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Books and Records Demands 2023 Recap

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As discussed in prior articles, stockholder plaintiffs have increasingly sought to obtain companies' books and records under 8 Del. C. § 220 (Section 220) and the Delaware Limited Liability Company Act's analogous provision, Section 18-305(a), which has led the Court of Chancery to face a record number of books and records actions. In response, over the past year, Chancellor Kathaleen St. J. McCormick has begun assigning books and records actions to magistrates in Chancery in an attempt to reduce the court's ballooning docket.

While magistrates are now also contributing to books and records case law, existing trends for books and records actions appear, at the moment, to remain roughly the same. The court has reiterated that a stockholder's burden to establish a proper purpose for inspection is low but not inconsequential. Moreover, a stockholder can only obtain those documents that are necessary and essential to the stockholder's purpose, and formal board-level materials are typically the starting point and ending point for inspection.

The court also continues to shift fees when defendant companies engage in extreme and vexatious litigation conduct. Finally, this past year saw an order from the Delaware Supreme Court that clarified the standard for the confidential treatment of documents provided in response to a books and records demand.

A New Process Is Adopted for Recently Filed Actions

Accompanying the increase in books and records actions assigned to magistrates, the court has in recent months set forth a new process that is intended to clearly identify and potentially narrow the disputes at issue between the parties.

The new procedure works as follows:

- After a books and records action is filed, the court issues a letter directing the parties to promptly meet and confer regarding any defenses the defendant company intends to assert and instructing the defendant company to identify the location of documents sought.

- If documents pertaining to certain categories do not exist, the defendant must indicate as much.

The court has also reminded parties that books and records actions are summary in nature and should be resolved within 90 days. Accordingly, the court expects that proceedings in front of a magistrate reach final resolution within 60 days so that the exceptions process permitted by Court of Chancery Rule 144 can be timely completed.

The court encourages parties to submit the action to the magistrate for a final decision, not subject to further judicial review, if they prefer a more leisurely schedule.

The Court Largely Continues To Focus Its Analysis on the Scope of Inspection

Despite shifts in process and assignment, the substantive trends in books and records actions remain largely the same, with the focus being on whether the requested documents are necessary and essential to the plaintiff's purpose. However, one notable exception to the trend of Delaware courts finding a proper purpose is *Simeone v. Walt Disney Company*, 302 A.3d 956 (Del. Ch. 2023).

In *Disney*, the stockholder sought books and records to investigate alleged wrongdoing and potential breaches of fiduciary duty in connection with Disney's opposition to Florida House Bill 1557, also known as the "Don't Say Gay" bill. In response to the demand, Disney voluntarily produced 73 pages of board minutes and corporate policies related to the company's opposition, but the stockholder continued to seek the production of electronic communications.

Vice Chancellor Lori W. Will held that the stockholder's disagreement with Disney's business decision to publicly oppose a bill did not provide a credible basis to suspect wrongdoing. The court also determined that the demand's stated purposes belonged to the stockholder's counsel, not the stockholder, given the stockholder's limited and non-substantive involvement in the demand and litigation.

Finally, Vice Chancellor Will held that, even if the stockholder had stated a proper purpose, he was not entitled to additional documents because the produced formal materials contained all the necessary and essential information.

Following *Disney*, two decisions from Magistrate Bonnie W. David reiterated that, generally, the production of formal, board-level materials is all that is necessary and essential.

Pompano Beach General Employees' Retirement System v. Wells Fargo & Co. involved an ESG-related matter like that at issue in *Disney*. C.A. No. 2023-0656-BWD (Del. Ch. Sept. 14, 2023) (Transcript). Specifically, a stockholder served a Section 220 demand related to the Wells Fargo board's

handling of allegations related to diversity hiring practices. After Wells Fargo voluntarily produced formal board- and officer-level documents, the stockholder demanded email communications.

At a one-day paper trial, the parties limited their arguments to the scope of the demand. Magistrate David held that, in the aggregate, the formal materials already provided were sufficient to understand what information the board received about the allegations, when it received that information and the board's response. No evidence suggested that the board acted outside formal channels, and the stockholder was not entitled to fish for potentially relevant emails without such evidence.

Likewise, in *In re Zendesk, Inc. Section 220 Litigation*, Zendesk voluntarily produced board-level documents in response to demands seeking to investigate potential wrongdoing in connection with an all-stock merger. 2023 WL 5496485 (Del. Ch. Aug. 25, 2023). Unsatisfied, the plaintiffs claimed there were "gaps" and "inconsistencies" in the formal board materials.

Magistrate David held that the stockholders failed to establish that electronic communications were essential to accomplish their purpose, where the board honored corporate formalities during the deal process and the produced formal materials answered "the who, what, where, when, and why of the possible wrongdoing." The court noted that the stockholders were not entitled to "discovery-style email production" in order to "flesh out [their] theories" with incremental details.

