* at 7-8.

November 2011.[4] The company contends it was forced to delist after short sellers caused its stock price to drop significantly and "a spate of anonymous Internet postings containing allegations of management misconduct led to a NASDAQ investigation and the filing of class and derivative actions against [ABAT] in New York state and federal courts."[5] Since ABAT was delisted, it has traded publicly on the "pink sheets" and has made only a handful of filings with the SEC, including the recent filings that were made after trial and are described below. Since August 2011, ABAT's stockholders have not received any financial information about the company, other than ABAT's 2012 financial results, which were posted on ABAT's website in May 2013.[6] Those financial results were not prepared in accordance with United States Generally Accepted Accounting Principles "(U.S. GAAP") and have not been audited by an external auditor.

Southpaw purchased 1,676,319 shares of ABAT stock between March 4, 2014 and March 14, 2014 and candidly concedes that it purchased its shares with full knowledge of ABAT's delisting. Southpaw believed at the time of purchase that ABAT's stock was undervalued, and purchased its shares with the intent of valuing its position by seeking inspection of ABAT's books and records under 8 *Del. C.* § 220.[7] On March 7, 2014, Southpaw sent ABAT a books and records demand (the "Demand").[8] The Demand listed two purposes for the inspection: (i) to "[d]etermine the financial risk associated with acquiring a greater position in the company as well as the risks associated with

[4] Joint Exhibit (hereinafter "JX") 22.
[5] Def.'s Pre-Trial Br. at 8.
[6] JX 3.
[7] JX 32 at 42-43; JX 33 (Cohen dep.) at 107.
[8] JX 28, Ex. A.

maintaining [Southpaw's] current position" (the "Risk Assessment Purpose"), and (ii) to "[d]etermine actual value of shares currently held (the "Valuation Purpose").[9] In furtherance of its Risk Assessment Purpose, Southpaw sought 20 categories of documents that included fairly standard valuation information along with information regarding ABAT's indemnification obligations for its board and management, plans for new products, market penetration information, expected profit margins and tax rates, acquisition and stock buyback plans, dividend plans, and any plans to take the company private or to take the company public in China.[10] As to its Valuation Purpose, Southpaw sought nine categories of books and records, eight of which are duplicative of the categories sought in connection with the Risk Assessment Purpose.[11]

On March 14, 2014, ABAT's New York counsel responded to the Demand and indicated that ABAT no longer maintained an office in the United States, but that Southpaw's representative could visit ABAT's office in Harbin, China to view the records requested in the Demand.[12] ABAT's response further stated that, before any such review, Southpaw would be required to confirm that it would not disclose ABAT's information to any other person or trade in ABAT's stock before the information gained from the inspection was disclosed to the public.[13] After some additional non-productive communications between the parties, Southpaw filed its books and records demand in this Court, ABAT retained Delaware counsel, and the parties engaged in discovery.

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[9] *Id.* Ex. A at 1-2.
[10] *Id.*
[11] *Id.* Ex. A at 2-3 (categories (b)(i)-(iv) and (vi)-(ix) are duplicative of categories (a)(i)-(viii)).
[12] *Id.* Ex. C.
[13] *Id.*

Part of ABAT's defense of this case involves the location and custody of its books and records. According to ABAT, the financial information Southpaw seeks is generated by ABAT's three operating subsidiaries. Each subsidiary maintains its own books and records and sends periodic – typically quarterly – "work performance reports" to ABAT.[14] ABAT maintains those work performance reports at its offices and uses the reports to create plans and documents for ABAT's internal use. ABAT's witness, Guohua Wan ("Ms. Wan") – an ABAT consultant who previously served as its CFO – testified that those work performance reports contain some, if not all, of the information sought in connection with Demand.[15] Other than the work performance reports, and any books and records ABAT may generate based on those reports, ABAT's operating subsidiaries each retain their own books and records, including financial and accounting records.[16] Aside from Ms. Wan's testimony, ABAT has not distinguished in the record what categories of books and records are in its possession and what categories (if any) solely are in the possession of its subsidiaries.

ABAT views all of its records, both those maintained at its headquarters and those at its subsidiaries' offices, as confidential until they are converted to U.S. GAAP, audited, and provided to the SEC. It does not appear from the record that any of ABAT's financial records have been converted to U.S. GAAP since 2011. In other words, ABAT maintains that all the information requested in the Demand is confidential. Southpaw is willing to inspect ABAT's books and records in whatever form they are maintained, but

[14] JX 36 (Wan dep.) at 46-47, 60-61.
[15] *Id.* at 47-53.
[16] *Id.* at 47.

does not want to receive any information designated as confidential because Southpaw does not want to be restricted from trading in ABAT's stock.[17]

Shortly before the deposition of its witness, ABAT for the first time took the position that certain accounting laws and regulations applicable to companies incorporated in China might preclude ABAT from producing for inspection or copying outside mainland China any accounting records of ABAT's subsidiaries. The evidence ABAT submitted on this issue consists of the testimony of Ms. Wan, who is not a lawyer, a client alert issued by the law firm Jones Day, and uncertified translations of the laws and regulations at issue. ABAT did not raise this defense until a week before trial. Southpaw objected to the late introduction of this issue, while ABAT sought to delay trial in order to explore the defense and submit expert testimony regarding the applicable laws. I allowed ABAT to present the defense, but refused to delay trial or allow the submission of expert reports (which would have had the effect of delaying trial).

