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KIRKLAND **M&A UPDATE**

August 11, 2014

Books and Records Demands Becoming an Open Book

The recent Wal-Mart decision highlights the growing risks to companies from statutory "books and records" demands. In light of these developments, companies should be thoughtful about their document creation practices and policies.

A recent Delaware Supreme Court decision highlights the growing risks to companies of extensive statutory "books and records" demands that recently have become a favorite in the toolkit of plaintiffs' lawyers and even activist shareholders conducting what are often speculative fishing expeditions under the guise of investigating alleged corporate wrongdoing. The statutory inspection right under Section 220 of the Delaware corporation law (and analogous rights in other states) permits shareholders with a holding of any size to access almost any internal information under the control of the company as long as there is a "proper purpose" for the request. Most often, these demands are made within the context of constructing so-called "*Caremark*" claims that allege that directors violated their fiduciary duties by not appropriately overseeing the corporation's affairs or to collect grist for proxy and PR campaigns against incumbent directors.

In theory, companies have a number of ways to challenge books and records demands, including by questioning whether there is a "proper purpose" for the demand, and whether the request is sufficiently focused and proscribed to meet the statutory requirements. However, a progression of Delaware cases has shown that courts take expansive views of what constitutes a "proper purpose" (including the most common, to "investigate potential corporate mismanagement, wrongdoing or waste"), and at best only will permit defendant corporations to narrow some of the typically open-ended requests. As a result, Section 220 demands, which can be made at virtually no cost to a potential plaintiff, have increasingly generated expensive and time-consuming document production exercises as well as provided an avenue to trawl for documents that could facilitate derivative litigation against boards of directors.

The extent of these risks was expanded in the recent Delaware Supreme Court decision in the *Wal-Mart* case, which affirmed a trial court decision by then-Chancellor Strine that required the production of extensive documents, including those subject to the attorney-client privilege and attorney work product doctrine. As background, plaintiffs' lawyers representing a Wal-Mart shareholder had issued a demand for books and records in relation to a *New York Times* article regarding alleged illegal payments made to Mexican officials. The stated purpose of the demand was to investigate potential wrongdoing associated with the payments. In response to the demand, Wal-Mart produced an initial set of documents, and the shareholder filed a lawsuit to obtain even more materials.

Wal-Mart supplemented its production and made available a corporate representative for a deposition regarding its production. The trial court was unsatisfied and ordered Wal-Mart to produce a broad range of additional documents. The Supreme Court affirmed this order, including its requirement that Wal-Mart produce (i) officer-level documents even though they were never presented to the board, including documents from at least 11 custodians; (ii) documents spanning a seven-year time period; (iii) documents on disaster recovery tapes for two custodians (Wal-Mart had already agreed to produce documents from such tapes for nine custodians); (iv) documents "known to exist by . . . the Office of the General Counsel of Wal-Mart" (even though "Office of General Counsel" was undefined and could theoretically include the entire in-house legal department); and (v) documents that were otherwise protected by the attorney-client privilege and work product doctrine.

The last point is of particular significance. The Delaware Supreme Court adopted for the first time the so-called *Garner* doctrine, which allows "stockholders of a corporation to invade the corporation's attorney-client

privilege in order to prove fiduciary breaches by those in control of the corporation upon showing good cause." The Court held that the *Garner* exception could apply to even a Section 220 demand, the very earliest stages of potential litigation. The Court acknowledged that the "attorney-client privilege can be traced back to Roman times and is the oldest privilege recognized by Anglo–American jurisprudence." However, the Court determined that even though the *Garner* doctrine "is narrow, exacting, and intended to be very difficult to satisfy," the documents sought from Wal-Mart were "necessary and essential" to the shareholder's purpose and, therefore, should be produced. It is worth noting that the extensive public information about the Wal-Mart situation likely influenced the Court's willingness to grant the exception in this case, and that it may set a higher bar on what appear to be more speculative allegations.

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Effective management of the ever-evolving threat of corporate litigation is heavily dependent on the ability of corporations to limit the expense and duration of these cases, as well as preventing litigation being used to facilitate speculative fishing expeditions as a means to spawn further litigation. Successfully executing that strategy has become more complicated with the more pervasive deployment of Section 220 demands as well as accommodating court decisions that have generously interpreted the proper purpose and scope requirements of the resulting inspections. The recent *Wal-Mart* decision has added another risk factor for defendant companies with its possible exposure to shareholder inspection of materials subject to attorney-client privilege and/or work product doctrines, including those prepared in internal investigations of possible wrongdoing. In light of these developments, companies should be thoughtful about their policies and practices relating to document creation, especially in the context of sensitive or crisis situations and even within the framework of attorney communications that are typically assumed to benefit from iron-clad protection under various privileges.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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