Skadden

Supreme Court Provides Further Guidance on Demands to Inspect Electronic Communications

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Recently, Delaware corporations faced with demands for books and records under *8 Del. C.* § 220 have increasingly been forced to contend with demands for electronic communications, such as emails. Historically, the Delaware courts have mostly limited stockholder access to formal board-level documents, such as meeting minutes, board presentations and resolutions. The courts rarely required corporations to produce email. Electronic information was believed to be more in the nature of civil discovery, which is beyond the scope of a Section 220 request.

While electronic discovery is still rare in books and records cases, some recent decisions have required corporations to produce electronic information in addition to more traditional corporate books and records. In particular, courts have expanded the reach of Section 220 into electronic information when key decisions are made over email and are not formally documented in minutes or other board materials. This culminated in the Delaware Supreme Court's recent opinion in *KT4 Partners LLC v. Palantir Technologies Inc.*,[1] which suggests the importance of formality in record keeping as a defense to attempts by plaintiff stockholders to inspect emails and other electronic communications.

Background

Section 220 governs the "inspection of books and records" of Delaware corporations by stockholders and directors. The legal framework under Section 220 is settled: Stockholders of a Delaware corporation have a qualified right to inspect its books and records. Unlike directors, who have a "virtually unfettered" right to inspect books and records, stockholders may inspect books and records only if they show by a preponderance of the evidence that they have a "proper purpose." The courts have recognized that investigating wrongdoing or mismanagement is a proper purpose. If a stockholder seeks to investigate wrongdoing, it must present a "credible basis" from which the court can infer that wrongdoing may have occurred. If a stockholder satisfies this burden, the court will then allow the stockholder to inspect only the documents that are "essential and sufficient" to satisfy its stated purpose.

The Court of Chancery has stated that "books and records of the corporation" means "those [documents] that affect the corporation's rights, duties, and obligations."[2] The court has also explained that Section 220 demands are not the equivalent of civil discovery but instead are "a limited form of document production narrowly tailored to the express purposes of the shareholder."[3] Consistent with those observations, the court, when approving a Section 220 demand, has ordered the production of documents that "reflect the decision-making" of the corporation[4] and has noted that "[a] corporate record retains its character regardless of the medium used to create it."[5]

[1] No. 281, 2018, slip op. (Del. Jan. 29, 2019).

[2] *Chammas v. Navlink, Inc.*, C.A. No. 11265-VCN, slip op. at 21 (Del. Ch. Feb. 1, 2016).

[3] *Paul v. China MediaExpress Holdings, Inc.*, C.A. No. 6570-VCP, slip op. at 14 (Del. Ch. Jan. 5, 2012).

[4] *Dobler v. Montgomery Cellular Holding, Co.*, C.A. Nos. 18105 & 18499, slip op. at 13-14 (Del. Ch. Oct. 19, 2001).

[5] *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 793 (Del. Ch. 2016).

While the Court of Chancery first considered the issue of allowing access to emails through Section 220 in the early 2000s,[6] recently stockholders have intensified demands to inspect emails of board members and senior officers. In addressing a demand to inspect email communications belonging to a corporation's board members and management, the Court of Chancery explained in *Chammas v. Navlink, Inc.* that "subjecting Section 220 proceedings to such broad requests, even by directors, runs contrary to the 'summary nature of a Section 220 proceeding.'"[7] However, the court did not entirely shut the door on emails, explaining that "any request for communications among corporate directors and officers must (1) state a proper purpose, (2) encompass communications constituting books and records of the corporation ... and (3) be sufficiently tailored to direct the Court to the specific books and records relevant to the [petitioner's] proper purpose."[8]

More recently, the Court of Chancery emphasized that there is no bright-line rule pertaining to the types of documents subject to inspection under Section 220. As the Court of Chancery held in *Schnatter v. Papa John's*, "[W]hen considering requests for information from personal accounts and devices in Section 220 proceedings, the court should apply its discretion on a case-by-case basis to balance the need for the information sought against the burdens of production and the availability of the information from other sources, as the statute contemplates."[9] The court went on to state that:

> The reality of today's world is that people communicate in many more ways than ever before, aided by technological advances that are convenient and efficient to use. Although some methods of communication (*e.g.*, text messages) present greater challenges for collection and review than others, and thus may impose more expense on the company to produce, the utility of Section 220 as a means of investigating mismanagement would be undermined if the court categorically were to rule out the need to produce communications in these formats.[10]

Delaware Supreme Court Clarifies When Electronic Communications Must Be Produced

On January 29, 2019, the Delaware Supreme Court issued its decision in *KT4 Partners*, clarifying when it is appropriate for stockholders to inspect emails or other electronic communications. The court stated that "if a company observes traditional formalities, such as documenting its actions through board minutes, resolutions, and official letters, it will likely be able to satisfy a § 220 petitioner's needs solely by producing those books and records."[11]

The Supreme Court reversed a decision of the Court of Chancery that limited a stockholder's inspection to formal board documents, holding that the lower court

[6] *E.g.*, *Dobler*, C.A. Nos. 18105 & 18499, slip op. at 13-14.