At trial, therefore, ABAT introduced uncertified translations of excerpts of the Accounting Law of the People's Republic of China ("PRC") and the "Accounting Archives Management Measures" (the "Management Measures"), which are regulations issued by the Ministry of Finance of the PRC. According to ABAT's translation, Article 7 of the Management Measures provides:

> Article 7. Each entities' [sic] accounting records cannot be taken out of its recordkeeping system. If there is any special need, records can be inspected or copied. Such inspection or copying must be approved by the accounting manager of each entity and also must be registered. Personnel

[17] JX 33 (Cohen dep.) at 105.

> participating in the inspection or copying are prohibited from painting on, unpacking, or swapping the records.
>
> Each entity must establish proper procedure to register inspections and copying of accounting records.[18]

Ms. Wan also translated Article 18 of the Management Measures during her deposition. According to Ms. Wan, Article 18 provides:

> The accounting files of companies within the border of the PRC cannot be carried out over the border. Institutions that are overseas as well as companies that have established companies or enterprise overseas (overseas company), their account filings should be managed according to this approach and the relevant regulation of [the PRC].[19]

The parties dispute the applicability of these Management Measures to this proceeding.

Several unusual post-trial developments bear mention. First, after trial the parties supplemented the record with recent public filings and pronouncements by ABAT. On October 20, 2014, ABAT issued a press release and filed a Form 8-K with the SEC in which ABAT announced that it had released its independent accounting firm, EFP Rotenberg, LLP, and retained a new accounting firm, Paritz & Company, P.A., to audit ABAT's financial statements for 2011-2014.[20] ABAT's Chairman and CEO, Zhiguo Fu, explained that the retention and audit was part of ABAT's effort to "become fully compliant with SEC reporting rules."[21] On November 20, 2014, ABAT issued a press release announcing that ABAT and Zhiguo Fu planned to buy back up to 5 million shares

[18] JX 35, Ex. D.
[19] JX 16; JX 36 (Wan dep.) at 148-49.
[20] Def.'s Mot. to Supplement the R., Ex. 1. I granted ABAT's motion to supplement on January 30, 2015.
[21] *Id.* Ex. 2.

of ABAT common stock over the next 12 months, subject to board approval.[22] In the press release, ABAT explained that the company and its chairman believe "ABAT's share price does not fairly reflect our company's intrinsic value."[23]

Second, one of ABAT's stockholders, Joel Caplan, filed a motion to intervene on October 22, 2014, seeking to be added as a party to this case (the "Motion to Intervene"). Both Southpaw and ABAT oppose that motion on the basis that it is procedurally improper and lacks merit. Mr. Caplan argues that he demanded books and records from ABAT in September 2013, but did not pursue litigation to enforce his inspection rights due to the associated legal fees. In his motion, Mr. Caplan argues that he has several concerns about "how various scenarios in this case may play out," and that "[s]everal possible outcomes of the current [a]ction place [Mr.] Caplan and other shareholders at risk for losing some if not all of their investment without intervention." Specifically, Mr. Caplan muses that ABAT may (1) negotiate a private settlement with Southpaw, (2) refuse to abide by an inspection order issued by this Court, leading to contempt proceedings and sanctions, or (3) appeal any decision of this Court, and that any of those scenarios could diminish ABAT's available cash and thereby prejudice Mr. Caplan and ABAT's other stockholders. The merits of the motion to intervene are addressed below.

Finally, in early December, ABAT's counsel moved to withdraw from its representation of the company, citing disputes regarding ABAT's payment of counsel's

[22] Pl.'s Mot. to Supplement the R., Ex. 1. I granted Southpaw's motion to supplement on February 2, 2015.
[23] *Id.*

bills. I granted the motion to withdraw on December 22, 2014. No other Delaware attorney has entered an appearance for ABAT in this action.

II. Legal Analysis

ABAT's defense to the Demand coalesced shortly before trial into three arguments: (1) Southpaw does not have a proper purpose for its demand and – assuming its purpose is proper – the scope of the demand exceeds what is necessary and essential to satisfy that purpose, (2) certain rules and regulations in China preclude ABAT from fully complying with the demand because the bulk of its books and records are in the possession and control of its operating subsidiaries, which are subject to those rules, and (3) any inspection ordered by the Court should be conditioned on a confidentiality order that applies to all the books and records and includes a trading restriction precluding Southpaw from trading on the information it received.

