Current Bounds on Books and Records Demands

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For decades, Delaware courts have encouraged stockholders to use the "tools at hand" — before initiating lawsuits — by obtaining corporations' books and records through 8 *Del. C.* § 220 (Section 220). As described in prior articles,[1] in recent years, stockholder plaintiffs utilized this tool with increased frequency, resulting in the Delaware courts issuing further guidance to litigants as they assess their rights and obligations under the statute.

Although Delaware courts have placed limits on defenses for companies in the Section 220 context over the past few years, decisions issued in recent months serve as a reminder that books and records demands are not an "open sesame" for stockholders. Delaware courts have reaffirmed that although the burden to demonstrate a "credible basis" to suspect wrongdoing before being allowed to access books and records is a low bar for stockholders to meet, it is not inconsequential. Delaware courts have also continued to emphasize that formal board-level materials are typically the starting point *and* ending point of a Section 220 inspection, rejecting stockholders' attempts to access emails and text messages through a books and records demand.

The Collar Around the Credible Basis Standard

Under Section 220, a stockholder plaintiff must have a proper purpose for seeking a corporation's books and records. When that purpose is to investigate possible wrongdoing, she bears the burden to demonstrate a "credible basis" to suspect that wrongdoing has occurred. Although the credible basis standard "sets the lowest possible burden of proof"[2] under Delaware law, three recent Section 220 decisions provide guidance regarding the type of evidence necessary to satisfy this burden, and reiterate that stockholders must allege *some* evidence to suggest that wrongdoing occurred.

In *NVIDIA Corp. v. City of Westland Police & Fire Retirement System*,[3] the Delaware Supreme Court affirmed the Court of Chancery's holding that potential wrongdoing could be inferred. The Delaware Supreme Court accepted allegations that the defendants had potentially manipulated stock prices, "connecting the dots" based on public statements, timing of stock sales and the contents of a federal securities complaint. The Supreme Court explained that when demonstrating a credible basis to infer wrongdoing or mismanagement, a Section 220 plaintiff is not confined to one single theory of what wrongdoing occurred.[4] Further, the Supreme Court clarified that a stockholder plaintiff may rely on hearsay in a Section 220 proceeding if it is "sufficiently reliable."[5]

In *Hightower v. SharpSpring, Inc.*, Chancellor Kathaleen St. J. McCormick provided guidance on what does, and what does not, support a "credible basis" for wrongdoing[6] The court found a credible basis to suspect potential wrongdoing where discrepancies between proxy statement disclosures and board minutes revealed an executive's potential conflict in preserving value in a bonus pool from which he would have benefited in a merger.[7] On the other hand, the court rejected the plaintiff's argument that a director's

[1] Edward B. Micheletti, Jenness E. Parker and Bonnie W. David, *Developments in Delaware Corporation Law*, Westlaw (Feb. 2, 2021).

[2] *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006).

[3] No. 259, 2021 (Del. July 25, 2022).

[4] *Id.* at 46.

[5] *Id.* at 38.

[6] C.A. No. 2021-0720-KSJM, at *16 (Del. Ch. Aug. 31, 2022).

[7] *Id.* at 6-7, 15-16.

resignation during the sale process provided a credible basis to infer wrongdoing, explaining that the resignation was "of no moment in the court's eyes" because "[s]ales processes happen all the time and can demand much from a director."[8]

Finally, in *Oklahoma Firefighters Pension & Retirement Systems v. Amazon.com, Inc.*,[9] Vice Chancellor Lori W. Will determined that a stockholder failed to prove a credible basis of wrongdoing. In so holding, the court explained that, despite being the "lowest" standard of proof under Delaware law, the credible basis standard nevertheless is "not inconsequential."[10] Rejecting the plaintiff's attempt to rely on government investigations and litigation against Amazon, the court explained that "Delaware law does not … provide that evidence of open inquiries and lawsuits alone necessarily begets a credible basis from which the court can infer possible mismanagement."[11] Rather, the severity or results of the inquiries must be considered, as well as whether "corporate trauma" occurred.[12] The court concluded that the investigations had not resulted in adverse outcomes and that the litigation either was ultimately dismissed or unrelated to alleged violations the plaintiff sought to investigate.[13]

Production of Formal Board Materials — No More and No Less

Delaware courts repeatedly have held that the starting point, and often the ending point, for a books and records inspection is typically "formal board materials" — minutes of meetings and supporting materials, such as presentations, that were provided to the board of directors or committees at official meetings.[14] In two recent decisions, the Court of Chancery reaffirmed this rule, particularly where companies voluntarily produced formal board materials prior to being in court on the Section 220 demand.

