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Books And Records Requests In The Era Of Text Messages

By **Jason Levine and Andrew Erdlen** (July 22, 2019, 2:27 PM EDT)

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Emails, texts, instant messages and other forms of electronic communication have long been a fixture of the social landscape. But companies' directors and officers have also embraced those forms of communication as a means to decide issues of significance to the business.

In recent years, company managers have increasingly held meetings and debated and decided issues via electronic communications. In an increasingly competitive landscape, businesses that rigidly adhere to the traditional formalities of in-person meetings may miss out on opportunities to competitors who can more rapidly make those decisions. This trend favoring informal communication is likely to continue, and businesses will need to adapt.

For all the good it may do, the use of electronic communications by directors and officers — who, for better or worse, historically confined their decision-making to the boardroom — may open up new fronts for stakeholders asserting their statutory right to inspect businesses' books and records and, on the flipside, could potentially create new headaches for businesses dealing with the costs, burdens and intrusions of shareholder information demands.

Courts in Delaware, Pennsylvania and New Jersey have responded to these developments by both broadening and narrowing the permissible scope of books and records requests. In this article, we look at recent decisions with an eye toward how technological shifts have impacted how courts adjudicate statutory books and records demands. We then discuss potential strategies for the use of, and defense against, those demands.

The Basics of Books and Records Requests

A shareholder's right to inspect corporate books and records has long been a feature of Anglo-American common law, coming into existence no later than the mid-18th century. The contours of the right have evolved in the intervening centuries, and much more recently, states have codified the longstanding common law rules.

In essence, books and records statutes permit a shareholder to inspect a company's stock ledger, list of shareholders and other "books and records," which is understood to cover both official corporate

records and less formal written communications.[1] Inspection rights are necessary to provide stakeholders with a mechanism to protect their ownership interest.

For public companies, there is generally no contractual entitlement of a shareholder to certain information made available by statute; while public reporting requirements provide for the disclosure of certain financial information, there is no obligation to provide the vast majority of company information, and therefore inspection rights are critical. As to shareholders in privately-held companies, one could negotiate the right to obtain certain company information, but frequently no such contract right exists and the statutes afford an informational baseline.

The right to a company's records is not unlimited. Rather, shareholders must offer a "proper purpose" for obtaining documents, and are entitled to only the documents that are essential to that purpose. A proper purpose is one that is reasonably related to such person's interest as a stockholder. Whether a purpose is proper will always be a fact-sensitive determination, but courts often find inspection requests are proper when made to (1) value the shareholder's interest in the company; (2) identify other shareholders; and (3) investigate wrongdoing, mismanagement or corporate waste.

The latter purpose requires stockholders to present evidence sufficient to suggest a "credible basis" from which one can infer wrongdoing or waste. Although this standard sets a lower burden of proof than the standard for obtaining discovery in civil litigation, it is not a mere formality, and must be supported by documents, testimony or logic, not simply suspicion of wrongdoing.[2]

Moreover, because of the potentially probing nature of such requests, courts will scrutinize them to ensure they are not for a purpose adverse to the interests of the company, or being used as an end run around the limits on discovery in civil litigation. As an example, a company need not produce documents in response to a books and records request if the directors or officers cannot be liable for the alleged wrongdoing (e.g., a certificate of incorporation exculpates directors from liability for breach of the duty of care),[3] or if the allegations otherwise do not support a cause of action.[4]

Similarly, where a pending litigation addresses the questions raised by the shareholder in the books and records requests, courts have found there is no proper purpose.[5]

Any current shareholder of a corporation, regardless of its percentage ownership, can request books and records.[6] An LLC member has certain additional rights to information regarding the LLC's financial condition, operating agreements, tax returns and other formational documents.[7]

Courts have significant discretion to shape a shareholder's relief (if any) by prescribing limitations or conditions on inspection rights. This discretion allows courts to act as a backstop, but, just as importantly, allows the statute to be flexible and accommodate new and changing ways in which inspection rights are asserted.

With these principles in mind, we turn to how courts have applied them in the context of demands for electronic "books and records."

Judicial Discretion to Balance Competing Principles

Our technology-driven culture has had significant effects on shareholder information rights, specifically, the circumstances in which a company is required to produce electronic documents in response to a books and records demand.

Recent cases underscore the competing principles at issue: Although these cases acknowledge that managers now communicate and make decisions in different ways, they recognize there are increased costs and intrusions associated with an obligation to retrieve such communications. Given the potential for sweeping demands, courts must exercise their discretion carefully to determine the scope of a shareholder's remedy.

In a recent Delaware Supreme Court decision, KT4 Partners LLC v. Palantir Technologies Inc., the court heard an appeal of a decision denying a shareholder access to emails relating to a transaction about which the shareholder alleged wrongdoing. Although first noting that "discovery is limited" in books and records proceedings, the court reaffirmed that the phrase "books and records" encompasses informal written communications.

The court held that, because the corporation "did not honor traditional corporate formalities," and instead conducted business through email, it needed to produce such emails and other electronic documents.[8] The court attempted to limit the scope of its decision, stating that "if a company observes traditional formalities, such as documenting its actions through board minutes, resolutions, and official letters," it will likely be able to respond to a books and records request by producing only those corporate documents.[9] But as a practical matter, all companies discuss and make some decisions through informal means.

