Harvard Law School Forum on
Corporate Governance and Financial Regulation

SUPPORTED BY:
pwc

Developments in Section 220 Litigation

Posted by Sarah T. Runnells Martin and Michelle L. Davis, Skadden, Arps, Slate, Meagher and Flom LLP, on Thursday, December 14, 2017

Editor's note: Sarah T. Runnells Martin is counsel and Michelle L. Davis is an associate at Skadden, Arps, Slate, Meagher and Flom LLP. This post is based on a Skadden publication by Ms. Martin and Ms. Davis and is part of the Delaware law series; links to other posts in the series are available here.

Since its issuance in 2015, the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC*[1] has been routinely applied, in appropriate circumstances, to dismiss post-closing deal litigation. However, *Corwin*'s applicability remained untested in certain areas, such as stockholder demands to inspect books and records under 8 Del. C. § 220 relating to transactions to which *Corwin* could arguably apply. Recently, in *Salberg v. Genworth Financial, Inc.*,[2] the Delaware Court of Chancery answered the question of *Corwin*'s applicability in such demands in the context of discussing the *Garner* doctrine, which is based on a 1970 U.S. Court of Appeals for the Fifth Circuit case[3] and permits a stockholder plaintiff to obtain privileged documents in certain circumstances under a showing of good cause.

Garner's Applicability in Section 220 Matters

The *Garner* doctrine is a judicial recognition that when "the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show 'good cause' why the privilege should not apply."[4]

Although certain Delaware cases over the years[5] have touched on *Garner*, it was not officially adopted by the Delaware Supreme Court until 2014 in *Wal-Mart Stores, Inc. v. Indiana Elec.*

[1] 125 A.3d 304 (Del. 2015). *Corwin* dictates that the business judgment presumption will apply to a transaction that was approved by the fully informed, uncoerced vote of a majority of disinterested stockholders. Cases applying *Corwin* to dismiss post-closing stockholder merger litigation include, among others, *In re MeadWestvaco Stockholders Litig.*, C.A. No. 10617-CB (Del. Ch. Aug. 17, 2017); *In re Solera Holdings, Inc. Stockholder Litig.*, C.A. No. 11524-CB (Del. Ch. Jan. 5, 2017); and *In re Merge Healthcare Inc. Stockholders Litig.*, C.A. No. 11388 -VCG (Del. Ch. Jan. 30, 2017).

[2] C.A. No. 2017-0018 -JRS, 2017 WL 3499807 (Del. Ch. July 27, 2017).

[3] *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).

[4] *Salberg*, 2017 WL 3499807, at *4 (quoting *Grimes v. DSC Commcn's Corp.*, 724 A.2d 561, 568 (Del. Ch. 1998).

[5] *See*, *e.g.*, *Grimes*, 724 A.2d at 568; *Lee v. Engle*, 1995 WL 761222 (Del. Ch. Dec. 15, 1995) ("Although not a binding case, this court adopted and consistently has followed *Garner v. Wolfinbarger* …"); *In re Information Mgmt. Services, Inc.*, C.A. No. 8168 -VCL, 2013 WL 4772670, at *14 (Del. Ch. Sept. 5, 2013) ("[E]quity historically has imposed other limitations on a stockholder plaintiff's ability to obtain corporate documents in a derivative action, even after the stockholder gains standing to sue on behalf of the corporation. For example, a stockholder seeking to penetrate the corporation's privilege had to show good cause under *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).)."

Workers Pension Trust Fund IBEW.[6] In *Wal-Mart*, a case affirming the Court of Chancery's decision that Wal-Mart had to produce books and records pursuant to a Section 220 demand, the Delaware Supreme Court held that *Garner* could apply in both plenary actions and Section 220 actions and identified numerous factors that could be established to demonstrate the requisite "good cause" to set aside the attorney-client privilege, including:

1. the number of shareholders and the percentage of stock they represent;
2. the bona fides of the shareholders;
3. the nature of the shareholders' claim and whether it is obviously colorable;
4. the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources;
5. whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality;
6. whether the communication is of advice concerning the litigation itself;
7. the extent to which the communication is identified versus the extent to which shareholders are blindly fishing; and
8. the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.[7]

Shortly after *Wal-Mart* was decided, the Court of Chancery had an opportunity to apply *Garner* in *In re LuluLemon Athletica Inc. 220 Litigation*. In that case, the court found that the plaintiffs demonstrated good cause to access privileged documents in a Section 220 action. In doing so, the court considered several of *Garner*'s factors, including whether the plaintiffs' claims were obviously colorable; whether the communications were necessary and unavailable from other sources; whether the alleged wrongdoing constituted a criminal act; and whether the communications at issue related to advice concerning the current litigation at issue. In considering the last factor regarding whether the communications related to advice about the pending litigation, the court noted that "[t]his aspect of the analysis is not applied rigidly … and depends of the specific facts of the case."[8]