For its part, Southpaw takes the position that both its purposes are valid under Delaware law, that ABAT has not met its burden of showing that the purposes stated in the Demand are pretextual or not Southpaw's true purposes, and that the scope of the demand is narrowly tailored to only those documents Southpaw needs to accomplish its purposes. Southpaw also argues that none of the books and records it demanded should be subject to a confidentiality agreement, that a trading restriction should not be imposed on Southpaw as a condition to its inspection, and that ABAT should be required publicly to disclose any of the books and records that the Court orders ABAT to produce for inspection. Southpaw also seeks its attorneys' fees in connection with this action.

A. Southpaw is entitled to inspect some of the books and records in the Demand.

ABAT challenges both purposes stated in Southpaw's Demand, but for different reasons. ABAT argues that the Risk Assessment Purpose is too vague and subjective to withstand scrutiny under this Court's precedent, while arguing that Southpaw's Valuation Purpose is pretextual and should be rejected on that basis. Southpaw argues that both its stated purposes are its primary purposes and should be accepted by this Court.

A stockholder's purpose is "proper" if it is "reasonably related to such person's interest as a stockholder" and is not adverse to the company.[24] When a stockholder seeks to inspect books and records other than a stocklist, the stockholder bears the burden of establishing that his primary purpose is proper.[25] If a stockholder carries that burden, any secondary purpose is considered irrelevant.[26] Any number of purposes may be proper, depending on the context of a particular case, but a stockholder's purpose must not be adverse to the company, unrelated to a legitimate interest of the stockholder, or intended to harass the corporation.[27]

ABAT first challenges the "Risk Assessment Purpose" as impermissibly vague and subjective. Even a purpose reasonably related to a stockholder's interest must be "sufficiently specific to permit both the corporation and the court to evaluate

[24] 8 *Del. C.* § 220(b); *CM & M Gp., Inc. v. Carroll*, 453 A.2d 788, 792 (Del. 1982).
[25] *Beiser v. PMC-Sierra, Inc.*, 2009 WL 483321, at *2 (Del. Ch. Feb. 26, 2009).
[26] *Norfolk County Retirement Sys. v. Jos. A. Bank Clothiers, Inc.*, 2009 WL 353746, at *5 (Del. Ch. Feb. 12, 2009); *BBC Acquisition Corp. v. Durr-Fillauer Medical, Inc.*, 623 A.2d 85, 88 (Del. Ch. 1992).
[27] *CM & M Gp., Inc.*, 453 A.2d at 792.

meaningfully its substantive propriety."[28] Thus, it is not sufficient for a stockholder to recite a generally accepted purpose or a purpose theoretically related to a stockholder's interest. Southpaw can point to no decision of this Court in which its Risk Assessment Purpose has been accepted. That alone is not fatal to the request, but it is notable. More importantly, however, Southpaw cannot articulate what type of risk assessment – other than valuation of its shares – is necessary for Southpaw to determine whether to buy, sell, or hold ABAT stock. Indeed, Southpaw's witness testified that the general meaning of risk assessment is equivalent to valuation:

> Q. What's your understanding of the financial risk as it's used in [the Risk Assessment Purpose]?
>
> A. I think the general meaning is to understand the risk that the stock could be worth more or less than its current price.[29]

In other words, Southpaw believes that its risk assessment and its decision to buy, sell, or hold ABAT stock turns on whether the current price of the stock differs from Southpaw's valuation. In that sense, this purpose is redundant of the Valuation Purpose. Having heard the testimony and Southpaw's consistent push throughout this case to force ABAT into compliance with SEC regulations, I believe that Southpaw's Risk Assessment Purpose actually is a veiled effort to obtain all the information to which Southpaw might be entitled if ABAT were meeting its reporting requirements under SEC rules.[30]

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[28] Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery*, § 8.06[e][2], at 8-132 (2013).
[29] JX 33 (Cohen dep.) at 46-47.
[30] *Id.* at 60-61 ("In every investment that I look at I want the most complete set of information that I can, and when evaluating a publicly traded stock I would want to see the same information that all public companies make available if they are reporting properly, so that would be the information I would hope to see in this case"). As I pointed out at trial, however, much of what

I discuss in detail in Section II.C. why Section 220 is not an appropriate mechanism for this Court – or a public company's stockholders – to police and enforce compliance with SEC reporting requirements. Suffice to say that, to the extent Southpaw's Risk Assessment Purpose is an effort to achieve that end, it is not a proper purpose, in my view. To the extent Southpaw simply is seeking the most complete information it can obtain, that desire is understandable, but it is not sufficiently specific and concrete for this Court to evaluate, and a vague reference to "risk assessment" suffers the further problem of being nearly unmanageable when attempting to define the proper scope of the inspection.[31] Southpaw's Risk Assessment Purpose is closely akin to other amorphous purposes previously rejected by this Court, such as inspections intended to generally "influence management policies," evaluate the effectiveness of management, or to safeguard stockholders' equity.[32] For those reasons, I believe Southpaw has not sustained its burden regarding the Risk Assessment Purpose.