In a recent decision applying KT4, the Delaware Chancery Court relied on this principle to require Facebook to produce certain electronic communications involving a 2015 security breach, stating that "[p]laintiffs have presented evidence that Board members were not saving their communications regarding data privacy issues for the boardroom."[10]

KT4 evidences courts' willingness to require production of electronic documents and information, but courts have also increasingly scrutinized shareholders' alleged purposes for seeking such documents, as well as the scope of their requests. In a recent New Jersey decision, Feuer v. Merck & Co.,[11] a Merck shareholder requested the books and records relating to the company's acquisition of another company, as well as the board's consideration of the shareholder's demand that the company file a lawsuit against the directors and certain officers involved with the acquisition.

The court denied the request, finding that it was too broad and exceeded the shareholder's statutory entitlement to books and records. The court stated that "Feuer is not entitled to broad-ranging inspection under the statute just because it would be useful, or because he prefers it to discovery within a derivative action,"[12] exercising its discretion to reign in the request on the basis that the scope of potentially available documents was narrower than what the shareholder sought.

Notably, the court also balanced the extent of the requesting shareholder's ownership percentage against the corporation's burden of complying with the shareholder's request. The court cited other cases which state that a shareholder with a relatively small percentage of the corporation must show a "probability" that his/her requests would serve all shareholders.[13]

Analysis, Takeaways and Strategy

These decisions exemplify how courts are grappling with the competing concerns of a shareholder's entitlement to protect its ownership interest by seeking information from the company, on the one

hand, with a company's freedom from onerous shareholder demands, on the other hand. The Delaware Chancery Court aptly summarized this delicate balance:

> The reality of today's world is that people communicate in many more ways than ever before, aided by technological advances that are convenient and efficient to use. Although some methods of communication (e.g., text messages) present greater challenges for collection and review than others, and thus may impose more expense on the company to produce, the utility of Section 220 as a means of investigating mismanagement would be undermined if the court categorically were to rule out the need to produce communications in these formats.[14]

Thus, companies must potentially search and produce more forms of documents and communications, but courts have also more rigorously assessed the shareholder's alleged purposes for demanding information and narrowly tailored what must be produced to those permissible purposes.

Courts are acutely sensitive to shareholders using books and records requests to circumvent the pleadings threshold and discovery limitations in civil litigation and, accordingly, are increasingly scrutinizing the shareholders' bases for such requests to ensure there is at least some evidence from which actionable wrongdoing can be inferred. In response to these technological and jurisprudential developments, companies may change how they conduct business in several ways.

First, companies may adopt bylaws on how corporate business is to be conducted, such as limiting the ability to make certain decisions to in-person meetings, rather than over email. The downside to this approach is that it may impede decision-making for the sake of such formalities.

A less restrictive approach is for companies to attempt to limit the manner in which business is done by, among other things, (1) prohibiting managers from conducting business on personal email or via text message, and (2) memorializing decisions in minutes and formal resolutions. While somewhat inconvenient, this may insulate managers from surrendering their personal devices for data collection.

Companies may also implement bylaw restrictions on the use and dissemination of information obtained from such requests, such as requiring that such information be kept confidential, or prohibiting the use of such information in proceedings outside the state of incorporation.

Although shareholders may now gain access to electronic communications subject to the lower credible basis standard, they may first attempt to more fully exhaust other means of obtaining information, including by consulting company disclosures, analyst reports and other public information, in order to withstand the increased level of judicial scrutiny of the purported purpose(s) of books and records requests. To preemptively address courts' balancing of the benefits and burdens of such requests, shareholders may also attempt to link up with other shareholders to submit joint requests.

At a minimum, disputes about the scope of books and records demands, and related litigation, will continue to increase, as shareholders attempt to shore up breach of fiduciary duty, minority shareholder oppression and securities claims before filing lawsuits, and as companies reject such probing requests and bank on courts to exercise their discretion and narrow the scope of what must be produced.

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[1] E.g., KT4 Partners LLC v. Palantir Technologies Inc., 203 A.3d 738, 750 (Del. 2019); Ackerman v. Kasual Computing, 2016 WL 3034746, at *3 (Pa. Super. Ct. May 25, 2016) (acknowledging courts' willingness to require production of documents beyond those specifically identified in books and record statute).

[2] See Seinfeld v. Verizon Commc'ns Inc., 909 A.2d 117, 123 (Del. 2006) (describing standard as "the lowest burden of proof," but requiring more than mere suspicion or curiosity).

[3] E.g., SEPTA v. AbbVie Inc., 2015 WL 1753033, at *1 (Del. Ch. April 15, 2015), aff'd 132 A.3d 1 (2016); cf. 8 Del. Code 102(b)(7); N.J.S.A. 14A:2-7(3); 15 Pa. C.S. § 513.

[4] E.g., Walther v. ITT Educ. Servs. Inc., 2015 WL 545331, at *14-16 (Del. Ch. Feb. 10, 2015).

[5] E.g., CHC Investments LLC v. FirstSun Capital Bancorp, 2019 WL 328414, at *3 (Del. Ch. Jan. 24, 2019).

[6] 8 Del. Code § 220; N.J.S.A. 14A:5-28; 15 Pa. C.S. § 1508.

[7] 6 Del. Code § 18-305; N.J.S.A. 42:2C-40; 15 Pa. C.S. § 8850.

[8] KT4 Partners, 203 A.3d 738, 742 (Del. 2019).

[9] Id.

[10] In re Facebook Inc. Section 220 Litig., 2019 WL 2320842, at *18 n.185 (Del. Ch. May 31, 2019).

[11] Feuer v. Merck & Co., 455 N.J. Super. 69 (2018), aff'd 238 N.J. 27 (May 15, 2019).

[12] Id at 82.

[13] Id. at 88-89.

[14] Schnatter v. Papa John's Int'l, 2019 WL 194634, at *16 (Del. Ch. Jan. 15, 2019).