Salberg: The Interplay of *Corwin*, *Garner* and Section 220

Enter *Salberg*. Stockholder plaintiffs had filed derivative claims against Genworth's board, alleging that the directors failed to oversee systemic fraud in connection with the company's insurance lines. After the derivative action was filed, Genworth announced it was being acquired by China Oceanwide—a transaction that, if completed, would eliminate the plaintiffs' standing to pursue their derivative claims. The same stockholders represented by the same counsel as in the derivative action then made a Section 220 demand seeking documents regarding whether the Genworth board considered the value of the derivative claims when evaluating the merger. This Section 220 demand was clearly targeting evidence that would help the stockholders argue that post-merger derivative standing should be preserved under the test discussed in *In re Primedia*

[6] 95 A.3d 1264 (Del. 2014).
[7] *Wal-Mart*, 95 A.3d at 1278-80.
[8] *In re LuluLemon Athletica Inc. 220 Litig*., C.A. No. 9039-VCP, 2015 WL 1957196, at *13 (Del. Ch. Apr. 30, 2015).

Inc. Shareholders Litigation.[9] Genworth produced documents in response to the demand, many of which were redacted on privilege grounds.

The plaintiffs argued that they were entitled to the documents that Genworth withheld or redacted on the basis of privilege under *Garner*. In evaluating whether the plaintiffs had satisfied the *Garner* factors and demonstrated "good cause" to obtain privileged documents, the court emphasized three factors that have "particular significance": 1) the colorability of the claim; 2) the extent to which there is an identified privileged communication versus merely fishing for one; and 3) the necessity or desirability of stockholders having the information and its availability from other sources. The court also reiterated what it recognized in *LuluLemon*—that whether the privileged communication being sought relates to advice concerning the litigation itself is also an important factor in the *Garner* analysis.[10]

In reviewing these factors, the court first held that the plaintiffs had stated a colorable claim, and in doing so, made important statements regarding *Corwin* in the Section 220 context. The defendants argued that any breach of fiduciary duty claims challenging the merger that extinguished the plaintiffs' derivative standing would be dismissed under *Corwin*. However, the court declined to apply *Corwin* when determining whether the plaintiffs had stated a colorable claim, holding that the "colorability" of a plaintiff 's claim for purposes of *Garner* must be assessed under the applicable Section 220 standard—whether there is a "credible basis" to suspect wrongdoing.[11]

The court then went on to consider the nature of the privileged advice in deciding whether privilege should be waived. While the litigation the privileged communications related to was not the litigation directly before the court—*i.e.*, the Section 220 action—but the pending derivative action, the court refused to take a "talismanic" approach to that *Garner* factor. Rather, the court observed that the plaintiffs and their counsel were the same in both actions, and that they initiated the Section 220 action to get privileged documents they would not have been able to obtain in the derivative action. Thus, the court found that the case did not warrant production of privileged communications under *Garner*. In doing so, the court noted that "[p]laintiffs cannot achieve via Section 220 what they could not achieve via discovery in the Derivative Action."[12]

Key Takeaways

The court in *Salberg* appears to have answered in the negative—at least in the *Garner* context—whether *Corwin*'s business judgment presumptions will apply in determining whether claims are colorable for purposes of a Section 220 demand. Rather, it appears that when considering whether a plaintiff has stated a "proper purpose" to warrant inspection, the court will maintain adherence to the "credible basis" standard and not read *Corwin*'s business judgment presumption into Section 220's standards.

---

[9] 67 A.3d 455 (Del. Ch. 2013) (discussing situations where a stockholder of an acquired corporation can challenge the fairness of the merger by which their standing to sue was extinguished).

[10] *Salberg*, 2017 WL 3499807, at *5.

[11] *Id*. at *5-7 (noting "[t]o be clear, the strength of Plaintiffs' claims in the Derivative Action as measured against Chancery Rule 12(b)(6) or Rule 23.1 standards is not at issue here. The question is whether Plaintiffs have articulated a credible basis from which the Court may infer possible mismanagement or wrongdoing in connection with the Genworth board's evaluation of the derivative claims during the negotiation of the merger.").

[12] *Id*. at *7. However, it is not clear that, had the plaintiffs not been party to a derivative action, the court would have found that *Garner* had been satisfied.

However, it remains to be seen whether *Corwin* will be inapplicable in every Section 220 demand under the reasoning of *Salberg*. *Salberg* was not a case where a plaintiff was seeking documents in order to directly challenge a merger transaction; rather, stockholders sought to evaluate whether a merger properly valued their pre-existing derivative claims for purposes of maintaining derivative standing. It is unclear if *Corwin* would even properly apply in such a situation, whether in the Section 220 context or in a plenary action. Thus, it is possible that *Corwin* might still have a place in evaluating whether a stockholder has stated a proper purpose to bring a Section 220 demand for the purpose of asserting a direct fiduciary challenge to a stockholder-approved merger.