Published on *The National Law Review* https://natlawreview.com

Responding to Books and Records Demands in an Increasingly Digital World - 3 Key Tips

Article By:

Trademark, Copyright & Advertising Counseling at Foley & Lardner LLP

Stockholder “books and records” requests have become increasingly prevalent in the past decade. These requests can be a used as tools by activist investors to gather information to support demands for corporate change or a means for a potential stockholder plaintiff to gather information in preparation for a derivative lawsuit. Historically, companies generally had limited responsibilities in these cases. Courts would generally require only that companies furnish formal documents and presentations to satisfy most demands, which were required to serve a “proper purpose.”

However, as courts continue to adapt historic principles of corporate law to the digital world, companies face new risks. The historical limitation on books and records requests to formal corporate documents may be fading as courts look at how executives and directors communicate with one another when making corporate decisions. In recognizing the realities of modern communication, Delaware courts shown increasing willingness to grant shareholders access to electronic records (e-mails, messages, etc.), especially if the company is not observing formal corporate procedures. If a company does not take the proper precautionary steps, they too may be subject to costly and invasive searches that reach to communications that are beyond the scope of any proper books and records request.

Background

Section 220 of the Delaware General Corporation Law and comparable statutes in other states provide stockholders a right to obtain copies of a corporation’s books and records for any “proper purpose.” A commonly recognized “proper purpose” (and one often invoked by activist stockholders and potential stockholder litigants) is investigating potential corporate wrongdoing. However, in order to establish this “proper purpose,” a shareholder must provide a “credible basis” to proceed. Although the burden to establish a “credible basis” is relatively low, courts will limit a stockholder’s investigation only to those book and records that are “essential and sufficient” to the investigation.

Historically, companies had little trouble in furnishing “essential and sufficient” documents in books and records demands, with courts generally interpreting the required disclosure to be limited to formal corporate documents (board minutes, resolutions, stockholder records, etc.) and presentations. Courts have shown greater reluctance to expand the scope of books and records requests to encompass more informal means of communication such as text messages and emails.

Recently, courts have engaged in a reexamination of this historical norm, largely driven by the recognition of the use of digital communications in business. This reexamination has led courts to show a greater willingness to open up books and records requests to include ordinary electronic communications in certain circumstances. Two recent cases illustrate this shift.

KT4 Partners v. Palantir Technologies.

In *KT4 Partners*, the Delaware Supreme Court took up the question of providing electronic communications in satisfaction of a books and records request, ultimately requiring disclosure of emails related to the wrongdoing alleged by the requesting stockholder. The plaintiff was able to successfully argue that electronic communications were “necessary and sufficient” to prove corporate wrongdoing because the company kept few formal documents and records, instead choosing to conduct most of its business over email and other electronic media. The court therefore required disclosure of the electronic communication as it was the “only documentary evidence” of the suspected wrongdoing.

Schnatter v. Papa John’s International, Inc.

The Delaware Chancery Court went further in *Schnatter v. Papa John’s International, Inc.*, granting John Schnatter, director, founder and namesake of Papa John’s, access to emails and text messages from personal accounts and devices of board members even though Papa John’s had the capacity to furnish traditional corporate documents. Suspecting corporate wrongdoing in connection with his termination from the board, Schnatter sought emails and text messages between fellow directors regarding the issue. The court determined the electronic correspondence constituted books and records that were “necessary and sufficient” to carry out his investigation. While acknowledging the greater challenge for collection and review, the court determined that the benefits of disclosure outweighed the burdens. “[I]nvestigating mismanagement would be undermined if the court categorically were to rule out the need to produce communications in these formats.” The court did note, however, that this was not a bright line rule and will allow access to these types of electronic communications only on a case-by-case basis.

While these two recent rulings suggest a growing burden for companies facing books and records demands from shareholders under Section 220 and similar statutes, companies can take proactive steps to reduce the risk of costly and invasive disclosures.

Tip #1: Adhere to Traditional Corporate Formalities

Companies should not give courts a reason to compel disclosure of electronic communication by being lax in their adherence to corporate formalities. As evidenced in KT4, courts may look beyond traditional corporate documentation and compel electronic communications if a company does not maintain formal corporate records and instead communicates informally. If a company chooses to conduct business over email or by other electronic means rather than at formal board or stockholder meetings, then, the court is more likely to grant shareholders access to electronic communications. As noted by the Delaware Supreme Court in that case, by not observing corporate formalities and adequately documenting them, the company “[had] no one to blame but itself for making the production of those emails necessary.”

To avoid or reduce disclosure of electronic communications, a company should ensure that formal policies and procedures to record deliberations and communications between the board and

management are adhered to in order to ensure that a company's traditional corporate documents are sufficient to satisfy a Section 220 or similar demand and to not provide a basis for a court to compel the production of personal electronic communications.

Tip #2: Provide a Singular Platform to Conduct Business Electronically

Another potential method to limit burdensome disclosure of electronic communications where such communication is common among board members and management is to keep the relevant data on an isolated platform. For example, a company could set up separate e-mail accounts or other electronic communications platforms specifically designated for corporate communications and deliberations by the board and management. By keeping all conversation in a segregated location, a company can easily isolate and retrieve relevant corporate documentation when requested by stockholders. This would significantly ease the burden on companies and avoid having to produce personal correspondence of directors and officers that is irrelevant to the books and records request. However, companies adopting this approach will want to carefully monitor and administer any separate platform, including providing training to directors and management on the purpose and use of the platform to ensure that it is used properly and only as a forum for official communications.

Tip #3: Be Adaptive to Change

A key takeaway from recent books and records cases is that companies need to be proactive and adapt as courts adapt and apply historical legal concepts to the digital world. As a result, companies should continue to expect to see changes in the pursuit and application of books and records claims as the ways we communicate continue to change. Workplace chat applications, for example, have become another forum where corporate communications take place. Over the past few years, apps like Slack, Skype for Business, and Voxer have changed the way businesses communicate. Helping employees communicate better and faster, these apps have vastly increased the amount of business correspondence stored electronically. Companies utilizing these apps should be careful to train employees, management and directors on the proper use of the apps (including appropriate subject matter) to avoid the risk of being required to review or produce large volumes of unorganized communications in response to a books and records request.

Please note Foley Summer Associate Alex Karnopp was a contributing author of this post. The Manufacturing Industry Advisor team thanks Alex for his contributions.

National Law Review, Volume IX, Number 219