

Delaware Courts Expand Plaintiffs' Rights in Section 220 Cases

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The rise in Section 220 demands (and related lawsuits) has resulted in several recent opinions that continue a trend in favor of greater access for stockholders to corporate books and records. These decisions, which are analyzed below, will likely impact how companies respond to Section 220 demands, the types of defenses that can be raised in response to a Section 220 lawsuit, and how companies maintain their books and records.

Curtailing Merits-Based Defenses

AmerisourceBergen¹

In the wake of multiple government investigations and lawsuits concerning its role in the national opioid crisis, AmerisourceBergen was served with a Section 220 demand requesting to inspect board materials regarding the same issues. The demand indicated several purposes for inspection, including to investigate possible breaches of fiduciary duty and to evaluate potential litigation. The company rejected the demand entirely, and the stockholders filed an action in the Court of Chancery to compel production of the documents.

AmerisourceBergen moved to dismiss the action, arguing — despite the multiple purposes for the requested documents stated in the demand — that the stockholders' only purpose was to file a *Caremark* claim for lack of oversight and that they had not presented evidence demonstrating a credible basis to suspect an actionable claim. This argument was based on AmerisourceBergen's Section 102(b)(7) charter provision, which bars money damages for breaches of the duty of care. The Court of Chancery rejected this defense for several reasons, including that (i) stockholders may investigate wrongdoing without needing to identify how specifically they intend to use the fruits of their investigation, and (ii) stockholders do not need to provide evidence of actionable wrongdoing to state a proper purpose for an information request.²

The Delaware Supreme Court affirmed. First, the court agreed that “a stockholder is not required to state the objectives of his investigation” because “corporate wrongdoing is, as the Court of Chancery noted, in and of itself ‘a legitimate matter of concern that is reasonably related to [a stockholder’s] interest[] as [a] stockholder[].’”³ While corporations may still “challenge the *bona fides* of a stockholder’s stated purpose and present evidence from which the court can infer that the stockholder’s stated purpose is not its actual purpose,” stockholders are nevertheless “not required to specify the ends to which [they] might use the books and records.”⁴

¹ *AmerisourceBergen Corporation v. Lebanon County Employees' Retirement Fund*, 243 A.3d 417 (Del. 2020).

² *Lebanon County Employees' Retirement Fund v. AmerisourceBergen Corporation*, 2020 WL 132752, at *13, *20 (Del. Ch. Jan. 13, 2020).

³ 243 A.3d at 427-28.

⁴ 243 A.3d at 429-30.

Second, the court affirmed that, even where follow-on derivative litigation is the stockholders' sole purpose in investigating wrongdoing, they do not need to present evidence that the wrongdoing could support claims raised in a subsequent action that are capable of surviving a motion to dismiss. The court examined several recent Court of Chancery opinions, noting an apparent divide in willingness to entertain merits-based defenses to Section 220 demands. However, observing that Section 220 proceedings are intended to be "summary," and thus "managed expeditiously," the court stated that "[i]t has become evident that the interjection of merits-based defenses — defenses that turn on the quality of the wrongdoing to be investigated — interferes with that process."⁵

The court then clarified the credible basis standard that courts are to apply going forward:

To obtain books and records, a stockholder must show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement or wrongdoing warranting further investigation. The stockholder need not demonstrate that the alleged mismanagement or wrongdoing is actionable.⁶

However, the court left open the possibility for companies to raise certain defenses "[i]n the rare case in which the stockholder's sole reason for investigating mismanagement or wrongdoing is to pursue litigation." If "a purely procedural obstacle, such as standing or the statute of limitations, stands in the stockholder's way such that the court can determine, without adjudicating merits-based defenses, that the anticipated litigation will be dead on arrival, the court may be justified in denying inspection."⁷

⁵243 A.3d at 437.

⁶243 A.3d at 437.

⁷243 A.3d at 437.

