

## Section 220 Demands: Inspecting Books & Records to Make an Impact

### An Overview – What is a Section 220 Demand?

Section (§) 220 of the Delaware General Corporation Law (DGCL) outlines the procedures for inspecting a corporate entity's books and records. Section 220(b) provides stockholders the qualified right to inspect a company's books and records, during normal business hours, if certain requirements are met. The stockholder must prove by a preponderance of the evidence that:

1. The stockholder making the demand of the company is a stockholder of that company.
2. The stockholder making the demand has complied with the form and manner of the demand as detailed in 8 Del. C. 1953, § 220.
3. The demand for inspection serves a "proper purpose," defined as a purpose that is "reasonably related to such person's interest as a stockholder."

Next, the plaintiff must prove by a preponderance of the evidence that "each category of books and records is essential to [the] accomplishment of the stockholder's articulated purpose for the inspection."<sup>1</sup> Delaware courts have made clear that Section 220 is "an important part of the corporate governance landscape."<sup>2</sup> Therefore,

stockholders have wide latitude in making a Section 220 demand on a company, and there is not an exhaustive list of reasons or rationales that constitute a proper purpose when making such a demand. Two common reasons include:

1. To investigate potential corporate mismanagement, wrongdoing, or waste;
2. To communicate with the Board regarding corporate decisions (such as mergers, acquisitions, tender offers, appraisals, etc)

### How § 220 Operates

Making a 220 demand is the first step that stockholders take to determine whether there was any wrongdoing. By 1997, the Court of Chancery recognized that it had been "well established that investigation of mismanagement is a proper purpose for a Section 220 books and records inspection."<sup>3</sup> In an empirical study conducted by Professors Cox, Martin, and Thomas, an analysis of 220 demands filed between 1997 and 2018 revealed that the number of these demands have increased 13 times since Delaware courts firmly embraced the "Tools at Hand" doctrine.<sup>4</sup> An analysis of 699 corporate cases filed in Delaware between 2004 and 2018 showed 510 instances of a 220 demand for

<sup>1</sup> *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1035 (Del. 1996).

<sup>2</sup> *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 120 (Del. 2006).

<sup>3</sup> *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 567 (Del. 1997).

<sup>4</sup> See James D. Cox et al., *The Paradox of Delaware's "Tools at Hand" Doctrine: An Empirical Investigation*, 75 Bus. Law. 2123 (2020).

inspection of books and records as compared to 144 instances of a 220 demand between 1981 and 1994.

Generally, § 220 demands allow stockholders the right and resources to investigate a company's management when they believe that the company has engaged in improper actions contrary to the stockholders' or the company's interests. It should be noted that a 220 demand cannot be rooted in simple curiosity and desire "to investigate possible general mismanagement, without more, will not entitle a shareholder to broad 220 inspection relief."<sup>5</sup> However, the Court of Chancery has made clear that stockholders need not prove that there was actual wrongdoing or mismanagement when serving a 220 demand; rather, the stockholder need only prove that it's more likely than not that there is "a credible basis from which the court can infer a *possibility* of wrongdoing."<sup>6</sup> To that end, stockholders must offer proof that such a credible basis exists.

As the Court of Chancery made clear in *Mizel v. Connelly*, lawyers who fail to file a 220 demand "do so at some peril," and could yield in a stockholder losing standing, granting of a defendant's motion to dismiss, and other unfavorable outcomes.<sup>7</sup> Thus, the number of 220 demands began to increase exponentially over the next few decades as described above. In the landmark case, *In re Caremark International, Inc. Derivative Litigation*, the Delaware courts established that directors or officers who fail to oversee operations or intervene when facing

proverbial red flags will be in violation of their fiduciary duties.<sup>8</sup> Such claims that directors failed to exercise due care and oversight over a company are referred to as "Caremark claims." However, they were rarely brought forth and often dismissed since Chancellor Allen explained that winning a claim on duty of oversight allegations was "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."<sup>9</sup> This changed with the Delaware Supreme Court's 2019 decision in *Marchand v. Barnhill*, wherein the DE Supreme Court ruled that a Caremark claim could proceed against the directors of one of the largest ice cream producers in the country for failing to implement and monitor safety protocols after a listeria outbreak caused multiple injuries and deaths to consumers.

## Impact and Implications for ESG

With more attention and emphasis on ESG protocols, the Court of Chancery has been more likely to examine the 220 demands from the lens of assessing whether "proper purpose" has been met to gauging whether the type and extent of the books and records requested are necessary for the stated purpose. One notable exception to this trend of finding a proper purpose is *Simeone v. Walt Disney Company*, 302 A.3d 956 (Del. 2023). In this case, stockholders made a 220 demand on the Disney Board of Directors in response to Disney's decision to criticize Florida House bill HB 1557, titled the "Parental Rights

<sup>5</sup> *Id.* at 122.

<sup>6</sup> *Lebanon Cnty. Employees' Ret. Fund v. Amerisourcebergen Corp.*, 2020 WL 132752, at \*8 (Del. Ch. Jan 13, 2020), *aff'd*, 243 A.3d 417 (Del. 2020).

<sup>7</sup> *Mizel v. Connelly*, No. 16638, 1999 WL 550369, at \*4, n.5 (Del. Ch. Aug. 2, 1999).

<sup>8</sup> *In re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

<sup>9</sup> *Id.* at 967.