ABAT acknowledges, as it must, that valuation often is accepted as a proper purpose by Delaware courts applying Section 220.[33] The company argues, however, that Southpaw's Valuation Purpose is pretextual, without articulating what Southpaw's true

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Southpaw sought in connection with its Risk Assessment Purpose exceeds what the company would be required to disclose in SEC filings.

[31] *See Neely v. Oklahoma Publishing Co.*, 1977 WL 2563 at *3 (Del. Ch. Aug. 15, 1977) ("If the standard is limited to that which is sufficient and essential, then obviously it stops short of including all books and records of a corporation … or, stated another way, it stops short of all books and records which the petitioning stockholder, in his or her personal opinion, deems to be essential. … [T]o attempt to reach the ultimate of near-precision [in valuing stock], it can be assumed that one can never get enough information unless he is given access to everything.").

[32] *See Haber v. Harnischfeger Corp.*, 1983 WL 17996 (Del. Ch. Feb. 3, 1983); *Hatleigh v. Lane Bryant, Inc.*, 1980 WL 268069, at *2-3 (Del. Ch. Oct. 3, 1980); *Catalano v. Trans World Airlines, Inc.*, 1977 WL 2579, at *3 (Del. Ch. Dec. 27, 1977).

[33] *CM & M Gp., Inc.*, 453 A.2d at 792.

purpose might be. Instead, ABAT argues that because Southpaw purchased its ABAT stock with knowledge of ABAT's delisting from the NASDAQ, and without performing any valuation other than an informal "book value" analysis based on ABAT's most recent public filings, Southpaw must not really need to value its stock in ABAT. This argument is circular, at best. That Southpaw chose to purchase stock in ABAT without a current financial picture does not mean that it is not now entitled to seek that information using Section 220. Other than vague allusions to using this litigation as leverage over ABAT, the company has introduced no evidence that Southpaw's Valuation Purpose is not genuine. The fact that Southpaw likely would not be entitled to books and records for this purpose if the company regularly were reporting its financial position under the Exchange Act is immaterial. Even ABAT acknowledges that the current price for the Company's stock is not a true reflection of its value.[34]

Southpaw therefore is entitled to inspect books and records that are necessary and essential to valuing its stock in ABAT. ABAT acknowledges that the vast majority of the records Southpaw seeks in connection with its Valuation Purpose are necessary to value the company, and only disputes Southpaw's request for historical quarterly information.[35] Specifically, ABAT argues that Southpaw has not shown that historical quarterly information is essential to its valuation. A document is "essential" under Section 220 if "it addresses the crux of the shareholder's purpose," and the "information the document

[34] Pl.'s Mot. to Supplement the R. Ex.A.
[35] *See* Def.'s Pre-Trial Br. at 24-35; *Southpaw Credit Opportunity Master Fund LP v. Advanced Battery Techs., Inc.*, C.A. No. 9542-ML (September 26, 2014) (TRANSCRIPT) at 24-27.

contains is unavailable from another source."[36] This inquiry depends on the context of a particular case.[37] Southpaw has shown that it is entitled to books and records necessary to value the company, that its inspection should extend from August 2011 – the date of ABAT's last quarterly filing with the SEC – through the date of this Court's inspection order, and that ABAT should provide some quarterly information. Southpaw has not, however, articulated a coherent need for quarterly information dating back to 2011, and such information almost certainly is stale for valuation purposes. In contrast, more recent quarterly information likely is necessary to give Southpaw sufficient data to produce a reliable valuation. Under the circumstances of this case, namely ABAT's evasive answers regarding how its data is compiled and maintained, and the fact that none of ABAT's financial information has been audited according to U.S. GAAP, Southpaw is entitled to inspect the quarterly financial data it demanded for the last 12 months, in addition to annual information – to the extent available – from 2011 through the date of this Court's order. To be clear: I recommend that the Court enter an order requiring ABAT to permit Southpaw to inspect books and records within the date ranges identified above for the nine categories listed in Paragraph IV(b) of its Demand, which are: (i) revenue, (ii) income before tax, (iii) new income, (iv) earnings per share, (v) cash and

[36] *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 371–72 (Del. 2011).
[37] *Id.* at 372.

equivalents, (vi) total assets, (vii) current asset figures, (viii) current liability figures, and (ix) stockholder equity.[38]

B. ABAT has not shown that foreign laws preclude it from satisfying the Demand.

ABAT contends that Articles 7 and 18 of the Management Measures demonstrate that the company is unable to produce the demanded books and records for inspection because such inspection would require ABAT to export its subsidiaries' accounting records in violation of certain accounting laws. To reiterate, Article 7 of the Management Measures – according to ABAT's translation – prohibits removal of accounting records from a Chinese company's recordkeeping system, but permits inspection and copying under certain circumstances and if properly registered. Article 18 of the Management Measures, as interpreted by Ms. Wan, states that accounting files of companies within the PRC cannot be carried across the border of the PRC.