[7] *Chammas*, C.A. No. 11265-VCN, slip op. at 21 (citation omitted).

[8] *Id.* at 21-22.

[9] *Schnatter v. Papa John's Int'l, Inc.*, C.A. No. 2018-0542-AGB, slip op. at 43 (Del. Ch. Jan. 15, 2019).

[10] *Id.* at 42.

[11] *KT4 Partners*, No. 281, 2018, slip op. at 4.

should have also allowed access to electronic communications. The plaintiff stockholder sought to inspect various categories of documents, including books and records related to amendments to an investors' rights agreement. The Court of Chancery held that the plaintiff had shown a proper purpose of investigating suspected wrongdoing related to those amendments but refused to order the corporation, Palantir, to produce email communications related to the amendments.

Palantir conceded that it conducted its business informally through email and lacked formal documents, such as meeting minutes. In light of these circumstances, the Supreme Court held that the Court of Chancery abused its discretion in refusing to allow plaintiff to inspect email communications relating to the amendments. The court reasoned that "[i]f the only documentary evidence of the board's and company's involvement in the amendments comes in the form of emails, then those emails must be produced."[12]

Importantly, the Supreme Court noted that corporations are not "defenseless" to requests for email and other electronic information. In doing so, the court reaffirmed the long-standing idea that, in connection with a Section 220 demand, a "corporation should not have to produce electronic documents" if it "has traditional, non-electronic documents sufficient to satisfy the petitioner's needs."[13]

[12] *Id.* at 35.

[13] *Id.* at 32.

Takeaways

Practitioners should closely monitor how the Court of Chancery interprets and applies *KT4 Partners*, particularly in the merger litigation context, in 2019. In the past, plaintiff stockholders challenging mergers often were able to obtain documents through expedited discovery in connection with motions for preliminary injunction. Following a series of recent decisions from the Delaware Supreme Court and the Court of Chancery,[14] and a decline in stockholder M&A injunction requests, plaintiff stockholders have had less success at obtaining pre-closing discovery through expedited proceedings. As a result, they have turned to Section 220, and the Delaware courts have approved that approach, largely on the theory that plaintiffs should have access to documents to help plead around dismissal arguments premised on the *Corwin* doctrine.[15] Many of these merger-related Section 220 demands include requests for electronic documents, and in certain cases, the courts have ordered such production.[16] The extent to which *KT4 Partners* will impact Section 220 demands in the merger context remains to be seen. Other takeaways from *KT4 Partners* and other notable cases include the following:

- Electronic communications may be considered books and records of the corporation if they affect the corporation's rights, duties and obligations or reflect the decision-making of the corporation.
- By properly documenting corporate activities, and mainly through formal books and records of decision-making, under the *KT4 Partners* decision, companies can reduce the risk of a stockholder obtaining access to email or text messages of directors and senior management.
- Directors and officers can observe corporate formalities by documenting decision-making in minutes, written consents, official letters, resolutions and formal board presentations.
- Additionally, because Delaware courts have viewed electronic communications to or from outside directors as corporate books and records, directors should consider using a company email address for all company business in order to avoid inspection of their personal devices and accounts by stockholders.
- Consult with your counsel to make sure that you establish the best protocol and practice to defend against stockholder demands to inspect emails and text messages.

[14] *C & J Energy Servs., Inc v. City of Miami General Emps'.*, 107 A.3d 1049 (Del. 2014); *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015); *In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884 (Del. Ch. 2016).

[15] *E.g., Lavin v. West Corp.*, C.A. No. 2017–0547–JRS, slip op. (Del. Ch. Dec. 29, 2017). For further discussion, see the first article in this edition, "Examining *Corwin*: Latest Trends and Results."

[16] *E.g., Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp.*, C.A. No. 2017-0910-MTZ, slip op. at 46-50 (Del. Ch. Jan. 25, 2019).