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Implications for Section 220 'Books and Records' Demands Following High River Limited Partnership

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Section 220 Demands

Section 220 of the Delaware General Corporation Law ("DGCL") provides that "[a]ny stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose, and to make copies and extracts from... [t]the corporation's stock ledger, a list of its stockholders, and its other books and records." While the statutory language of the DGCL has been interpreted as setting a low bar for what would constitute a "proper purpose," Delaware courts have long held they will not interpret the language as "a mere speed bump." *Hoeller v. Tempur Sealy Int'l, Inc.*, 2019 WL 551318, at *1 (Del. Ch. Feb. 12, 2019).

Delaware courts consider Section 220 inspection rights to be "qualified out of considerations that are practical, rather than equitable." *Pa. Transp. Auth. v. Abbvie, Inc.*, 2015 WL 1753033, at *10 (Del. Ch. Apr. 15, 2015). As held by the court in *Pa. Transp. Auth*, "if a stockholder were permitted to inspect records out of a sense of mere curiosity, or to satisfy a desire to oversee matters properly within the province of corporate management . . . a considerable expense and distraction would be foisted upon the company and its (less curious) stockholders." Id.

The outer boundaries of a permissible purpose remain "murky" at best, however, and "mere disagreement with a business decision" is not sufficient to state a proper purpose in a books and records demand. The Delaware courts have illustrated deference to the business judgement rule in the context of a Section 220 demand.[1]

In *High River*, plaintiffs sent a demand letter to defendant corporation seeking to inspect books and records in furtherance of an anticipated proxy contest, and specifically requesting books and records relating to (1) the Occidental-Anadarko merger, (2) defendant corporation's decision to be buyer rather than seller in such transaction and (3) provisions of defendant corporation's organization documents relating to requirements to call a special meeting of stockholders. The plaintiffs proffered two "proper purposes" in support of their demand request: (A) an intended proxy contest and related communications with existing stockholders, and (B) that plaintiffs had "established a credible basis to infer corporate mismanagement or wrongdoing." 2019 WL 6040285 at 12-13.

The court held that (1) it will refuse to enforce Section 220 demands that are merely for purposes of furthering a proxy contest and (2) while the court acknowledged certain instances where limited requests in furtherance of a proxy contest relating to either "purely logistical information" (such as how to communicate with other stockholders) or confirming certain corporate actions that specifically impact the proxy contest demands and bargaining positions of the plaintiff stockholders (such as whether the corporation had actually completed certain previously negotiated and agreed governance reforms) may be entertained,[2] it refused to broadly support proxy actions as a proper purpose for Section 220 demands. In line with the court decisions discussed above, the court's decision in *High River* also seems to be implying that a Delaware court would assume a deferential view of a corporation's business judgment.

Caremark Duty of Loyalty Claims

However, there are other avenues for stockholders to explore their legitimate inquires about a board's behavior. If the appropriate facts are present, stockholders could also pursue a breach of duty of loyalty under *Caremark*. See *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). Under *Caremark*, "directors have a duty 'to exercise oversight' and to monitor the corporation's operational viability, legal compliance, and financial performance." See *Marchand v. Barnhill*, 212 A.3d 805, 809 (Del. Ch. 2019) (quoting *Caremark*, 698 A.2d at 971). For a stockholder to prevail on a *Caremark* claim, the stockholder must show a fiduciary acted in bad faith, which is established under *Caremark* as when a director fails to make a good faith effort to implement an oversight system and then monitor it. See id. at 821. However, directors have a lot of discretion to design oversight systems tailored to their business's needs and resources, making *Caremark* claims difficult to plead and prove. Id. at 820. Accordingly, stockholders must plead their claims with particularized facts. Id. However,

if successful, stockholders could receive damages with respect to their *Caremark* pleadings. See *Melbourne Mun. Firefighters' Pension Trust Fund v. Jacobs*, 158 A.3d 449 (Del. Ch. 2017) (stating that in typical *Caremark* cases plaintiffs argue that defendants are liable for damages).

