

Delaware Courts Expand Books and Records Inspection Rights under Section 220 to Allow Greater Access to Electronic Communications

In two recent cases, the Delaware Supreme Court and Delaware Court of Chancery upheld demands for electronic communications in Section 220 books and records actions. In both *KT4 Partners LLC v. Palantir Technologies, Inc.* and *Schnatter v. Papa John's International, Inc.*, the courts observed that as modern record-keeping and business practices evolve in the digital age, so too should Delaware's interpretation of Section 220 evolve to match the corporate migration towards electronic communications.¹

I. Background

Section 220 of the Delaware General Corporation Law provides that any stockholder of a Delaware corporation “shall, upon written demand under oath stating the purpose thereof, have the right to inspect for any proper purpose . . . the corporation's stock ledger, a list of its stockholders, and its other books and records.”² If a corporation does not comply with a stockholder's demand for access to books and records, the stockholder may file a summary proceeding in the Delaware Court of Chancery to compel inspection.³

Section 220 permits a stockholder to inspect corporate books and records for “any proper purpose.”⁴ The burden is on the stockholder to demonstrate a proper purpose for each item sought by a preponderance of the evidence.⁵ The Chancery Court has recognized that, “[t]here is no shortage of proper purposes under Delaware law,” but the most common “is the desire to investigate potential corporate mismanagement, wrongdoing, or waste.”⁶ So long as a stockholder is able to show that a credible basis exists to infer actual mismanagement, Delaware allows inspection for this purpose. Despite the variety of acceptable purposes, §220 actions are nevertheless limited by the Chancery Court's obligation to tailor orders to cover only books and records that are “essential and sufficient to the stockholder's stated purpose” or, in shorthand, those that are “necessary.”⁷

As business practices have evolved, many corporations are increasingly moving away from formalities such as documenting corporate actions through board minutes and resolutions, and instead rely on electronic communications to conduct business that used to be the sole provenance of paper. As this evolution in corporate behavior progresses, Delaware's courts are increasingly being asked to decide whether emails and other electronic communications are “necessary” to accomplish a stockholder's purpose in investigating suspected mismanagement.

II. KT4 Partners v. Palantir Technologies Chancery Court Decision

It was in this context of evolving corporate practices that, in February 2018, the Delaware Court of Chancery decided *KT4 Partners LLC v. Palantir Technologies, Inc.* Factually, the matter stemmed from a falling

¹ *KT4 Partners LLC v. Palantir Techs. Inc.*, 2019 WL 347934 (Del. Jan. 29, 2019); *Schnatter v. Papa John's Int'l, Inc.*, 2019 WL 194634 (Del. Ch. Jan. 15, 2019).

² DEL. CODE ANN. tit. 8, §220 (West 2018).

³ 8 Del. C. §220(c).

⁴ 8 Del. C. §220.

⁵ See *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 372 (Del. 2011).

⁶ *Melzer v. CNET Networks, Inc.*, 934 A.2d 912, 917 (Del. Ch. 2007).

⁷ *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1035 (Del. 1996).

out between the executives of Palantir and a major stockholder, KT4, over allegations that the stockholder had stolen trade secrets from the corporation.⁸ Following these accusations, and a subsequent lawsuit against KT4, KT4 made a formal Demand for inspection under §220, stating as the purpose, “to investigate fraud, mismanagement, abuse, and breach of fiduciary duty by [Palantir].”⁹ KT4’s Demand included language requesting electronic documents as part of the materials for inspection, specifically, “the books and records of the corporation (*including ... electronic documents and information*).”¹⁰

At trial, the Chancery Court found that KT4 showed a proper purpose of investigating potential wrongdoing, and a credible basis to justify further investigation into Palantir. However, despite granting certain requests in KT4’s Demand, in its final order the Court specifically “declined to include electronic mail within the inspection information.”¹¹ Subsequently, KT4 filed a motion for limited reargument in which it asked the Court to include email. KT4 argued that inspection of emails was essential to investigating potential wrongdoing related to Palantir’s Investors’ Rights Agreement, and specifically, any representations the company made to other stockholders related to amendments to the agreement.¹² KT4 further argued that, as Palantir did not observe some traditional corporate formalities, the value of traditional corporate books and records was limited, making inspection of email necessary.¹³ The Chancery Court denied the motion, finding that inspection of emails was not essential to fulfilling KT4’s purpose.¹⁴

