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Two Recent Delaware Decisions Further Illustrate The Scope Of Section 220 Discovery

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Two recent Delaware Court of Chancery decisions demonstrate that narrow statutory standards continue to govern access to corporate books and records pursuant to Section 220 of the Delaware General Corporation Law. In the wake of *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, 95 A.3d 1264 (Del. 2014), legitimate questions existed regarding whether the Delaware Supreme Court's decision might usher in an era of expansive Section 220 discovery. *See* Michael C. Hefter, Ryan M. Philp & Kate E. Olivieri, *Scope of Section 220 Discovery After 'Wal-Mart'*, N.Y. L.J., July 13, 2015, at S8. However, cases following the *Wal-Mart* decision suggested that the far-reaching access granted in that case was a product of exceptional circumstances that allowed the plaintiffs to leverage unusually strong evidence of officer and director wrongdoing. *Id.* at S9.

Amalgamated Bank, et al. v. Yahoo! Inc. and *George Chammas, et al. v. NavLink, Inc.*, both decided this month, signal that *Wal-Mart* likely did not open the door to vast email discovery under Section 220. Rather, these cases further illustrate that, while Section 220 may in certain circumstances permit access to emails, courts will continue to determine the permissible scope of Section 220 discovery based on a stringent application of Section 220's statutory requirements.

Amalgamated Bank, et al. v. Yahoo! Inc.

In *Amalgamated Bank, et al. v. Yahoo! Inc.*, C.A. No. 10774-VCL (Del. Ch. Feb. 2, 2016), Amalgamated Bank sought production of internal Yahoo communications pursuant to Section 220 in order to investigate the hiring and subsequent firing of Henrique de Castro as Yahoo's Chief Operating Officer. The terms of de Castro's hiring were negotiated by Yahoo CEO Marissa Mayer and on several occasions Mayer reported to the Board and received authorization to continue talks with de Castro. The Court (V.C. Laster) determined Amalgamated's alleged facts were sufficient to provide a "credible basis" from which it could infer possible mismanagement warranting further investigation. *Id.* at 37. Chief among Amalgamated's allegations were inconsistencies between the information possessed by Mayer and the information presented to the Board, and material changes Mayer made to de Castro's final offer letter without Board approval. *See id.* at 40-41. Under the revised compensation package, de Castro would receive the same aggregate compensation. The Court found, however, that the revised plan impacted his "incentives and the size of his payout if he was terminated without cause." *Id.* at 16-17. Essentially, Mayer's new plan "resulted in payouts that made earlier termination without cause dramatically more favorable to de Castro." *Id.* at 20. When de Castro's performance failed to meet expected benchmarks, Mayer proposed his termination without cause. The proposal was approved by the Board and triggered a substantial payout pursuant to the terms of de Castro's compensation package.

Amalgamated served a Section 220 demand requesting several categories of documents related to de Castro's employment and compensation terms. The dispute before the Court centered on its request for access to (1) officer-level files belonging to Mayer, including emails, and (2) documents reflecting discussions or decisions of the full Board or Committee, again including emails. *Id.* at 57. Documents in the broad second category "would include memos and notes about the subject matter of the Demand. It also would include emails to and from the directors from management or the compensation consultant, emails among the directors themselves, and documents and communications prepared by Yahoo officers and employees about the Board's deliberations." *Id.*

The Court first considered production of Mayer's files. Vice Chancellor Laster distinguished the exceptional circumstances of *Wal-Mart*, noting "the facts of this case do not support the type of production that the Delaware Supreme Court approved there." *Id.* at 59. However, the Court did grant full access to Mayer's files, "including notes and emails," and expressly confirmed that email and "other electronic documents" are within the permissible scope of Section 220 production. *Id.* at 59-60. Still, Vice Chancellor Laster's analysis adhered to the traditional requirement that Section 220 production be "necessary and essential" to the demanding party's purpose. The Court determined that because Mayer was the corporate officer who principally orchestrated de Castro's hire, her email and other documents "will provide otherwise unavailable information about and insight into her discussions and negotiations." *Id.* at 59. The Court found specifically that the emails "will show what Mayer knew and when, and they will reveal any variations between what Mayer knew and what she told the Board." *Id.* Thus, while Mayer herself was not a director, Amalgamated's assertion that Mayer failed to disclose certain material information to the Board warranted access to Mayer's documents; they were essential to investigating whether and to what extent Mayer withheld information, and the effect of any alleged omissions on the Board's decision making.

