

The Shifting Landscape and Proliferation of Books and Records Demands in Delaware

Section 220 of the General Corporation Law of the State of Delaware provides stockholders with the right to inspect the books and records of a corporation for a “proper purpose” that is “reasonably related to such person’s interest as a stockholder.”

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Section 220 of the General Corporation Law of the State of Delaware provides stockholders with the right to inspect the books and records of a corporation for a “proper purpose” that is “reasonably related to such person’s interest as a stockholder.” Delaware courts have long urged stockholders to utilize Section 220 investigations as one of the “tools on hand” prior to filing derivative lawsuits. Use of Section 220 by stockholders has increased steadily in recent years and has been met with what the Delaware Court of Chancery has recently characterized as “massive resistance” by defendant corporations. In *Petry v. Gilead Sciences, Inc.*, 2020 WL 6870461 (Del. Ch. Nov. 24, 2020), the Court of Chancery observed that the defendant’s “overly aggressive defensive strategy epitomized a trend” in which “defendants are increasingly treating Section 220 actions as ‘surrogate proceeding[s] to litigate the possible merits of the suit’ and ‘place obstacles in the plaintiffs’ way to obstruct them from employing it as a quick and easy pre-filing discovery tool.’” Suggesting the desire to curtail this kind of behavior, the court granted the plaintiffs leave to move for fee-shifting. This “trend” in “overly aggressive defensive strategy”—if such trend does exist—is likely in response to the recent proliferation of books and records demands, especially in the context of stockholder investigations of potential *Caremark* claims, and the ever-broadening categories of documents that are being sought in such demands.

The increased focus on the fiduciary duty of oversight following *Marchand v. Barnhill*, 2019 WL 2509617 (Del. 2019), has led to a rise in Section 220 demands brought by stockholders for the purpose of investigating potential breaches of such fiduciary duty (also known as “*Caremark* claims”). For example, in *In re Facebook, Inc. Section 220 Litig.*, 2019 WL 2320842 (Del. Ch. May 31, 2019), the Delaware Court of Chancery ordered Facebook to produce to certain stockholders documents that were deemed “necessary and essential to [their] investigation of *Caremark*-based claims” arising from an unauthorized release of confidential Facebook user data to Cambridge Analytica, a data analytics firm. In *Petry v. Gilead*, the Delaware Court of Chancery held that the plaintiffs had established a credible basis to infer wrongdoing in connection with the development and commercialization of Gilead’s HIV treatments and therefore had stated a proper purpose for inspection under Section 220. In *Jacob v. Bloom Energy Corp.*, 2021 WL 733438 (Del. Ch. Feb. 25, 2021), the Delaware Court of Chancery granted stockholder the right to inspect certain documents for the purpose of investigating potential mismanagement by the company’s board of directors in connection with alleged misrepresentations in Bloom’s financial statements and the performance of its “green” energy technology. In one of the more recent cases, *Gross v. Biogen Inc.*, 2021 WL 1399282 (Del. Ch. Apr. 14, 2021), the Delaware Court of Chancery granted stockholders the right to inspect certain board documents for the purpose of investigating potential wrongdoing by the board in connection with certain state and federal investigations into Biogen’s sales and promotional practices and potential violations of federal kick-back rules. This trend suggests corporations can generally anticipate that, following a public announcement of bad news, it is becoming increasingly likely they will receive one or more Section 220 demands from stockholders seeking to investigate potential oversight failures by directors or officers in connection with the underlying event.

The proliferation of Section 220 demands has been further fueled by the Delaware Supreme Court's recent opinion in *AmerisourceBergen Corp. v. Lebanon County Employees' Retirement Fund*, 2020 WL 7266362 (Del. Dec. 10, 2020), a case in which the plaintiffs again sought to inspect the corporation's books and records in connection with their investigation into *Caremark* claims or potential wrongdoing. The investigation focused on whether the corporation wrongfully distributed opioids. The Supreme Court held, among other things, that "when a Section 220 inspection demand states a proper investigatory purpose, it need not identify the particular course of action the stockholder will take if the books and records confirm the stockholder's suspicion of wrongdoing." The Court further ruled that an investigating stockholder is not always required to establish that the wrongdoing under investigation is actionable, although "actionability" can be a relevant factor for the Court of Chancery to consider when assessing the legitimacy of a stockholder's stated purpose. The court emphasized that to obtain books and records under Section 220, a stockholder need only show, "by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement or wrongdoing warranting further investigation." This clarification by the court will likely further fuel the proliferation of Section 220 demands, both by emboldening stockholders who might otherwise have been reluctant to bring Section 220 demands due to a concern that the alleged wrongdoing at issue was not actionable and by making it easier for stockholders to meet the credible basis threshold and obtain documents.

As use of Section 220 has expanded, so too has the scope of records that plaintiffs seek to inspect. Though the appropriate scope of inspection is limited to those books and records that are necessary and essential to accomplish the stockholder's stated, proper purpose, the categories of documents available for stockholder review have expanded in recent years from traditional books and records (such as board minutes and board books) to less traditional records, such as officer-level documents, corporate emails, personal emails, text messages and privilege logs. For example, in *KT4 Partners LLC v. Palantir Techs. Inc.*, 2019 WL 347934 (Del. Jan. 29, 2019), the Delaware Supreme Court found that emails were necessary to accomplish the stockholder's purpose and therefore should be produced in response to the Section 220 demand. The Delaware Court of Chancery had found that the corporation had "a history of not complying with required corporate formalities, such as the requirement that it hold annual stockholders' meetings," and the Delaware Supreme Court considered evidence that the corporation "conducted other corporate business informally, including over email in connection with the [relevant transactions]." Accordingly, the court found 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." More recently, in *Employees' Retirement System of Rhode Island v. Facebook, Inc.*, 2021 WL 529439 (Del. Ch. Feb. 10, 2021), the Delaware Court of Chancery ordered the production to a stockholder of non-privileged electronic communications—which included emails and text messages—for the purpose of investigating whether Facebook overpaid in its \$5 billion Federal Trade Commission settlement in order to protect its CEO from substantial personal liability. In rendering its opinion, the court explained that the materials previously provided did not allow the stockholder "to engage in the kind of investigation contemplated by Section 220," noting that the special committee report and heavily redacted board minutes provided little, and the privilege log provided no, substantive insight into the board's decision making. Accordingly, the court found the production of emails and text messages to be necessary to assess the process undertaken by the board to reach the FTC settlement. Though the scope of production is highly fact-dependent and will turn on the court's assessment of whether specific types of materials are necessary to investigate the identified issues, the willingness of Delaware courts to provide stockholders with non-traditional documents when deemed necessary emphasizes the importance of following corporate formalities and maintaining detailed minutes of board meetings.

As a result of these trends, Section 220 litigation in Delaware has been undergoing a rapid shift from a preliminary proceeding with limited scope to one that is more complicated and costly for defendant corporations—resulting in the

production of a wide range of documents that had traditionally only been available in pre-trial discovery. With no sign that these trends will slow in the foreseeable future, corporations should recognize that the stakes in Section 220 litigations can be high and they should consult qualified outside counsel as soon as they receive a Section 220 demand. In addition, corporations should consider preparing for and attempting to mitigate the risks of potential Section 220 litigation by ensuring that board minutes thoroughly and accurately document corporate actions and the processes related thereto and the board's consideration of material risks facing the corporation.

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