Sharpening the Tools at Hand: New Rulings Provide Sensible Balance to Section 220 Litigation

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Section 220 of the General Corporation Law of the State of Delaware is the statute allowing shareholders of a Delaware corporation to seek books and records for various purposes, including to investigate potential corporate wrongdoing, among other things. When properly utilized, stockholder use of the Section 220 remedy should help avoid litigation where corporate records can correct misconceptions about how and why questionable events took place, resulting in a higher quality of the claims that are actually pursued to litigation.

Over the last decade or more, the courts of Delaware at first suggested, and then nearly insisted, that plaintiffs utilize the statute to conduct pre-filing investigations prior to bringing cases challenging fiduciary misconduct in transactions and other contexts. The response has been the widespread use of Section 220 among Plaintiffs' counsel to conduct pre-filing investigations.[1]

As the use of Section 220 as a pre-filing investigative tool has expanded, issuers have responded by attempting to make what was designed as a "summary" and "streamlined" proceeding into protracted, burdensome and expensive litigation. Although in the past issuers routinely settled Section 220 demands short of litigation, more recently, the apparent desire to test the boundaries of the statute and to develop methods to slow the stream of investigations seems to be high on the list of the defense bar. An often repeated (but apparently false) etymology of the word "sabotage" ascribes the source of the word as the practice of laborers throwing their wooden shoes, or "sabots" into machinery to disrupt production.[2] Whether the story is false or not, it serves as an apt metaphor for the latest defense strategies to foul the workings of the streamlined and summary Section 220 litigation in practice.

Defendants' most recent attempts to "sabotage" Section 220 litigation and the Delaware courts' sensible response to these incursions is best seen in several recent decisions, including the recent post trial decision in the *AmerisourceBergen* case, as well as the bench ruling issued just last week in the *Gilead Sciences* litigation.

How to Try the Section 220 Case?

Readers are likely to find it passing strange that, given the rich vein of Section 220 litigation in Delaware, defendants are claiming that it is an open question as to how Section 220 cases should be tried. That, however,

[1] The upsurge in Section 220 cases was noted as long ago as 2006. *See, e.g.* Norman, S. *Books and Records Litigation: The Precursor to Derivative and Class Actions*, (Jan. 1, 2006), *available at* https://www.potteranderson.com/newsroom-publications-147.html, noting "close to ninety 'books and records' complaints filed" between January 2003 and November 2004.

[2] Amusingly, *Wikipedia* tracks the origin of the false etymology to the 1991 movie *Star Trek VI*. Whether the story first emerged there or elsewhere is a topic for a separate article.

is precisely what is happening. Until recently, litigants on both sides of the "v" generally agreed that the law was more or less settled that, in order to investigate possible wrongdoing by accessing corporate books and records, a plaintiff needed to bear the dual burdens at trial of demonstrating a "proper purpose" and showing that the records being sought were "necessary and essential" to that purpose. Where the "purpose" identified was to investigate potential wrongdoing, the law required the demanding shareholder to be able to demonstrate a "credible basis" that wrongdoing had occurred, that is, to be able to show that he or she was not simply "fishing."

Where a stockholder proves a credible basis to suspect wrongdoing, the stockholder is entitled to books and records "necessary and essential" to determining whether wrongdoing in fact occurred and, if so, whether management and/or the board was aware of and/or involved in that wrongdoing. This standard "achieves an appropriate balance between providing stockholders who can offer some evidence of possible wrongdoing with access to corporate records and safeguarding the right of the corporation to deny requests for inspections that are based only upon suspicion or curiosity."[3] The careful balance struck is beneficial, we would argue, in that the result of at least some investigations under the statute is no litigation at all, and in other cases, more substantial and well substantiated claims. We thought that this much, at least was settled. But the law is never static, and the dialectic that produces new law never stops.