Next, the Court turned to the second category: communications reflecting discussions or decisions of the Board or its compensation committee. While the Court granted full access to Mayer's files, it substantially narrowed Yahoo's production of documents in this second category. Vice Chancellor Laster explained that the category was "expansive and could encompass numerous document custodians." *Id.* at 63. Beyond Yahoo's directors, possible custodians included the company's compensation consultant and members of his team, and any other officers or employees involved in the hiring decision, including even personnel in Yahoo's human resources department. *Id.* The range of possible documents would be similarly far reaching and would include "anything memorializing or referring to the hiring decision and the directors' deliberations, including emails." *Id*. The Court determined production of that scope – potentially including documents with no direct nexus to the board – was not justified and narrowed the production to include only those communications of the four directors who had comprised the compensation committee involved in de Castro's hire. *Id.*

The Court in *Amalgamated* also addressed an issue of first impression: "Yahoo asks that this court condition any further production on Amalgamated incorporating by reference into any derivative action complaint that it files the full scope of the documents that Yahoo has produced or will produce in response to the Demand" (the "Incorporation Condition"). *Id.* at 67. The Court granted Yahoo's request, noting the long-recognized authority of Delaware courts to limit the scope of Section 220 production, for example by conditioning access on confidentiality or the agreement to file subsequent litigation in Delaware. *Id.* at 67-68. Vice

Chancellor Laster explained the Incorporation Condition flowed naturally from the incorporation-by-reference doctrine and served to protect the same interest, *i.e.*, limiting a plaintiff's ability to take language out of context in its complaint in order to gain an unfair pleading advantage. *Id.* at 69-70. Further, the Court emphasized that the Incorporation Condition would in no way impact the pleading standards for derivative actions or for a motion to dismiss under Rule 12(b)(6). *Id.* at 71. "In the end, the only effect of the Incorporation Condition will be to ensure that the plaintiff cannot seize on a document, take it out of context, and insist on an unreasonable inference that the court could not draw if it considered related documents." *Id.* at 72.

George Chammas, et al. v. NavLink, Inc.

George Chammas, et al. v. NavLink, Inc., C.A. No. 11265-VCN (Del. Ch. Feb. 1, 2016), decided one day before *Amalgamated*, addressed a Section 220 demand served by directors, rather than shareholders. *Chammas* involved two NavLink directors who claimed to have been excluded from certain Board decision making and otherwise to have been denied access to information necessary to inform their actions as members of the Board. To investigate their claims, the plaintiff directors sought, pursuant to Section 220, access to various corporate books and records, including all communications between the non-plaintiff directors and officers as well as communications between the non-plaintiff directors and the company's Chairman, John Gibson. *Id.* at 17-18.

In one of his last decisions on the bench, Vice Chancellor Noble recognized that "directors' access to company books and records is broader than that of stockholders" and encompasses all records reasonably related to the director's position as a director. *Id.* at 20. Where a director establishes a proper purpose for the records, his or her right to inspection is "virtually unfettered." *Id.* at 15. However, in *Chammas*, the production sought by plaintiff directors included private communications exchanged between directors outside of official Board deliberations. The Court drew an important distinction with respect to these communications: they were not alleged to constitute official Board action, nor was there any indication that official Board action resulted from the communications or the alleged "Secret Meetings" they preceded. *Id.* at 18. The plaintiff directors only asserted that "Secret Meetings" and "other communication resulted in the non-Plaintiff directors 'agree[ing] on a course of action' without notifying Plaintiffs." *Id.* The Court held that "[m]ere suspicions of pre-meeting collusion among board members or board members and management, in the context of a Section 220 action, is insufficient to compel the production of private communications between such officers and directors, even to the extent that such communications are stored on the defendant company's servers." *Id.* at 19-20.

Ultimately, the Court concluded that these communications – never alleged to have constituted or caused any official Board action – did not qualify as company "books and records" under Section 220. *Id.* at 21-22. This distinction was further reiterated by the Court as it considered the remaining categories of production sought: "mere conversations, especially in the absence of alleged mismanagement or wrongdoing, . . . do not rise to the level of corporate records." *Id.* at 28.

Takeaways

These cases, decided one day apart, provide a snapshot of the Section 220 landscape more than a year after *Wal-Mart* and appear to alleviate any concerns that the Delaware Supreme Court's decision opened the floodgates to vast email discovery under Section 220. To the contrary,

these cases illustrate that Delaware courts will continue to evaluate Section 220 demands against the specific facts before the Court and will rigorously apply Section 220's statutory requirements. *Amalgamated* and *Chammas* together demonstrate that the scope of email discovery under Section 220 remains firmly tethered to the investigation of official action or inaction of the Board, and suggest a reluctance to grant access to email where the connection between the communications sought and official Board action becomes attenuated. Indeed, Vice Chancellor Laster explicitly distinguished *Wal-Mart* in a manner that suggests that vast email discovery will remain the exception rather than the norm.

The *Amalgamated* decision, which Yahoo has appealed to the Delaware Supreme Court, also illustrates Delaware courts' broad powers to condition Section 220 discovery such as by requiring the plaintiff to incorporate the entire Section 220 production into its pleading by reference. In addition to the statutory requirements, this Incorporation Condition may prove a powerful tool for companies to resist overbroad Section 220 demands.