Permitting Access Beyond Formal Board Materials

Facebook⁸

Following a data breach involving the unauthorized release of confidential user data to a data analytics firm, Facebook, Inc. (Facebook) faced investigation from the Federal Trade Commission (FTC) regarding potential violation of a consent decree entered in 2012 over previous data privacy breaches. The company settled with the FTC in 2019 for a record-breaking \$5 billion, and the settlement included a release for Facebook's CEO, Mark Zuckerberg. Shortly thereafter, a stockholder served a demand to inspect Facebook's books and records to investigate whether the company had overpaid in the settlement to protect Mr. Zuckerberg from personal liability.

Facebook responded to the demand by agreeing to provide certain categories of documents, and produced over 30,000 pages. However, Facebook resisted the stockholder's request for board-level emails and text messages concerning its settlement negotiations with the FTC. When the stockholder filed a suit to obtain the communications, Facebook objected, arguing that the additional documents were not necessary and essential to establish the stockholders' stated purpose for inspection.

Vice Chancellor Slight's rejected Facebook's arguments. First, the court explained that the stockholder had not

forfeit[ed] its statutory inspection rights by candidly describing the strength of its potential claims. That a stockholder plaintiff believes it has a basis in facts already known to pursue claims of wrongdoing against company fiduciaries does not mean the stockholder should be denied use of the "tools at hand" to

⁸*Employees' Retirement System of Rhode Island v. Facebook, Inc.*, 2021 WL 529439 (Del. Ch. Feb. 10, 2021).

develop those facts further so that it can well-plead its claims in a complaint, particularly a derivative complaint.⁹

Second, the court determined that the materials Facebook had already provided “do not allow [the plaintiff stockholder] to engage in the kind of investigation contemplated by Section 220.”¹⁰ The court noted that the board and special committee minutes were “heavily redacted[,] providing only a basic outline of the Board’s process and the resulting negotiations with the FTC leading to the 2019 Settlement.”¹¹ The court described the documents as “bereft of any information concerning the substance of Facebook’s nonprivileged discussions with the FTC,”¹² and added, “[t]he fact that Facebook’s more traditional Board materials reveal little or

nothing of the Board’s thinking with respect to the negotiations and decision to enter the 2019 Settlement indicate strongly that, if such information exists, it will be in the nonprivileged electronic communications ...”¹³

On a separate note, Vice Chancellor Slight signaled that he agrees with Chancellor McCormick regarding how corporations ought to approach Section 220 demands and litigation. In a footnote, he “commend[ed] the parties” for focusing the trial on the scope of documents to be produced, rather than the propriety of the stockholder’s stated purpose, and noted that their conduct stood “in marked contrast to the tactics that have prompted expressions of concern by this court regarding ‘overly aggressive’ Section 220 litigation.”¹⁴

⁹2021 WL 529439, at *6.

¹⁰2021 WL 529439, at *6.

¹¹2021 WL 529439, at *7.

¹²2021 WL 529439, at *7.

¹³2021 WL 529439, at *8.

¹⁴2021 WL 529439, at *2 n.11 (citing *Gilead Sciences*).

Takeaways

- In light of *AmerisourceBergen*, the Delaware courts are no longer likely to entertain merits-based defenses to Section 220 demands, whether or not a stockholder has identified any particular intended use for the documents it is seeking to inspect. However, other defenses, such as standing or scope-based defenses, may be applicable.
- Even where corporations voluntarily produce formal board records in response to a demand, that will not necessarily defeat a demand for informal board materials or emails, particularly if the formal board records are lacking in substance.
- Based on another recent case, when a court views a particular defense against a Section 220 demand as overly aggressive, it may entertain plaintiff fee-sharing demands.¹⁵
- Boards should seek legal guidance upon receipt of a Section 220 demand to ensure that they are considering the most recent case law developments before responding.

¹⁵ *Petry v. Gilead Sciences, Inc.*, 2020 WL 6870461 (Del. Ch. Nov. 24, 2020).

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