ABAT acknowledges the ambiguity of these directives, and in fact urges that this ambiguity allows ABAT to avoid its obligations under Section 220. Specifically, ABAT argues that the Management Measures "may" be read as prohibiting ABAT from providing Southpaw with copies of books and records that are in the possession of either ABAT or its subsidiaries, at least to the extent those books and records could be considered the subsidiaries' accounting files.[39] According to ABAT, that restriction

[38] That Southpaw might be entitled to inspect additional categories of books and records for purposes of valuing ABAT's stock is irrelevant because Southpaw did not request any additional categories in connection with its Valuation Purpose.

[39] Def.'s Opening Post-Tr. Br. at 27, 29. *See also* JX 25 at 1 ("Generally speaking, the laws of the PRC suffer from an overwhelming lack of clarity. Whether stating broad principles of

"may" include both the files in the custody of its subsidiaries as well as the "work reports" the subsidiaries regularly send to ABAT.[40]

In support of its argument, ABAT points to a client alert prepared by Jones Day, which states, in relevant part,

> [T]he Accounting Archives Management Measures prohibit all entities within the PRC territory from taking their "accounting archives" outside of PRC territory. Furthermore, the Archives Law of the [PRC] provides that if archives or duplicates thereof are removed from China in violation of law, the archives shall be confiscated by China Customs, a fine may be imposed, and if the case constitutes a crime, criminal responsibility shall be investigated.
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> All this gives rise to question of exactly what accounting archives are. Once again, the answer is not completely clear. Article 5 of the management measures defines "accounting archives" as "professional accounting materials" recording and reflecting the economics and business of entities in China. However, it would be a mistake to conclude that this definition covers only the work papers of professional accounting firms. The management measures give specific examples of accounting archives that include typical corporate accounting documents such as accounting vouchers, accounting books, financial reports, and bank statements.
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> * * *
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> Where it is not possible to confine all financial information to China, as for example, where financial discovery is required by a U.S. court, there is unfortunately no simple solution. One can reduce the risk by taking steps to ensure that none of the specific examples of accounting archives enumerated in the law are exported from China. It is also advisable to ensure that only copies of financial documents, and no originals, are exported. If the original accounting archives are well maintained and readily available for inspection in China, the risk posed by export of copies may be manageable. But the risk remains and must be understood before a company exports financial documentation.[41]

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protection or proscribing specific conduct, the PRC laws and regulations inevitably leave open large areas of ambiguity and uncertainty.").

[40] Def.'s Opening Post-Tr. Br. at 28.

[41] JX 25 at 4.

ABAT argues that (1) as to books and records in the control of ABAT's subsidiaries, this Court cannot order inspection under 8 *Del. C.* § 220(b)(2)(b)(2) because the subsidiaries would have the right to deny ABAT access, and (2) even the work reports sent to ABAT by the subsidiaries – and therefore within ABAT's possession – cannot be produced because it could cause ABAT to violate the law in China. That argument fails for two reasons. First, ABAT has not met its burden of showing the substance of foreign law. Second, ABAT has not shown that – even if the law applies as ABAT contends – the company cannot comply with an inspection order from this Court.

ABAT argues that Southpaw cannot inspect the books and records in the possession of ABAT's subsidiaries because ABAT could not exercise its control over the subsidiaries to require them to produce the books and records for inspection. ABAT relies on 8 *Del. C.* § 220(b)(2)(b)(2), which provides:

> (b) 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:
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> * * *
>
> (2) A subsidiary's books and records, to the extent that:
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> * * *
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> b. The corporation could obtain such records through the exercise of control over such subsidiary, provided that as of the date of the making of the demand:
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> * * *
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> 2. The subsidiary would not have the right under the law applicable to it to deny the corporation access to such books and records upon demand by the corporation.

ABAT contends that Southpaw cannot inspect the subsidiaries' records because the subsidiaries would have the right under the Management Measures to deny ABAT access

to the books and records for the purposes of exporting them for inspection by Southpaw.[42] As to the work reports in its possession, ABAT contends it would be inequitable to enter an inspection order that would require the company to choose between violating a court order or the law in China.

ABAT has not, however, carried its burden of proving the substance of the foreign law that the company relies on as a basis to preclude inspection.[43] At most, ABAT has shown that Management Measures exist that *may* preclude the company from exporting *some* set of its subsidiaries' books and records. ABAT has not, however, shown (1) what books and records requested in the Demand fall within the scope of the Management Measures, or (2) whether the restrictions in the Management Measures apply to both photocopies and originals. Although ABAT has shown there is some ambiguity in the Management Measures, even among attorneys who regularly practice in the PRC, ABAT has not offered anything more concrete than uncertified translations of excerpts of the Management Measures and a half-page overview in a law firm-generated client alert. In my view, that is not sufficient to excuse ABAT from its obligations under Delaware law.[44]

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[42] *See Weinstein Enters., Inc. v. Orloff*, 870 A.2d 499, 511 n. 29 (Del. 2005). ABAT acknowledges that it has actual possession of the quarterly work reports the subsidiaries send to their parent company, although ABAT still argues that it may violate the Management Measures if it exports those work reports.