In *Amazon*, the court noted favorably that the company had produced sufficient board materials in response to the stockholder's demand, having taken "the lessons of [Delaware] case law to heart" and producing formal board materials despite questioning the basis for the plaintiff's demand.[15] After receiving formal board materials, the plaintiff pressed for informal records. The court found that in addition to the plaintiff's inability to demonstrate a credible basis to suspect wrongdoing, "the plaintiff [could not] prevail for another, simpler reason: the demand was satisfied. Amazon produced all necessary and essential documents related to the alleged wrongdoing discussed in the demand."[16] In its ruling, the court further noted that a company may redact board materials to the extent contents do not relate to the stockholder's stated purpose, which serves to balance companies' desire to cooperate and stockholders' entitlement to "necessary and essential" documents.[17]

Similarly, in *Frank v. National Holdings Corp.*,[18] Vice Chancellor Morgan T. Zurn explained that when a company has produced formal, board-level materials, as it did in this case, the plaintiff bears the burden to show that "the formal board materials and other documents he already has are not sufficient and that additional communications are necessary."[19] The court rejected the plaintiff's request for such communications, noting that "[h]ere, as in *Amazon*, extensive and sufficient materials and minutes were produced" and the company "produced over 30 sets of detailed meeting minutes, presentations from the special committee's financial advisor, and resolutions."[20]

Stockholders Cannot Shift Gears in Litigation

Delaware courts have held that if, after making a books and records demand, a stockholder expands the scope of documents she is

[8] *Id.* at 17.

[9] C.A. No. 2021-0484-LWW (Del. Ch. June 1, 2022).

[10] *Id.* at 16.

[11] *Id.* at 17.

[12] *Id.* at 19.

[13] *Id.* at 21-26.

[14] *Id.* at 30-31; *Hightower* at 20.

[15] *Id.* at 29.

[16] *Id.* at 2.

[17] *Id.* at 33.

[18] C.A. No. 2021-0160-MTZ (Del. Ch. July 22, 2022) (TRANSCRIPT).

[19] *Frank* at 19-20.

[20] *Id.* at 20.

seeking, then the corporation is improperly deprived of its ability to consider the request outside of litigation. In two recent cases, the Court of Chancery emphasized that a plaintiff may not use litigation to change her purpose or expand the scope of her demand.

In *Amazon*, the court made clear that a stockholder must assert evidence underlying her theories of possible mismanagement in her pre-suit demand or in her pleadings, not just prior to or at trial.[21] In *Frank*, the court explained that a stockholder cannot belatedly seek to expand the topics of documents sought in his demand once litigation has begun; rather, the company must be given an opportunity to respond to the demand before litigation is initiated.[22]

[21] *Amazon* at 23-25.
[22] *Frank* at 12-13.

Takeaways

- Recent Delaware decisions underscore that the credible basis standard, while low, is not inconsequential. Rather, the stockholder must establish, through documents, logic, testimony or otherwise, a possibility that wrong-doing occurred. In meeting that burden, a stockholder may rely on hearsay if it is sufficiently reliable.
- Delaware courts encourage the voluntary production of documents to resolve Section 220 demands or to limit the scope of litigation concerning a demand. However, the court will still assess whether a stockholder has stated a proper purpose for her demand even when the corporation has already agreed to produce a subset of the documents requested.
- Recent Delaware decisions further emphasize that formal, board-level materials are typically the beginning and end of a Section 220 request. Voluntarily producing formal board materials may position a corporation to assert in litigation that it has produced all documents necessary and essential to the stockholder's purported purpose.
- A plaintiff may not use litigation to change her purpose or expand the scope of her demand, which would deprive the company of the opportunity to assess the demand outside of litigation.

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Special thanks to **Stephen F. Arcano** and **Richard J. Grossman**.

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