Recent Delaware Cases Clarify Existing Limits and Adopt Novel Condition in Books-and-Records Demands

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Recent Delaware cases have helped clarify the limits of what the Court of Chancery will consider in a books-and-records demand under 8 Del. C. § 220, and one case has adopted a novel condition that defendants may seek to incorporate in future actions.

In 2015, the Court of Chancery held in *Southeastern Pennsylvania Transit Authority v. AbbVie, Inc.*, as a matter of first impression, that when a stockholder demands books and records for the sole stated purpose of building a case for future litigation, that stockholder must provide a credible basis to suspect possible wrongdoing that would lead to a "non-exculpated" claim — *i.e.*, a claim for which money damages would not be exculpated under 8 Del. C. § 102(b)(7).[1] In *AbbVie*, stockholders demanded books and records related to a failed merger between AbbVie, Inc. and Shire plc. The Court of Chancery found that the stockholders' only purpose was to pursue derivative litigation for breach of fiduciary duty.[2] In denying the stockholders' demand for books and records, the court found no credible basis to suspect wrongdoing because "the corporate wrongdoing which [a stockholder] seeks to investigate must necessarily be justiciable," and the facts alleged "fail[ed] to show a credible basis that the Company's directors have breached their duty of loyalty."[3] In a one-paragraph affirmation, the Delaware Supreme Court, sitting *en banc*, agreed that there was "no viable use" for the books and records sought.[4]

The impact of *AbbVie* is still unclear, however, because it may be possible for plaintiffs to avoid the *AbbVie* holding simply by stating additional purposes in their demand letters. Less than a month after the Delaware Supreme Court affirmed the *AbbVie* ruling, the Court of Chancery distinguished *AbbVie* both on the facts and on the stockholder's stated purposes.[5] In *Yahoo!*, a stockholder sought to investigate possible wrongdoing related to the hiring and firing of a highly compensated executive.[6] Relying heavily on the series of Delaware decisions that culminated in *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. 2006), the Court of Chancery distinguished *AbbVie* on its facts — finding that the plaintiff had alleged facts from which there was a credible basis to suspect nonexculpated wrongdoing by Yahoo! directors and officers — and noting, without elaboration, that the stockholder "ha[d] not similarly limited its potential uses of the fruits of its investigation."[7]

Relying on the general principle articulated by the Delaware Supreme Court in *United Technologies Corp. v. Treppel*, 109 A.3d 553 (Del. 2014), which held that 8 Del. C. § 220(c) confers "broad discretion to the Court of Chancery to condition a books and records inspection," the Court of Chancery broke new

[1] *Se. Pa. Transit Auth. v. AbbVie, Inc.*, C.A. Nos. 10374-VCG, 10408-VCG, 2015 WL 1753033, at *13 (Del. Ch. Apr. 15, 2015), *aff'd*, No. 239, 2015, 2016 WL 235217 (Del. Jan. 20, 2016).

[2] *Id.* at *13.

[3] *Id.* at *13, *17.

[4] *Se. Pa. Transit Auth. v. AbbVie, Inc.*, No. 239, 2015, 2016 WL 235217, at *1 (Del. Jan. 20, 2016).

[5] *Amalgamated Bank v. Yahoo! Inc.*, --- A.3d ---, C.A. No. 10774-VCL, 2016 WL 402540, at *22-23 (Del. Ch. Feb. 2, 2016) (appeal pending).

[6] *Yahoo!*, 2016 WL 402540, at *16-20.

[7] *Id.* at *22. Citing to *Seinfeld v. Verizon Communications, Inc.*, 909 A.2d 117 (Del. 2006), the Court of Chancery quoted examples from the Delaware Supreme Court of proper purposes stockholders could state that would not be impeded by an exculpation provision, such as seeking an audience with the board of directors, preparing a stockholder resolution or mounting a proxy fight. *Id.*

ground by accepting Yahoo!'s request for a novel condition to production: It required that any materials produced under the court's order be incorporated by reference in any future plenary action complaint that the plaintiff filed.[8] While the Court of Chancery noted that the condition "protect[ed] the legitimate interests of both Yahoo and the judiciary by ensuring that any complaint that Amalgamated files will not be based on cherry-picked documents," it also stressed that the condition did "*not change the pleading standard* that governs a motion to dismiss."[9] The Court of Chancery stated that "'all well-pleaded factual allegations' still w[ould] be accepted as true" and "plaintiff also w[ould] be entitled to 'all reasonable inferences.'"[10] Thus, even though the entire production would be incorporated by reference into any follow-on complaint, "if a document or the circumstances support more than one possible inference, and if the inference that the plaintiff seeks is reasonable, then the plaintiff receives the inference."[11]

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The Court of Chancery also recently clarified the utility of allegations for which breach of fiduciary duty claims would be time-barred.[12] In *Citigroup*, stockholders demanded books and records to investigate potential wrongdoing for a breach of fiduciary duty claim under the "oversight" theory of liability articulated in *In re Caremark International Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

The stockholders alleged three instances of purported misconduct as support for their demand, including one action for which any breach of fiduciary duty claim would be time-barred. The Court of Chancery found that the time-barred allegation was "useful … in determining whether there is a credible basis to investigate" because it could help evidence a pattern of potential misconduct.[13] Drawing a distinction between the "credible basis" inquiry and the scope of production, however, the Court of Chancery declined to order production of documents related to the time-barred allegation because it was "too remote in time to support liability."[14]

It is unknown whether the Court of Chancery would be willing to consider time-barred allegations at all if a plaintiff were not investigating potential wrongdoing for a future *Caremark* claim, which requires a plaintiff to prove facts showing a "sustained or systematic failure of the board to exercise oversight," or if the time-barred conduct could otherwise be segregated from other allegations relating to a broader course of behavior.[15] Nevertheless, the trio of cases discussed above provides important context for any company considering how to respond to a books-and-records demand.

[8] *Id.* at *31 (quoting *United Technologies Corp.*, 109 A.3d at 557-58).

[9] *Id.* at *32 (emphasis in original).

[10] *Id.* (citation omitted).

[11] *Id.* (citation omitted).

[12] *In re Citigroup Inc. Section 220 Litig.*, Consol. C.A. No. 11454-VCG, Tr. at 17, 35-36 (Del. Ch. Nov. 5, 2015) (TRANSCRIPT).

[13] The Court of Chancery also ordered production of documents related to additional allegations that were not time-barred.

[14] *Id.* at 36-37; *see also id.* at 43.

[15] *Caremark*, 698 A.2d at 971.