There is no guarantee that a *Caremark* claim will grant a stockholder access to a corporation's books and records under Section 220. However, pleading a *Caremark* claim may further the underlying factual basis or assertion about a board's underlying behavior associated with a Section 220 demand. For example, in *Melzer v. CNET Networks, Inc.*, 934 A.2d 912, 915 (Del. Ch. 2007), a federal district court held that while a stockholder had failed to plead a *Caremark* claim, the facts surrounding the *Caremark* claim were sufficient for the stockholder to establish a proper purpose for a Section 220 demand. Consequently, the court dismissed the case without prejudice so that the stockholder could use Section 220, which the court later granted. Id. at 920. See also *Security First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 568-69 (Del. 1997) (granting a stockholder's Section 220 demand after finding that while a stockholder's inference about possible wrongdoing could not have supported an actionable *Caremark* claim, it was sufficient to establish a proper purpose).

Conclusion

In light of these developments, stockholders making Section 220 books and records demands should be sure to (1) clearly demonstrate corporate mismanagement or wrongdoing (where applicable) and (2) clearly state the valid purpose for which such books and records will be used by the stockholder, and not merely rely on a purpose of pursuing a proxy contest and/or disagreement with a management business decision as the basis of demanding books and records. Where the basis of a Section 220 demand request relates to a business decision of the corporation, a stockholder must show a credible basis for an inference that management suffered from some self-interest or failed to exercise due care in a particular decision, or in other words, violated a fiduciary duty. See *Deephaven Risk Arb. Trading Ltd. V. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *5 (Del. Ch. Aug. 30, 2004).

It is also important to note that stockholders should also draft their Section 220 demands with specificity. As noted in *Norfolk Cnty. Ret. Sys. v. Jos. A. Bank Clothiers, Inc.*, "[T]o warrant relief, a demand for books and records must be sufficiently specific to permit the court (and the corporation) to evaluate its propriety.... '[U]nless a demand in itself unspecific as to purpose can in some way successfully be given an expanded reading viewed in the light of surrounding circumstances[,] a vague demand without more must a fortiori be deemed insufficient.'" 2009 WL 353746, at *11 (Del. Ch. Feb. 12, 2009) (quoting *Weisman v. W. Pac.*

Indus., Inc., 344 A.2d 267, 269 (Del Ch.1975)) (citing *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 260 A.2d 428, 429 (Del.1969)).

Finally, where the facts lend themselves to such a claim, it may be strategic for stockholders to plead their Section 220 demands in conjunction with a *Caremark* claim because it may result in the granting of the Section 220 demand. However, it is imperative that to do so, stockholders demonstrate a credible showing of legitimate issues of wrongdoing as they relate to oversight system and illustrate they are seeking books and records to further investigate and determine the nature of the wrongdoing and what further actions may be appropriate based on that information. See *Sec. First*, 687 A.2d at 568.

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[1] See *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 122 (Del. 2006) (affirming the Chancery Court finding that a "disagreement with the business judgement of Verizon's board of directors or its compensation committee is not evidence of wrongdoing and did not satisfy [plaintiff's] burden under section 220"); *Marathon P'rs L.P. v. M & F Worldwide Corp.*, 2004 WL 1728604, at *4 (Del. Ch. July 30, 2004) ("Stockholders cannot satisfy [the credible basis] burden merely by expressing disagreement with a business decision.").

[2] The court explicitly hints at this. "The law regarding whether a stockholder's desire to communicate with other stockholders is a proper purpose to justify inspection is, at best, murky. It may well be that, in the right case, this court might endorse a rule that would allow a stockholder to receive books and records relating to questionable, but not actionable, board-level decisions so that he can communicate with other stockholders in aid of a potential proxy contest. After carefully considering the evidence and the arguments of counsel, however, I am satisfied this is not that 'right case.'"

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