[43] *See Vichi v. Koninklijke Philips Electronics N.V.*, 62 A.3d 26, 46 (Del. Ch. 2012) ("the party seeking the application of foreign law has the burden of not only raising the issue that foreign law applies, but also the burden of adequately proving the substance of the foreign law.").

[44] Although ABAT sought to postpone trial in order to search for additional support for its argument, it did not offer any basis for the Court to conclude that the search would have been fruitful; ABAT had not at that time undertaken any effort to consult or procure an expert who

Second, even if ABAT had established that foreign law prohibited it from obtaining its subsidiaries' books and records and exporting them to the United States, ABAT has not shown that it cannot produce the records Southpaw seeks for inspection.[45] As a preliminary matter, ABAT has not established that it does not have within its possession all of the books and records I have determined Southpaw is entitled to inspect. ABAT's witness testified that, based upon the work reports its subsidiaries send each quarter, ABAT prepares a consolidated summary that contains most of the financial information that Southpaw seeks to inspect for purposes of valuing its stock.[46] ABAT does not argue those consolidated summaries are subject to the Management Measures, and the source on which ABAT relies indicates such derivative materials may be exported.[47] Therefore, it seems likely that ABAT could produce for inspection the information necessary and essential to Southpaw's requests, without resorting to exporting "accounting archives."

In addition, ABAT has not shown that it could not devise other means of making the documents available for inspection. At post-trial argument, the parties debated

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might have offered a reliable explanation of the law and how – if at all – it would apply to the books and records at issue in this case.

[45] As I explained to ABAT's counsel during post-trial argument, I believe this argument is better suited as a defense to a contempt action, should ABAT determine it is unable to comply with this Court's inspection order. That is, in view of the incomplete record, it seems more logical to me that the Court should issue its inspection order as to those documents in ABAT's possession, custody, or control, and if ABAT contends that it is impossible to comply with all or a portion of that order because of restrictions in the PRC, ABAT may introduce that defense in a contempt proceeding. Nevertheless, because ABAT raised the issue, I have addressed it on the current record, without prejudice to ABAT raising the issue in a contempt proceeding on a more complete record.

[46] JX 36 (Wan dep. at 47-53).

[47] *See also* JX 25 at 4 (suggesting that work based upon an examination of accounting records may be exported from the PRC without violating the management measures).

whether ABAT could make the documents available electronically. That may be one option. In addition, the client memo on which ABAT relies points out that – in view of the ambiguity in the Management Measures – "a safer approach is to conduct all review and analysis of financial information in China and to share only the results of that work outside China."[48] Although not typical of Section 220 inspections, it may be necessary under these unusual circumstances for ABAT to make the records available in China and bear Southpaw's associated travel expenses. Although that option seems best reserved as a "last resort," it is at least preferable to excusing ABAT altogether from its obligations under Delaware law.

C. A standard confidentiality agreement is appropriate.

The parties take starkly different stances with respect to the confidential treatment that can and should be afforded to the records ABAT is required to produce in response to the Demand. ABAT argues that all the records Southpaw seeks are confidential and that Southpaw should be required to sign – as a condition to the inspection – a confidentiality agreement that prohibits Southpaw from trading in ABAT stock until the confidential information becomes public.[49] Southpaw, on the other hand, contends that ABAT has not established that any of the books and records at issue are confidential and the company should be required to disclose publicly the books and records that are the subject to the Court's order.

[48] *Id.*

[49] *See* JX 11 (proposed confidentiality agreement) page 1 (defining as confidential information all documents produced in response to the Demand) & ¶ 4 (prohibiting Southpaw from purchasing or selling ABAT stock until the confidential information is disclosed to the public).

It is well settled that this Court has the discretion to place reasonable restrictions on stockholders' inspection rights.[50] Under the discretion afforded to it by Section 220(c), this Court commonly conditions books and records inspections on a stockholder's agreement to be bound by an appropriate confidentiality agreement.[51] That is not to say that a company is entitled to a confidentiality agreement as a matter of right.[52] Nonetheless, this Court has acknowledged the legitimate interests of both public and private companies in maintaining the confidentiality of their information, and a corporation need not show specific harm that would result from disclosure before the Court will impose a confidentiality agreement on a stockholder seeking inspection.[53]

ABAT argues that the company treats all its financial information as confidential until such time as it is converted to U.S. GAAP, audited and authorized for release.[54] Southpaw argues that ABAT has not provided any basis on which this Court could conclude that the books and records at issue are confidential, namely because ABAT is required by federal securities regulations to disclose the information contained in those records. That ABAT – as a public company – is required to disclose certain financial information is beyond dispute. The evidence also showed, however, that ABAT is not presently reporting under SEC regulations and its financial information is not even

[50] *United Technologies Corp. v. Treppel*, --- A.3d ---, 2014 WL 7662608, at *4 (Del. Dec. 23, 2014) ("Section 220(c) of the DGCL gives broad discretion to the Court of Chancery to condition a books and records inspection.").
[51] *See id.* at *4 n.29.
[52] *See Amalgamated Bank v. UICI*, 2005 WL 1377432 at *6 (Del. Ch. June 2, 2005); *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 685 A.2d 702, 713 (Del. Ch. 1995).
[53] *See e.g., Disney v. Walt Disney Corp.*, 857 A.2d 444, 447-48 (Del. Ch. 2004). *See also Amalgamated Bank*, 2005 WL 137742, at *6.
[54] *See* JX 36 (Wan dep.) at 61-63.