III. KT4 Partners v. Palantir Technologies Supreme Court Decision

In December 2018, KT4 appealed from the Delaware Court of Chancery’s post-trial order granting in part and denying in part their request to inspect various books and records of Palantir. Specifically, KT4 argued on appeal that the Chancery Court erred when it held that KT4’s Demand did not request emails, and that emails were unnecessary for KT4’s investigation.¹⁵ In January of this year, the Supreme Court of Delaware held that the Chancery Court erred by denying KT4’s Demand to inspect the requested emails.¹⁶

⁸ *KT4 Partners LLC v. Palantir Techs., Inc.*, 2018 WL 1023155 (Del. Ch. Feb. 22, 2018).

⁹ *Id.* at *1.

¹⁰ *KT4 Partners LLC v. Palantir Techs., Inc.*, (Palantir Order Denying Reargument) 2018 WL 2045831, at *1 (Del. Ch. May 1, 2018) (ORDER).

¹¹ *Id.*

¹² *Id.*

¹³ *KT4 Partners*, 2018 WL 1023155 at *2.

¹⁴ *See KT4 Partners LLC v. Palantir Techs., Inc.*, (Palantir Opposition Reply to KT4 Motion for Reargument) 2018 WL 1639813 (Del. Ch. Mar. 29, 2018) (“KT4 simply failed to show that emails are necessary to any proper purpose here.”).

¹⁵ *KT4 Partners*, 2019 WL 347934 at *8.

¹⁶ Though *KT4* represents a notable evolution in stockholder demands for email, whether emails are “necessary” to accomplish a stockholder’s purpose has been addressed previously by the Delaware Supreme Court at least once, and by the Chancery Court on several occasions. *See, e.g., Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 1264, 1273 (Del. 2014) (“Wal-Mart’s argument that officer-level documents are not ‘necessary and essential’ to one of IBEW’s three proper purposes is not supported by the record.”); *Mudrick Capital Mgmt., L.P. v. Globalstar, Inc.*, 2018 WL 3625680, at *9 (Del. Ch. Jul. 30, 2018) (ordering the production of the CEO’s, general counsel’s, and two directors’ emails); *In re UnitedHealth Grp., Inc. Section 220 Litig.*, 2018 WL 1110849, at *9-10 (Del. Ch. Feb. 28, 2018) (denying petitioners’ request for certain officer emails because they failed to show that board-level and other materials, including some emails, would be insufficient); *In re Plans All Am. Pipeline, L.P.*, 2017 WL 6016570, at *4-5 (Del. Ch. Aug. 8, 2017) (rejecting the petitioners’ request for the CEO’s emails “because board-level materials are sufficient for their stated purpose”).

The Delaware Supreme Court found that because Palantir could not provide responsive records in “traditional” materials, it was required to produce electronic communications related to KT4’s investigation. The Court suggested that in many companies, documents related to investigating fraud or mismanagement would be found in the form of “board minutes, PowerPoint Presentations or memoranda addressed to the board, board resolutions, official hardcopy letters from the company to investors, and other non-email documents.”¹⁷ The Supreme Court found that Palantir failed “to honor traditional corporate formalities” when it consistently neglected to hold annual stockholder meetings and acted instead through email in connection with the alleged wrongdoing.¹⁸

The Supreme Court also held that KT4 had met its evidentiary burden that emails were necessary to investigate the alleged wrongdoing by providing evidence that Palantir “had acted through email in connection with the same alleged wrongdoing” and in light of the fact that Palantir could not produce any “traditional” materials of its own.¹⁹ The Court dismissed the trial court’s finding that KT4’s original Demand did not request emails when they used the term “electronic documents” in the Demand.²⁰

According to the Court, the petitioner made a sufficient showing of necessity “by identifying the categories of books and records” needed and presenting “some” evidence that those documents were necessary.²¹ The Court credited KT4’s evidence that Palantir conducted corporate business over email, and in one case, even a LinkedIn message.²² The Court stated that §220 has long been interpreted in “light of actual and evolving record-keeping and communication practices,” observing that “today, emails and other electronic communications do much of the work.”²³ Although the Court agreed with Palantir that §220 actions only provide stockholders access to a “discrete” set of records, it denied Palantir’s contention that KT4 had to prove by “compelling evidence that emails are *necessary* to a proper purpose,” in order to obtain that set.²⁴

