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The increasing risk for companies of being required to produce emails and texts in Section 220 actions

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MAY 1, 2019

Two recent Delaware decisions, *Schnatter v. Papa John's International Inc.*, No. 2018-0542, 2019 WL 194634 (Jan. 15, 2019), and *KT4 Partners LLC v. Palantir Technologies Inc.*, No. 281, 2018, 2019 WL 347934 (Del. Jan. 29, 2019), highlight an increased willingness by the Delaware courts, in Section 220 actions, to order that directors' and officers' emails and/or texts be produced. This trend is evolving against a backdrop of significantly expanded use of emails and texts in connection with modern business practices and recordkeeping.

We note that, due to the real-time nature of and oftentimes more informal and less guarded approach with respect to email and text communications, when produced, they often provide critical evidence that is rarely discovered through more traditional written records and communications (such as board presentations and meeting minutes).

SECTION 220

DGCL Section 220 permits a stockholder to inspect the company's books and records for any "proper purpose." What constitutes a proper purpose for a stockholder is not specified in the statute (but has been developed by case law), and the burden of proof is on the stockholder to prove that she has a proper purpose.

The statute defines a proper purpose for a director as "a purpose reasonably related to the director's position as a director," and the burden of proof is on the company to prove that a director does not have a proper purpose. (An officer would not have any right under Section 220 to inspect the books and records unless she were also a shareholder or a director.)

It is well established that, under Section 220, a director's right to obtain corporate books and records is broader than a stockholder's right.

PALANTIR

In *Palantir*, a Section 220 demand was made by a major stockholder for the purported purpose of investigating possible fraud, mismanagement and breach of fiduciary duty by company executives in connection with amendments to the company's Investors Rights Agreement and representations that may have been made by the company to the other stockholders relating to the amendments.

The Court of Chancery found that the plaintiff-stockholder had a proper purpose for the demand of both written and electronic books and records, but the court specifically rejected the demand for emails. Vice Chancellor Slights reasoned that the production of emails was not essential to fulfilling the plaintiff's purpose given that traditional, non-email books and records existed that could be produced.

On January 29, 2019, the Delaware Supreme Court overturned that part of the Court of Chancery's decision and ruled that the emails had to be produced because there were no non-email documents that were responsive to the Section 220 request.

The Supreme Court emphasized that the plaintiff had shown that the company generally had not observed corporate formalities (including by having repeatedly not held an annual meeting of stockholders), and had indeed conducted business by email (and, in one case, by a LinkedIn message).

Chief Justice Strine wrote that companies that "document their actions through board minutes, resolutions and official letters" should be able to satisfy a Section 220 request with these documents and not have to produce emails and texts.

However, he wrote further, the issue must be decided "in light of companies' actual and evolving record-keeping and communications practices." He observed as a general matter: "Today, emails and other electronic communications do much of the work of the paper correspondence of yore" and "[a company] cannot use its own choice of medium to keep stockholders in the dark about the substantive information to which §220 entitles them."

The Supreme Court also rejected the company's contention that a plaintiff had to prove by "compelling evidence that emails are necessary to a proper purpose."

PAPA JOHN'S

In *Papa John's*, in response to a director's Section 220 demand, the Court of Chancery granted access to directors' personal emails

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and text messages (i.e., communications on their personal email accounts and devices rather than just their corporate email accounts).

Although it declined to impose a bright-line rule for considering §220 requests for information from personal accounts and devices, the court emphasized the need to "apply its discretion on a case-by-case basis to balance the need for the information sought against the burdens of production and the availability of the information from other sources...."

JS, a Papa John's director who was the founder, largest stockholder, recent Chair, and long-time public face of the company, provoked intense negative media attention after stating on an earnings call his view that the company's revenues had declined due to the National Football League's mishandling of the players' protests during the playing of the national anthem. (Papa John's was then the NFL's exclusive pizza sponsor.)

Subsequently, a magazine article reported that JS had spoken a racial slur during an internal training session. In the wake of these events, the company's stock price fell significantly, the board removed JS as CEO and Chair and requested that JS resign as a director (which he refused to do) and the company terminated its contractual arrangements with JS relating to his marketing services and use of office space.

JS filed a Section 220 demand with the stated purpose of determining whether, in severing ties with him, the directors had breached their fiduciary duties to act in the best interests of the stockholders. According to JS, the board's actions had a significant negative impact on the company and were undertaken without the board having interviewed him or investigated his conduct.

Chancellor Bouchard ruled that JS was entitled to the access he sought.

Thereafter, activist firm Starboard acquired 10% of the company's shares, JS set up a proxy fight by nominating himself for reelection to the board and, after many months, the company and JS reached an agreement pursuant to which JS will resign from the board and be replaced by an independent director.