DEVELOPMENT #1: PRODUCTION SCOPE WIDENS TO MEET MODERN BUSINESS

The common law has recently begun the process of coming to grips with the fact that as the overwhelming volume of business correspondence shifts to e-mail and text platforms and away from hard copy, the ability to investigate potential wrongdoing risks becoming marginalized unless emails and other purely electronic communications are "fair game" as part of the Section 220 investigation. Cases such as *Mudrick v. Globalstar*[4] and the Delaware Supreme Court's decision in *KT4 v. Palantir*[5] were important early steps which balanced the need for electronic communications with the burden of producing those communications.

INCURSION #1: THE "CREDIBLE BASIS PLUS" LAW

At the same time that they were (unsuccessfully) fighting to cabin the usefulness of the Section 220 remedy by limiting production solely to hard copy documents, defendants were also working to develop an incursion into the usefulness of the remedy that was both subtler and more potentially destructive of the statute as a tool to investigate wrongdoing. In several cases, issuers were able to begin to limit the usefulness of the remedy by arguing that in order to investigate suspected corporate wrongdoing, it was necessary not only to show a

[3] *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 118 (Del. 2006).
[4] *Mudrick Capital Management, L.P. v. Globalstar, Inc.,* 2018 WL 3625680 (Del. Ch. July 30, 2018).
[5] *KT4 Partners, LLC v. Palantir Technologies Inc.,* 203 A.3d 738 (Del. 2019).

"credible basis" to suspect that wrongdoing had occurred, but also something else, *i.e.,* what the stockholder intended to do with the records if wrongdoing was identified.

Some cases even went so far as to suggest that the showing of a "credible basis" had to include a showing that would allow the stockholder to plead around exculpation provisions in the event that the investigation of litigation was the desired end. This novel interpretation of the "credible basis" standard arguably subverts decades of jurisprudence recognizing this standard as the "lowest possible burden of proof."[6] Ignoring the Court's proclamation that "[t]he only way to reduce the burden of proof further would be to eliminate *any* requirement that a stockholder show some evidence of possible wrongdoing,"[7] the corporate issuer community has read unprecedented requirements into the credible basis standard.

This strain of "legal virus" was dealt a possible death blow in the recent decision by Vice Chancellor Laster in *AmerisourceBergen*. After carefully reviewing the "credible basis plus" line of cases, the Court found that they constituted a departure from established Supreme Court precedent and declined to extend the law beyond the bedrock "credible basis" standard.[8] While the decision is on appeal before the Delaware Supreme Court, one trusts that the Court will rule in a way that is consistent with the purpose of the statute.

INCURSION #2: TRIAL BY AMBUSH

At the same time that the Section 220 common law dealt with the "credible basis plus" line of cases, defendants also began to join issue around the question of whether discovery by plaintiffs was permissible *at all* in Section 220 cases. Arguing that since plaintiff always bore the burden in a books and records case to establish a "proper purpose" and that the documents sought were "essential" to that purpose, the defendant in *Gilead Sciences* contended that there could be no relevant discovery of the defendant until and unless the plaintiff was able to carry its burden at trial. Gilead sought a protective order, seeking to shut down *all* discovery by plaintiff prior to post trial proceedings, effectively advocating for *de facto* bifurcation of all Section 220 trials.

The *Gilead* Court rejected this categorical rule. The Court ruled that it was aware of "no principled basis for categorically precluding this sort of discovery in Section 220 actions, even with the limiting principles applicable to these actions in mind."[9] Instead, the Court permitted interrogatories relating to Gilead's pleaded defenses, as well as interrogatories pertaining to the existence and location of the documents at issue. The Court also left the door open to a 30(b)(6) deposition of Gilead concerning these issues. Thus, defendant's attempt to categorically preclude *all* discovery, including discovery into their pleaded defenses, was derailed.[10]

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[6] *Seinfeld*, 909 A.2d at 123.
[7] *Id.* (emphasis added).
[8] *Lebanon Cnty. Empls' Ret. Fund, et al. v. AmerisourceBergen Corp.,* 2020 WL 132752, at *26 (Jan. 13, 2020).
[9] *Hollywood Police Officers' Ret. Sys. v. Gilead Sciences, Inc.*, C.A. No. 2020-0155-KSJM, Tr. at 62 (Del. Ch. May 8, 2020) (TRANSCRIPT) ("*Gilead* Tr.").
[10] *Id.* at 57, 62-63.