Fee-Shifting in Extreme Circumstances

Over the past year, the court continued to shift fees against defendant companies where the conduct was extreme and vexatious. In *Myers v. Academy Securities, Inc.*, Magistrate David partially shifted fees when the company took frivolous positions in response to the demand and adopted continually shifting defense theories. 2023 WL 6380449, at *2 (Del. Ch. Oct. 2, 2023), *report and recommendation adopted* (Del. Ch. 2023).

The court stated that the company raised "baseless factual assertions and legal red herrings" during the litigation, including by "focus[ing] significant time on an irrelevant argument that Plaintiff technically violated regulatory requirements …, which seemed intended more to harass or embarrass than to undermine Plaintiff's entitlement to books and records."

The court noted that, although "[i]ndividually, these arguments would not justify fee-shifting, … in the aggregate, they reflect an unfortunate pattern of unreasonable positions designed to unnecessarily complicate the proceedings."

Similarly, in *Seidman v. Blue Foundry Bancorp*, Vice Chancellor Morgan T. Zurn shifted fees where the defendant company "took a series of litigation positions that, when viewed collectively, were glaringly egregious." 2023 WL 4503948, at *6 (Del. Ch. July 7, 2023).

Among other things, the court determined that the defendant company:

- Made frivolous arguments, including that the plaintiff was required to demonstrate an actionable claim, even though Delaware law is clear that a Section 220 action "is not the time for a merits assessment of [a plaintiff's] potential claims."
- Refused to permit inspection of any documents, even formal board materials that, under prevailing law, "should nearly always be produced."
- Insisted that the plaintiff, a resident of Florida, appear in person for a half-day deposition in Delaware, forcing the plaintiff to engage in needless motion practice.
- Sandbagged the plaintiff with an improper purpose defense after the close of discovery, despite asserting in an earlier interrogatory that it would not raise that defense.

Moreover, in *Bruckel v. TAUC Holdings, LLC*, Vice Chancellor Zurn again shifted fees in an action by a manager of an LLC to inspect books and records related to his status as a manager. 2023 WL 4583575, at *1 (Del. Ch. July 17, 2023).

The court found that the defendant company engaged in bad faith conduct by, among other things:

- Arguing that the plaintiff lacked a proper purpose, even though it is clearly established under Delaware law that managers need not have a proper purpose to inspect books and records.
- Failing to identify whether formal board materials existed.
- Holding more than 60 manager meetings without the plaintiff (and without one additional manager on a rotating basis) "in order to represent to Plaintiff that no Board meetings were held or no Board materials existed."

To be sure, fees are not shifted as a matter of course. The court continues to deny fee requests where extreme circumstances are not present.[1]

Delaware Supreme Court Further Clarifies Standard for Confidentiality

In *Rivest v. Hauppauge Digital, Inc.*, the Court of Chancery adopted a magistrate's recommendation that the defendant company produce annual and quarterly financial statements, but rejected the magistrate's recommendation that the documents be subject to a confidentiality restriction. 2022 WL 3973101 (Del. Ch. Sept. 1, 2022).

[1] See, *e.g., Meehan v. Tiger Analytics, Inc.*, 2023 WL 6053017, at *3 (Del. Ch. Sept. 18, 2023), report and recommendation adopted (Del. Ch. 2023) (holding that, although nine-month delay in producing documents was dilatory, such delay was not in bad faith where the company did not follow corporate formalities, and good faith efforts were made to finalize and produce documents).

Vice Chancellor J. Travis Laster stated that there is no "presumption of confidentiality" for documents produced in response to a books and records demand and that the defendant company bore the burden of establishing a need for a confidentiality restriction. Vice Chancellor Laster held that the company failed to meet its burden because its concerns regarding competitor use of information were not credible. The court also stated that even if the company's concerns were credible, they were outweighed by the stockholder's countervailing interest in determining the value of his stock.

On appeal, the Delaware Supreme Court upheld the Court of Chancery's decision, stating that in the absence of compelling evidence showing the need for confidentiality, the lower court's rejection of such a provision was not an abuse of its discretion. *Hauppauge Digital, Inc. v. Rivest*, 300 A.3d 1270 (Del. 2023). The Supreme Court held that the Court of Chancery properly weighed the parties' legitimate interests consistent with Delaware precedent when it had concluded that placing confidentiality restrictions on financial statements for closed periods did not outweigh the stockholder's interest in free communication when attempting to value its stock.

Key Points

- While the new process for books and records actions appears to place a larger burden on defendant companies at an earlier stage of the proceedings, it is intended to minimize the scope of the disputes at issue. It is likely that this process will be further developed and refined as it is utilized more.
- Given that Delaware courts generally hold that a stockholder has established a proper purpose, most corporate defendants are well advised to consider producing board-level documents in response to a demand. However, if a stockholder insists on documents that go beyond formal, board-level materials, there is a significant amount of Delaware precedent holding that such materials need not be produced.
- If defendant companies engage in extreme or vexatious litigation conduct, including taking meritless defense positions, forcing needless motion practice and refusing to produce any board-level documents in the face of an established right, the Court of Chancery may shift fees.
- There is no *per se* rule that the documents provided in response to a books and records demand are confidential. To receive confidential treatment of its documents, a company must identify specific reasons why the documents should be subject to confidentiality restrictions.