maintained in a form appropriate for filing with the SEC. To conclude that ABAT's books and records are not confidential because the company is required by law to disclose some of the information contained therein once it is converted to U.S. GAAP would – in effect – allow a stockholder privately to enforce SEC regulations, which is a right not currently provided under federal law. Southpaw does not dispute that privately-held companies commonly and for good reason treat their financial results as confidential until such time, and in such form, as they choose to share those results. Because ABAT is not publicly reporting, it is more akin to a private company for purposes of this analysis.

In addition, there is good reason to err on the side of affording confidential treatment to books and records if there is a good faith basis to do so, until the Court can properly assess whether a particular document truly is confidential. To so err helps preserve the expedited and summary nature of a Section 220 proceeding, allows an inspection to proceed in short order, and affords a stockholder the opportunity to challenge a confidential designation once the particular record has been made available.[55]

ABAT has shown that it treats its financial information, as it currently is maintained, as confidential. The nature of the information and ABAT's treatment of it is sufficient for this Court to require Southpaw to execute a confidentiality agreement. The agreement proposed by ABAT, however, would apply confidential treatment to every book and record that is the subject of the Court's order, without ABAT having to make a good faith determination as to the confidentiality of a particular document. In standard

[55] *See Amalgamated*, 2005 WL 1377432, at *4.

confidentiality orders, the corporation designates as confidential those documents it believes in good faith are entitled to that treatment, subject to the stockholder's right to challenge that designation. ABAT's proposed order, on the other hand, assumes that every record it produces for inspection is confidential and does not provide Southpaw any opportunity to contest the confidentiality of a document. It seems doubtful all the records at issue truly are confidential. For example, I am skeptical that financial results dating back more than a year are entitled to confidential treatment. Therefore, any confidentiality agreement the parties execute should include clauses regarding good faith designations and a process to challenge such designations.

The parties also dispute whether the confidentiality agreement or this Court's order should (1) restrict Southpaw from trading on the basis of the books and records it inspects, or (2) require ABAT to make the books and records publicly available so that Southpaw will have freedom to trade without the possibility doing so may violate securities regulations. In this regard, the parties focus on SEC Regulation FD, which is the "Selective Disclosure and Insider Trading" rule adopted by the SEC. Under Regulation FD, "when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information."[56] ABAT argues that this Court's order "must address the issues raised by Regulation FD," and ABAT urges

[56] JX 17 at 1-2 ((Executive Summary).

the Court to enter a confidentiality order that would preclude Southpaw from trading in ABAT stock until the books and records it inspects become publicly available.[57]

This Court recently confronted and rejected a similar request in *Ravenswood Investment Co., L.P. v. Winmill & Co.*, which involved a stockholder's demand to inspect certain financial information of a publicly-traded company that had not released financial information in more than a year.[58] Like Southpaw, the stockholder sought to value its stock in the company. The company refused to permit the inspection unless the stockholder agreed to a restriction forbidding it from trading in the company's stock for a year after the stockholder received material, nonpublic information (unless the information became public sooner). In rejecting the company's proposed trading restriction, this Court reasoned:

> The overall argument advanced by Winmill – that a corporation could condition access to the information necessary for a stockholder to value its stock on an agreement not to trade – would inappropriately frustrate this fundamental stockholder right. The whole point of valuing stock is so that stockholder can determine what to do with it: to buy, to sell, or to use the value for some other appropriate purpose. After all, is there even a readily ascertainable value to stock that cannot be traded, under Winmill's proposal, for possibly an entire year? The Court is unwilling to incorporate such an inequitable notion into Delaware's Section 220 jurisprudence. Based on the arguments submitted by the parties, the Court concludes that the trading restriction proposed by Winmill is contrary to Delaware law.[59]

The same reasoning counsels in favor of rejecting ABAT's proposed trading restriction. Although this Court has broad authority to prescribe limitations on

[57] Def.'s Opening Post-Tr. Br. at 16; JX 11 ¶ 4.
[58] 2014 WL 2445776, at *2 (Del. Ch. May 30, 2014).
[59] *Id*. at *4.

inspections,[60] ABAT's proposed restriction would nullify the entire purpose of Southpaw's inspection, a result completely inconsistent with Section 220. As the *Ravenswood* Court acknowledged, such a restriction would make the value of Southpaw's holdings uncertain. That is not the intent of Section 220.