Importantly, the Court's ruling addressed particular discovery focused on the existence, location and volume of documents. The Court explained that "the analysis of the scope of production is fact-specific in nature and it is difficult to conduct the analysis in the abstract"[11] and deemed it "a waste of both litigant and judicial resources to examine the question of scope of production in the abstract with the knowledge of what documents actually exist."[12] The Court offered the following rationale:

> Consider the implications of a categorical rule protecting a company from answering basic questions concerning what documents exist in the context of discovery [i]n a Section 220 action. The trial court would have to wade through the often murky analysis of what categories of documents are necessary and essential to any proven proper purposes and enter a final order to that effect, and if that order is appealed, the Supreme Court would have to review that analysis, all blind to whether the documents sought actually exist, and all to protect the company from having to undertake the minimally intrusive act of stating whether those documents exist.[13]

Put simply, the Court swept aside the categorical anti-discovery rule proposed by the company and found that interrogatories requiring an issuer to identify whether documents existed, and if so the location of the documents, were both relevant and "helpful." Likewise, the Court made clear that the use of typical contention interrogatories in this context was appropriate as a means to narrow issues and allow the plaintiffs to prepare for trial. The Court's ruling goes a long way to preclude trial by ambush in the Section 220 context – another clog extracted from the machine.

INCURSION #3: TWO TRIALS FOR EVERY CASE

In addition to arguing that plaintiffs should be precluded categorically from taking discovery prior to trial in a Section 220 case, the defendants in *Gilead* also attempted to deploy a subtler attack on the statute which, if embraced, would effectively mandate a "second trial" in most Section 220 cases.

In their motion for protective order, defendant also argued that any discovery as to the existence and location of documents should await a finding at an initial trial that plaintiffs had carried their burden of demonstrating their proper purpose for making a demand. This discovery position necessarily implied that each Section 220 case required a second trial in every successful case: the first to determine entitlement i.e., proof of proper purpose; and the second to determine the proper scope of the remedy, i.e., whether the documents sought were "necessary and essential" and whether the production was "burdensome" to the defendants.

In its bench ruling, the *Gilead* court forcefully rejected the idea that Vice Chancellor Laster's earlier *AmerisourceBergen* decision was a departure from settled precedent and described that decision as comporting

[11] *Id.*
[12] *Id.*
[13] *Id.* at 58.

"directly with my view of what the law is and should be in Delaware concerning this very issue."[14] The Court also made clear that its own earlier decision[15] created no categorical rule that Section 220 trials should routinely be bifurcated as between proper purpose and scope and described that argument as "contrary to the summary nature of Section 220 actions" from a policy perspective.[16] The Court found "no support for the broad proposition Gilead advances."[17]

Indeed, in our experience, the way to address burdensomeness is to permit appropriately limited discovery as to the existence and scope of the issue, which is precisely what the Court did here. We also find that, where defense counsel bothers to engage around this topic, we are often able to resolve the issue without Court intervention. This is because the engagement by counsel around the actual facts surrounding the question of burden facilitates compromises on both sides, with plaintiffs focusing on the documents they most need and defendants becoming knowledgeable about what aspects of the demanded production actually create problems and what aspects either do not exist or are easy enough to produce without wasting judicial resources. Hopefully, the Court's ruling in Gilead sends us back to the developing and salutary practice of *conferring* about burden and, where necessary, allowing a record to be made pre-trial.

With any luck, *Gilead* will help counsel to "sharpen" the "tools at hand" in order to make using Section 220 more efficient and effective. The dialectic continues, however, and we have no doubt that it will not be long before the next attack on the statute is afoot.

[14] *Id.* at 59.
[15] *Kosinski v. GGP Inc.*, 214 A.3d 944 (Del. Ch. 2019).
[16] *Gilead* Tr. at 61.
[17] *Id.*