Act,” popularly referred to as the “Don’t Say Gay” law (the “Bill”). Shortly after the Bill was signed by Florida Governor DeSantis, Disney issued a public statement that Disney is “dedicated to standing up for the rights and safety of LGBTQ+ members of the Disney family, as well as the LGBTQ+ community in Florida and across the country.”<sup>10</sup>

In its 220 demand, the plaintiff alleged that “officers and directors of Disney may have breached their fiduciary duties to the Company and its stockholders by, *inter alia*, failing to appreciate the known risk that the Company’s political stance would have on its financial position and the value of Disney stock.”<sup>11</sup> In the judgment, Vice Chancellor Will made clear that this demand was insufficient and dismissed the case for three reasons:

1. The stated “purposes” was pretextual and “not the plaintiff’s own purposes”;
2. There was “no credible basis from which to infer possible wrongdoing,” and
3. “[Disney] provided the plaintiff with all necessary and essential documents.”

The court arrived at this conclusion because the plaintiff had been solicited by the law firm that holds highly conservative views that were aligned with the Bill. Additionally, Disney was entitled to make the statement that it wished to make as a matter of corporate policy, and “stockholders invest with the understanding that the board is empowered to direct the corporation’s affairs.”<sup>12</sup>

And even though Disney was not under an obligation to provide the plaintiff the documents requested, Disney provided the formal meeting minutes, presentations, and other formal board-level documents that demonstrated their discussions that led to their decision to issue the statement that they made. Lastly, the Court of Chancery made clear that a 220 demand is not appropriate simply due to disagreement with a company’s business decision (*i.e.*, disagreeing with a company’s policy is not evidence of wrongdoing).<sup>13</sup>

One significant takeaway from this case and others related to ESG may be that Delaware courts will continue to focus on the *extent* that stockholders are entitled to a company’s books and records rather than its *existence* when exercising their right to determine corporate mismanagement. Thus, stockholders should note that the outcome was not an indictment on the propriety of bringing a 220 claim in light of potential wrongdoing and more so on the process of demanding more than the “necessary and essential documents.”<sup>14</sup> Regarding the pretextual purpose and the role that played in declining the 220 demand for further documents, this outcome can be contrasted with that in *Greenlight Capital Offshore Partners, Ltd. v. Brighthouse Financial, Inc.*, wherein the plaintiff requested books and records for valuing its shares in the company.<sup>15</sup> In that case, the Court of Chancery recognized that Greenlight was at least partially motivated by activism.<sup>16</sup> However, a secondary improper

<sup>10</sup> Disney Vows to Repeal Don’t Say Gay law.

<sup>11</sup> *Simeone v. Walt Disney Co.*, 302 A.3d 956, 963 (Del. Ch.), judgment entered sub nom. *Simeone v. The Walt Disney Co.* (Del. Ch. 2023).

<sup>12</sup> *Id.* at 970.

<sup>13</sup> *Id.* at 973.

<sup>14</sup> *Id.* at 966.

<sup>15</sup> *Greenlight Capital Offshore Partners, Ltd. v. Brighthouse Fin., Inc.*, 2023 WL 8009057, at \*7 (Del. Ch. Nov. 20, 2023).

<sup>16</sup> *Id.*



motive or purpose does not preclude the validity of the primary purpose.<sup>17</sup> In other words, there is a key difference between having *only* a pretextual reason to make a 220 demand and having multiple reasons—the primary purpose of which is legitimate.

## Takeaways & Overview of Future Outlook

Stockholders should remember that there must be at least *some* evidence that there is mismanagement, wrongdoing, waste, etc. for the court to grant a 220 demand. As explained in *AmerisourceBergen*, plaintiffs are not allowed to engage in an “indiscriminate fishing expedition.”<sup>18</sup> However, legitimate and credible claims against a company for wrongdoing, such as the Caremark claim brought against Facebook in *In re Facebook, Inc. Section 220 Litigation*, will not be viewed as a fishing expedition. Stockholders may also bring forth 220 demands based on greenwashing issues.<sup>19</sup> When determining whether to pursue action against a company, stockholders should carefully consider the balance of their purpose, the specificity of the documents requested, and other motives that may be impugned by defendants.

Once the 220 demand is made and documents are produced, stockholders should review the documents carefully to assess whether the scope and nature of the production reasonably allows assessment of potential wrongdoing, mismanagement, etc. If the documents produced

are heavily redacted, deficient, or simply missing, then a negative inference may be drawn against the defendant. For example, Labaton Keller Sucharow is currently representing a pension fund in *Ontario Provincial Council of Carpenters’ Pension Trust Fund v. Walton*, and prevailed against a motion to dismiss after filing a 220 demand based on Walmart’s Board of Directors’ violating their fiduciary duties.<sup>20</sup> The 220 demand stemmed, in part, from the belief that Walmart’s pharmaceutical operations were not in compliance with a settlement agreement that it had entered into with the Drug Enforcement Agency in 2009 to monitor and ensure that Walmart was not dispensing controlled substances in violation of the Controlled Substances Act along with other federal laws.<sup>21</sup> When reviewing the 220 production, the Court of Chancery found that “They [the directors] knew about the problem and took no action whatsoever. Although that seems highly unlikely, that is the record that Walmart created through its highly redacted Section 220 production.”<sup>22</sup> In other words, the Court of Chancery determined that had the directors taken any corrective measures, then there would have been evidence left behind that Walmart could and would have turned over in response to the demand. At the preliminary stage, absence of evidence may be viewed as evidence of absence. Thus, stockholders may utilize 220 demands to determine preliminarily that the Board of Directors failed to take corrective action despite red flags or corporate harm from bad acts.

<sup>17</sup> *Id.*

<sup>18</sup> *AmerisourceBergen* at 11.

<sup>19</sup> For more information, See *ESG as a Shield: How Corporate Greenwashing Leads to Climate Change Litigation*.

<sup>20</sup> *Ontario Provincial Council of Carpenters’ Pension Trust Fund v. Walton*, 2023 WL 3093500 (Del. Ch. Apr. 26, 2023).

<sup>21</sup> *Id.* at 30.

<sup>22</sup> *Id.* at 17.

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