The Court was careful to clarify that only if a company chooses to conduct its formal business through electronic communications (or other non-traditional means) will it be required to produce those communications in response to a §220 demand. But, in a crucial nod to evolving business practices, the Court held that a company “cannot use its own choice of medium to keep stockholders in the dark about the substantive information to which §220 entitles them.”²⁵ Because the Supreme Court found that the Chancery Court abused its discretion in concluding the emails were unnecessary, the Supreme Court reversed the judgment in part and remanded it to the Chancery Court to determine the scope of emails that Palantir must now produce.

¹⁷ *KT4 Partners*, 2019 WL 347934 at *12.

¹⁸ *Id.* at *2.

¹⁹ *Id.*

²⁰ *Id.* at *6.

²¹ *Id.* at *11.

²² *Id.*

²³ *Id.* at *10.

²⁴ *Id.* at *11.

²⁵ *Id.* at *2.

IV. Schnatter v. Papa John's

While *KT4 Partners* represents an evolution in Delaware's jurisprudence related to §220 stockholder inspection rights, another recent Delaware case has gone even further in considering non-traditional books and records by expanding directors' rights to personal texts and emails. In July 2018, following reports that Papa John's International founder John Schnatter (a.k.a. Papa John himself) had used a racial slur during a training exercise, the company's board of directors asked Schnatter to resign as its Chairman. Though Schnatter did resign as Chairman, he refused to step down as a director, and the board subsequently formed a Special Committee to investigate all aspects of the relationship with Schnatter, and shortly thereafter took steps to terminate agreements between Schnatter and the company. Following these events, Schnatter made a §220 Demand in his capacity as a director, specifically seeking access to communications between and among the company's other directors and outside counsel related to his status at the company.²⁶ Papa John's rejected these demands, challenging both Schnatter's investigatory purpose as well as the scope of his request, and in particular, his demand for emails and text messages from personal accounts and devices.²⁷

The Delaware Court of Chancery found that Schnatter had demonstrated a proper purpose for the Demand, and notably, that he was entitled to relevant emails and text messages from personal accounts and stored on personal devices.²⁸ The Court's reasoning relied on its finding that the communications sought, despite being in the form of texts and emails, nonetheless constituted "books and records of a corporation for purposes of Section 220."²⁹ Because corporate officers and directors "used personal accounts and devices to communicate about changing the Company's relationship with [Schnatter]" they should have therefore "expect[ed] to provide that information . . ."³⁰ Crucially, the Chancery Court stressed that despite increased costs and burdens associated with collection and review of text messages and emails, "The reality of today's world is that people communicate in many more ways than ever before . . ." and cautioned, "[T]he 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."³¹ And though 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 . . ."³²

²⁶ *Schnatter v. Papa John's Int'l, Inc.*, 2019 WL 194634 at *1 (Del. Ch. Jan. 15, 2019).

²⁷ *Id.*

²⁸ It is well settled that directors have broader access to company books and records than do stockholders. *See, e.g. Chammas v. Navlink, Inc.*, 2016 WL 767714, at *7 (Del. Ch. Feb. 1, 2016) ("While directors' access to company books and records is broader than that of stockholders, the requested information itself must qualify as a book or record of the company before the Court will order its production."); *McGowan v. Empress Ent., Inc.*, 791 A.2d 1, 5 (Del. Ch. 2000) ("Under Delaware law, a director who has a proper purpose is entitled to virtually unfettered access to the books and records of the corporation.").

²⁹ *Id.* at *16.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

V. Conclusion

As the Delaware Supreme Court observed, it seems likely that the majority of future §220 requests will be satisfied by access to traditional corporate books and records. However, Delaware courts appear open to further expanding stockholder and director inspection rights to encompass certain electronic information and communications. As the ways in which corporations make and store information evolve, Delaware jurisprudence is likely to continue to progress in this area.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Elai Katz at 212.701.3039 or ekatz@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Ross Sturman at 212.701.3831 or rsturman@cahill.com; Scott B. Singer at 212.701.3757 or ssinger@cahill.com; Anna Wittman at 212.701.3446 or awittman@cahill.com.