As part of the agreement, the company has agreed to share with JS all of the company's records, giving him the option to sue if the documents reveal wrongdoing by the company.

The court focused on whether the communications that were sought constituted "corporate books and records." The court stated that, if the company's directors, CEO and General Counsel had "used personal accounts and devices to communicate about changing the Company's relationship with [JS], they should expect to provide that information to the Company."

Notably, the court emphasized "the reality of today's world" that people communicate frequently by emails and texts. The court wrote: "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."

OTHER CASES

The issue of the discoverability of emails and texts of directors, executives and/or bankers has figured prominently in other recent high-profile cases, with ensuing negative publicity for the companies and persons involved and apparently negative impact for them in the litigation.

These litigations have involved, for example, Rent-A-Center Inc., Kate Spade, Facebook, Uber, Xerox, Aruba Networks and Viacom. In one notable case, *In re Shawe & Elting LLC*, No. 9661, 2015 WL 4874733 (Del. Ch. Aug. 13, 2015), Chancellor Bouchard viewed a smiley-face emoticon in a party's texts as evidence of the party's malign intent.

PRACTICE POINTS

Critically, directors and officers should anticipate the possibility of corporate and personal emails having to be produced in response to a Section 220 demand or otherwise in litigation.

It cannot be emphasized enough that email communications should be (and so often are not) written and used with this possibility kept in mind. Appropriate use of and attention to emails should be a routine part of corporate training for directors.

Directors and officers generally should seek to refrain from conducting corporate business on their personal email accounts or devices.

Directors generally should use a dedicated email account for company business and should consider obtaining a corporate-issued email account for their board service and related work.

Personal emails and texts (including on a director's or officer's personal devices) may be producible in a Section 220 action if there is more than mere suspicion that page 4 corporate business was conducted in this way.

Factors that may create more than mere suspicion could include the company not regularly keeping traditional books and records (such as minutes), the directors not having corporate email accounts, and/or the company not having a policy expressing that directors should not use their personal email accounts for corporate business.

Companies should consider (i) providing officers and directors with corporate email accounts and cellphones or other mobile devices for their communications regarding company business and (ii) maintaining a written policy expressing that the company considers communications on directors' and officer's personal accounts and devices to be '"personal unrestricted information' outside the control of the company."

Companies should expect that, when the board seeks to sever ties with a director for alleged offensive misconduct, in addition to contractual, defamation and fiduciary claims, the director is likely to make a books and records demand.

We note that generally a board cannot force a director off the board. Papa John's has potentially broad applicability in the current era of increased sensitivity to allegations of sexual harassment or racism.

As Papa John's illustrates, once a director has established a proper purpose for a Section 220 demand (which could include to investigate whether the board mismanaged the company), the directors' access to books and records is essentially unfettered (and should not be thwarted by the director also having a personal purpose in seeking, for example, to restore his reputation, retain his position and/or increase his leverage in negotiating a separation settlement).

Clearly, a board should carefully weigh, based on the specific facts and circumstances, the advantages of taking quick action to seek to sever ties with (or, in particularly sensitive situations, to isolate) a director who allegedly has engaged in offensive misconduct versus taking time to conduct an internal or external investigation into the allegations.

In contrast to a stockholder, a director can successfully pursue a derivative lawsuit contemporaneously with a Section 220 demand.

A stockholder's filing of a derivative lawsuit generally in considered to be a concession by the stockholder that inspection of the company's books and records is not necessary or essential to pursuit of the claims he or she is making.

However, when a director-shareholder files a Section 220 demand (as a director) and simultaneously files a derivative suit (as a shareholder), the court does not automatically assume such a concession.

Generally, a director need not establish that books and records he or she seeks are necessary or essential to his or her proper purpose in seeking them because, given a director's fiduciary duties to the company and its stockholders, a director is accorded very broad access rights to books and records and in any event is subject to obligations not to misuse the information.

In Papa John's, JS agreed with the court that materials he obtained in the Section 220 action would not be used in the derivative lawsuit he was pursuing in his interest as a stockholder.

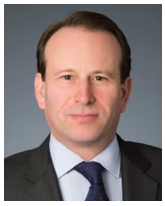
A Section 220 demand may still be successful even when the underlying fiduciary claims are likely to be dismissed.

Notably, in Papa John's, any duty of care violation by the Papa John's board would have been exculpated under the company's charter and a duty of loyalty violation generally would be untenable where the directors, as in that case, were independent.

This article first appeared on the Practitioner Insights Commentaries web page on MAY 1, 2019.

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