ABAT attempts to distinguish *Ravenswood* on the basis that the company in that case was not subject to Regulation FD and instead only was concerned with so-called "tipper liability" under the federal securities laws.[61] This appears to be a distinction without a difference, as the *Ravenswood* Court did not base its decision on the reasons the company sought the restriction, but whether such a restriction was consistent with Delaware law. Moreover, it is difficult to look past the inconsistencies in ABAT's position; the company argues that the fact it has not complied with its reporting obligations under SEC regulations is a basis to maintain the confidentiality of its financial information, while simultaneously relying on its need to comply with those regulations as a basis for this Court to impose a trading restriction. To allow ABAT to have it both ways smacks of inequity.

Conversely, Southpaw argues this Court's inspection order should require ABAT to disclose publicly any of the books and records it produces for inspection, to avoid any implicit trading restriction that may otherwise apply to Southpaw under Regulation FD. This again, however, would give stockholders a mechanism under Delaware law to enforce federal securities regulations. Whether this Court even has that authority is a

[60] *United Technologies Corp. v. Treppel*, -- A.3d ---, 2014 WL 7662608, at *4 (Del. Dec. 23, 2014).
[61] *See Ravenswood Investment Co., L.P.*, 2014 WL 2445776, at *2.

matter open to debate, but I need not resolve that issue for purposes of this case because I do not believe it is necessary for the Court to take such action. Whatever their obligations under Regulation FD, the parties may independently assess those obligations and determine how to comply with them without an order from this Court. In addition, I do not believe ordering parties to comply with federal law is consistent with the intent of Section 220. The inspection right afforded to stockholders under Section 220 is an important feature of the Delaware General Corporation Law, but it is a right entirely separate from the complex overlay of rights and regulations created under the federal securities laws. To introduce into Section 220 actions questions of either party's obligations under federal law would unnecessarily complicate what are intended to be summary proceedings. Although I sympathize with Southpaw that it may need to devise a way to inspect the records and value its shares without violating Regulation FD, or alternatively choose not to inspect the books and records because of that regulation, I do not believe it is either necessary or appropriate for this Court to remedy that issue.

The parties have not raised any other disputes regarding the terms of the confidentiality agreement that Southpaw must execute as a condition to its inspection. If the parties are unable to negotiate a resolution to any remaining issues regarding the agreement, they may present their dispute to the Court after good faith attempts to meet and confer.

D. The Motion to Intervene should be denied.

The Motion to Intervene filed by Mr. Caplan is puzzling. Although Mr. Caplan seeks to intervene, it is not clear on what basis he purports to do so or what relief he

hopes to achieve if the motion is granted. It appears Mr. Caplan may desire to act in some type of representative capacity for ABAT's other stockholders, but he does not articulate how he would do so, or the legal basis under which this Court could (let alone should) convert a summary Section 220 proceeding into a representative action.

In any event, I conclude that the Motion to Intervene should be denied because it fails to meet the requirements of Court of Chancery Rule 24. That rule requires a motion to intervene to "be accompanied by a pleading setting forth the claim or defense for which intervention is sought."[62] The requirement is not merely a procedural formality. Rather, it provides a basis on which the Court may assess the request to intervene. Here, in particular, where Mr. Caplan's right to intervene is entirely unclear from the record, the failure to attach the proposed pleading is fatal to the motion. I therefore recommend that the Court deny the Motion to Intervene unless and until Mr. Caplan supplements the record with a proposed pleading.[63]

E. Neither party is entitled to attorneys' fees.

Southpaw also seeks all or a portion of its attorneys' fees under the bad faith exception to the American Rule, contending that at least some of ABAT's defense to this litigation was baseless and that ABAT's conduct forced Southpaw to file suit to secure a clearly defined and established right.[64] Specifically, Southpaw argues that ABAT contested whether even basic financial information, such as revenue, was necessary and essential to Southpaw's valuation purpose. Although that argument might prevail if it

[62] Ct. Ch. R. 24(c).
[63] *See Schiff v. RKO Pictures Corp.*, 136 A.2d 193, 194 (Del. Ch. 1954).
[64] Tr. at 17.

were true, it is not. ABAT contested whether Southpaw's Valuation Purpose was genuine and argued that – if the purpose was genuine –historical quarterly information was not necessary and essential to the stated purpose, but ABAT's pre-trial brief effectively conceded that the categories sought in connection with the Valuation Purpose were necessary and essential to that purpose.[65] Although ABAT's witness may have disagreed,[66] ABAT did not adopt Ms. Wan's view in this litigation. I therefore cannot conclude that ABAT defended this litigation in bad faith.

Conclusion

For the foregoing reasons, I recommend that the Court order ABAT to produce its books and records for inspection, consistent with the parameters identified in this report and subject to Southpaw executing a confidentiality agreement containing standard terms typically agreed upon by parties in Section 220 actions. If the parties have any continuing dispute regarding the appropriate terms of a confidentiality agreement, they may raise their disputes with the Court only after engaging in good faith negotiations. This is my final report and exceptions may be taken in accordance with Court of Chancery Rule 144.

/s/ *Abigail M. LeGrow*
Master in Chancery

[65] *See* Def.'s Pre-Trial Br. at 23-28.
[66] *See* JX 36 (Wan dep.) at 108-09.