Harvard Law School Forum on Corporate Governance

Trends in Books and Records Litigation

Posted by Ed Micheletti, Bonnie David, and Alexis Wiseley, Skadden, Arps, Slate, Meagher & Flom LLP, on Tuesday, February 11, 2020

Editor's note: Ed Micheletti is partner and Bonnie David and Alexis Wiseley are associates at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum and is part of the Delaware law series; links to other posts in the series are available here.

Recently, the frequency of stockholder demands to inspect corporate books and records pursuant to Section 220 of the Delaware General Corporation Law has increased. In turn, the case law concerning Section 220 demands is rapidly developing. Section 220 demands were once conceived as the primary "tools at hand" available to stockholder plaintiffs to draft and file detailed derivative complaints. Now, given the marked decrease in M&A injunction requests and the corresponding decrease in discovery records created for that purpose, stockholder plaintiffs have increasingly turned to Section 220—particularly in the merger context—for access to documents in advance of filing post-closing class action complaints for money damages.

One practical result of decisions permitting plaintiffs to obtain merger-related documents under Section 220—which imposes the lowest possible burden under Delaware law—is a departure from long-standing precedent that required plaintiffs to withstand a motion to dismiss before obtaining discovery relating to a deal. Another general development is that books-and-records demands now frequently seek not only formal board materials, such as minutes and presentations, but also electronic communications, such as emails and text messages from personal accounts and devices. As a result, in a number of recent cases, Delaware courts have been forced to grapple with the types of electronic documents, including communications, that constitute corporate records and are required to be produced in response to a Section 220 demand. Recent decisions have addressed other issues as well, such as whether stockholders are entitled to books and records to aid in proxy contests, and the confidential status of documents produced in response to books-and-records requests.

Companies and their directors should take note of these developments and their impact on obligations to produce books and records in response to Section 220 demands.

Access to Personal Emails and Text Messages

Delaware courts are continuing to clarify when certain types of electronic documents should be made available to a stockholder or director in response to a Section 220 demand. Specifically, a number of recent cases address whether requests for emails from personal accounts and text messages stored on personal devices are properly within the scope of Section 220.

For example, in *Schnatter v. Papa John's International, Inc.*, the Court of Chancery granted a Section 220 demand made by the company's founder-director, ordering the company's directors,

CEO and general counsel to produce emails and text messages from their personal accounts and devices. In reaching its decision, the court rejected a bright-line rule that such electronic communications are not subject to production under Section 220, explaining that the scope of production pursuant to a Section 220 demand must be evaluated on a case-by-case basis.

Similarly, in *KT4 Partners LLC v. Palantir Techs. Inc.*, the Delaware Supreme Court ordered a company to produce electronic communications in response to a Section 220 demand. The court held that an order limited to formal board documents was insufficient because the plaintiff presented evidence that the company "conduct[ed] its corporate business informally over email and other electronic media," instead of through "more traditional means," such as board meeting materials and minutes. The court further explained that production of electronic communications was appropriate because the corporation failed to proffer "any evidence that other materials would be sufficient" to accomplish the plaintiff's purpose. However, in so ruling, the court noted that a corporation should not be required to produce electronic communications if other materials, such as board meeting minutes, exist and would accomplish the petitioner's proper purpose.

By contrast, in *Lebanon County Employees' Retirement Fund and Teamsters Local 443 Health Services & Insurance Plan v. AmerisourceBergen Corporation*, the Court of Chancery limited the scope of production pursuant to a Section 220 demand to "formal board materials." The court explained that "board-level documents that formally evidence the directors' deliberations" are "[t]he starting point (and often the ending point) for an adequate inspection" under Section 220, and that a plaintiff must first make a "proper showing" to access informal board materials such as "emails and other types of communication sent among the directors themselves." Although the court found that the stockholder-plaintiffs did not make such a showing, and therefore were not entitled to informal board materials, it permitted the plaintiffs to take limited discovery into how the company maintained its books and records.

