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Books and Records Demands

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The right of stockholders to seek corporate books and records is a well-established feature of corporate law in Delaware, where most big American companies are incorporated. But the number of statutory records demands has spiked in recent years, and the scope of the requests has broadened, as Delaware courts have limited companies' defenses and taken companies to task for aggressively resisting shareholder requests.

For boards and their companies, this has potential consequences. Stockholders, many with an eye toward litigation, are sometimes able to access emails, texts and other material through a records demand that can lay the grounds for a suit. What used to be a simple matter of granting access to formal, board-level books and records reflecting board decisions now has the potential to be more expansive and disruptive if casual communications that directors and executives assumed would not be part of the "official" corporate records are revealed to potential adversaries.

Below is a primer for directors on the evolving nature of these requests and what it means for boards.

What Has Changed

Section 220 of the Delaware General Corporation Law allows stockholders to access to corporate books and records for a "proper purpose" — most commonly to "investigate wrongdoing" such as a possible breach of fiduciary duty by the board or management. The stockholder must demonstrate a "credible basis" for suspecting wrongdoing or mismanagement, but that threshold has generally been considered a low hurdle to overcome.

In the past, courts gave companies some leeway to push back where it appeared the stock holders were just fishing for evidence on which to base a suit, with no meaningful prospect for success, and they were reluctant to force companies to turn over anything other than board-level materials, such as minutes, presentations and the like.

However, as recent Delaware decisions made it harder for stockholders to sue to block a merger, stockholders have resorted more frequently to books and records demands in order to obtain evidence they can use as the basis for damages actions brought after mergers are completed. That, in turn, has spawned litigation over the scope of Section 220, and Delaware courts have

construed it broadly and restricted the grounds on which corporations can limit or refuse the requests.

Here are answers to some questions directors may have:

1. Aren't "books and records" limited to formal board-level records like minutes?

No. Increasingly, the Delaware courts are open to giving stockholders access beyond formal board materials such as minutes and board decks, particularly when a company has a history of not complying with corporate formalities. For example, a recent Delaware Supreme Court decision held that, in some circumstances, electronic communications may be "necessary and essential" for purposes of a books and records demand. In nearly every Section 220 demand since, stockholders have sought electronic communications.

The courts have indicated that a corporation should not be required to produce electronic communications if other materials such as board minutes and decks exist and would satisfy the stockholder's "proper purpose" in making the demand. However, if a company and its board conduct business informally over email and other electronic media, instead of in the boardroom and at board meetings where minutes are taken, or where the formal board materials lack the relevant information, electronic information may be considered essential to the plaintiff's investigation. No hard and fast rule has emerged from the cases, but Delaware judges are willing to allow access to informal communications in these situations.

2. Documents produced as part of a Section 220 demand will remain non-public and strictly confidential, right?

Generally speaking, yes, but not always. The Delaware courts have said that confidentiality is not presumed in Section 220 productions, but the courts have typically been amenable to allowing companies to protect the records through confidentiality agreements, and by redacting privileged attorney-client communications. If the stockholder ends up filing a lawsuit based on the records, the confidentiality agreements usually require them to be filed under seal, consistent with court rules. However, a public version will eventually become available, and only truly confidential information — such as trade secrets or other sensitive material business or personal identifying information — will remain under seal.

3. Can a company "just say no" to these Section 220 demands?

Generally, not. Delaware courts have recently expressed frustration with overly aggressive company responses to Section 220 demands. In a July 2021 ruling, where a company refused to engage with the stockholders who had clearly identified a credible basis to investigate wrongdoing, and the company failed to offer a single document before litigation commenced, the Delaware Court of Chancery ordered the company to pay the stockholders' hefty fees in pursuing the demand.

By contrast, in another case, a court commended the parties for acting reasonably and resolving many issues on their own, leaving it to the court only to decide on the exact scope of documents to be produced.

The takeaway is that judges like to see corporations try to resolve Section 220 demands amicably before the matter spills into court.

4. What defenses can a company raise in fighting a books and records demand?

In a significant shift, the Delaware Supreme Court said in December 2020 that companies cannot resist a records demand on the ground that the alleged mismanagement or wrongdoing could not, if raised in a subsequent complaint, withstand a motion to dismiss. And a stockholder does not have to specify the precise ends to which they might use any books or records.

Some defenses remain, however, including technical compliance with the statute and whether or not the stated purpose of the demand is the true purpose. Companies can also still challenge the stockholder's standing to make a demand and the scope of the request.

5. What can a company do to better position itself to respond to a potential Section 220 demand?

There's no way to guarantee that emails or texts will not have to be produced in response to a Section 220 demand. With the changing law, it is vital to assess your corporation's policies and procedures governing board-level record-keeping.

- The board's use of electronic communications for discussions and decision-making deserves particular attention. Directors should consider limiting written electronic communications within the board to formal communications. Ideally, directors should avoid quick, informal emails or text messages about material matters.
- Substantive discussions are better suited for calls and meetings, and electronic communications are best used for logistical purposes, such as scheduling.
- Board members may also want to consider communicating only through authorized means, such as a board portal or dedicated email accounts. If directors use personal email accounts, or those of other companies with which they are affiliated, for board-level communications, those accounts may be accessed if a court finds that necessary to satisfy a records demand.
- It is also important to consider the tone and content of all written communications. A good rule of thumb, before texting or emailing, is to ask, "Would you want to read this in a newspaper?"

The bottom line is that directors should assume that their business-related communications — including those in emails, texts, voicemail messages, social media posts, etc. — might be made available to stockholders through a records demand, even if there is no litigation yet. But maintaining current, consistently enforced internal policies regarding board-level communications can help limit the risk that the company will have to turn over informal communications that might be misinterpreted or unfairly used against the company.