

Ignoring Corporate Formalities Could Expose Board of Directors' Emails to Stockholders

Delaware Law Update

02.04.2019

Related People:

Matthew J. Rifino

Philip D. Amoa

Companies that do not follow corporate formalities and accepted bookkeeping practices may be more susceptible to an expansion of the types or forms of records they have to make available—namely email communications—to inquiring stockholders.

In *KT4 Partners LLC v. Palantir Tech., Inc.*, the Delaware Supreme Court expanded the scope of documents potentially available to stockholders who demand access to a company's books and records, pursuant to Section 220 of the Delaware General Corporation Law (DGCL). Acknowledging the difference between traditional discovery in a litigation context and a Section 220 inspection, the Court held that the trial court must tailor its order of inspection to include only books and records "essential and sufficient to the stockholder's stated purpose," in which the petitioning stockholder must receive access to all "essential" items but stop at what is "sufficient."

Trial Court Decision

KT4 Partners concerned a stockholder's demand for various books and records under Section 220 related to the officers and directors' management of the company. The trial court found that the stockholder made a credible showing regarding the alleged misconduct relative to an amendment of the investors' rights agreement. The trial court also found that the company failed to honor certain corporate formalities (e.g., annual stockholders' meetings) and that it conducted business informally through email. Despite these findings, the trial court limited its relief mainly to "the company's stock ledger, its list of stockholders, information about the company's directors and officers, year-end audited financial statements, [and] books and records relating to annual stockholder meetings."

Supreme Court Decision

The Delaware Supreme Court held that the trial court abused its discretion in excluding emails and other electronic documents from its order of relief. Based on a *de novo* standard of review, the Court first held that the stockholder's formal demand for the company's books and records included email communications. The Court then reviewed the trial court's order concerning the stockholder's right to documents for abuse of discretion, in which it held that the trial court abused its discretion by excluding the emails from its order.

While a stockholder bears the burden of establishing that the types of documents sought are “necessary” or “essential” to its “articulated purpose[,]” the Court held that the stockholder satisfied the evidentiary burden to compel access to the emails. The absence of more formal documents played a significant role in this decision—it not only denied the stockholder the ability to complete an adequate investigation, but undermined the trial court’s order compelling the production of documents that the company knew did not exist. Accordingly, the Court reversed the order in part and remanded the case for further proceedings.

Although the access to email communications garners much of the attention, the Delaware Supreme Court reinforced traditional principles of Delaware law in no uncertain terms. Chief Justice Leo E. Strine, Jr., also dashed the hopes of stockholders and their legal counsel that electronic servers everywhere would be fair game when he stated, “This does not leave a respondent corporation like Palomar defenseless... If a corporation has traditional, nonelectronic documents sufficient to satisfy the petitioner’s needs, the corporation should not have to produce electronic documents.”

Key Takeaways

KT4 Partners represents a limited expansion of stockholders’ rights under Section 220. Companies that do not adhere to corporate best practices risk having more types of forms and records made available to inquiring stockholders. Directors who use email to conduct board business could expose their communications to stockholders’ demands if the official records of the company are not properly recorded and maintained.