In keeping with these decisions, other recent rulings—*In re Facebook, Inc. Section 220 Litigation, Bucks County Employees Retirement Fund v. CBS Corporation*, and *Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corporation*—have ordered the production of electronic communications in response to Section 220 demands. These cases further illustrate the Court of Chancery's willingness to order the production of electronic communications where board members acted informally through such means. While the types of documents stockholders are entitled to access have, in appropriate circumstances, expanded, the core inquiry—whether the documents are "necessary and essential" to achieve the stockholder's purpose—remains the same. These rulings therefore suggest that electronic communications may properly be within the scope of Section 220 to the limited extent that they are not duplicative of information available through traditional sources, such as formal board materials and minutes.

Books And Records To Aid in Proxy Contests

Section 220 permits stockholders and directors of Delaware corporations to inspect books and records where they have identified a "proper purpose" for doing so. In one recent case, *High River Limited Partnership v. Occidental Petroleum Corporation*, the Court of Chancery rejected a novel purpose for pursuing books and records, refusing to permit affiliates of activist investor Carl Icahn to inspect corporate documents for use in a proxy contest to replace members of Occidental's board of directors. The court declined to "recognize a new rule entitling stockholders to inspect documents under Section 220 if they can show a credible basis that the information

sought would be material in the prosecution of a proxy contest," as opposed to another proper purpose, such as the investigation of corporate wrongdoing or mismanagement. In addition, the court held that "a fishing expedition into the boardroom" was not "necessary and essential" to the plaintiffs' stated purpose because the plaintiffs sought documents related to transactions that already had been "widely publicized." The decision is currently on appeal.

Confidentiality of Documents Produced Pursuant to Section 220

In *Tiger v. Boast Apparel, Inc*., the Delaware Supreme Court recently offered guidance on the confidential status of documents produced in a Section 220 action, holding that there is "no presumption of confidentiality in Section 220 productions."

The plaintiff in the case filed its complaint after making two books-and-records demands, both of which the company rejected because the parties were unable to negotiate a confidentiality agreement. The Court of Chancery imposed an "indefinite confidentiality period" lasting up to and until the plaintiff filed suit based on facts learned through his inspection, and the plaintiff appealed. On appeal, the Delaware Supreme Court upheld the confidentiality order, clarifying that "the Court of Chancery may—and typically does—condition Section 220 inspections on the entry of a reasonable confidentiality order," but such inspections are "not subject to a presumption of confidentiality." The court further explained that in order to determine the degree and duration of confidentiality, the Court of Chancery must "assess and compare benefits and harms" and "cannot conclude reflexively that the need [for confidentiality] is readily apparent" in every case. The Supreme Court remanded the case, instructing the Court of Chancery to make "specific findings" as to whether the documents are confidential.

Following this precedent, in *Kosinski v. GGP Inc.*, the Court of Chancery ordered inspection, but declined to address whether the documents sought should be subject to reasonable confidentiality restrictions, explaining that "this Court does not presume that they should be" and instructing the parties to confer regarding confidentiality.

Takeaways

- Recently stockholder demands to inspect corporate books and records pursuant to Section 220 of the Delaware General Corporation Law have proliferated. Books-and-records demands are pursued not only to bolster derivative complaints, but also as back-door discovery to aid in challenging mergers and other corporate transactions. Accordingly, companies should prepare for potential books-and-records demands when a transaction is announced, and understand that when books-and-records requests are received, post-closing litigation often follows.
- Section 220 demands have evolved to permit requests seeking not only formal board materials, such as minutes and board decks, but also electronic documents, such as emails from personal accounts and text messages stored on personal devices. Recent rulings have rejected a bright-line rule that electronic communications are not subject to production under Section 220, and in some instances have required production of electronic communications and permitted discovery into how a company maintains its books and records.

- In light of the developing Section 220 case law, companies should consult with outside counsel to ensure that existing policies and procedures governing board-level record keeping are consistent with best practices and best position a company if a Section 220 demand is received. Given the complexity of these issues, companies also should consult with outside counsel immediately upon receipt of a books-and-records.
- The Delaware courts have clarified that confidentiality is not presumed in Section 220 productions. Nevertheless, where a books-and-records request is litigated and a production is ordered, the Court of Chancery typically will condition productions on the entry of a reasonable confidentiality order. Where books-and-records productions are made without court involvement, negotiating an appropriate confidentiality agreement is key.