

# Section 220 Fee-Shifting: Delaware Court of Chancery Refurbishes the Tools at Hand

## Article

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The rise of stockholder books-and-records actions filed annually against Delaware corporations has seized the attention of the Court of Chancery. The number of books-and-records actions filed against Delaware entities has increased steadily each year since 2017, with 73 actions filed in 2017, 79 filed in 2018, 109 filed in 2019, 138 filed in 2020, and 93 filed thus far in 2021.

Despite a string of recent decisions confirming the low threshold for stockholders to gain access to corporate books and records, Delaware corporations continue to resist inspection demands, and stockholders in turn continue seeking relief from the Court. In a pair of recent decisions, the Court signaled its willingness to respond with orders aimed at deterring defense conduct that has necessitated what the Court views as needless judicial intervention.

In *Pettry v. Gilead Sciences, Inc.* in 2021, the Court awarded attorney fees nearing \$1.8 million to stockholders, citing the company's "glaringly egregious litigation conduct." The award follows a post-trial decision criticizing the company's "overly aggressive defense strategy," which, according to the Court, "epitomizes a trend" in Delaware.

Recent Chancery decisions suggest that defendants should not chalk up the fee-shifting decision to a one-off. Instead, Delaware corporations would be wise to factor the decision into the delicate balancing act conducted when deciding how to respond to stockholder books-and-records demands.

## SECTION 220 AND THE TOOLS-AT-HAND

Section 220 of the Delaware General Corporation Law provides stockholders of Delaware corporations with the right to inspect corporate books and records upon showing a "proper purpose" for inspection. Investigating mismanagement and wrongdoing is a proper purpose so long as the stockholder presents some evidence to suggest a "credible basis" from which the Court can infer possible mismanagement or wrongdoing warranting further investigation. As the Court of Chancery has recognized in many decisions, including *Pettry*, the credible-basis standard is "the lowest

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possible burden of proof' under Delaware law.”

Section 220 provides stockholders with a powerful tool for investigating corporate wrongdoing — one that Delaware courts have repeatedly implored stockholders to use before pursuing potential claims. The recent uptick in Section 220 actions suggests that stockholders have listened, likely as a result of decisions like *Kahn v. M&F Worldwide Corp.* in 2014 and *Corwin v. KKR Financial Holdings LLC* in 2015, which effectively raised the pleading requirements for certain claims in the post-merger litigation context.

### ENFORCEMENT PROCEEDINGS TURN INTO SURROGATE PROCEEDINGS

The Court of Chancery recently took aim at what it perceived to be attempts to turn Section 220 litigation into “surrogate proceeding[s]” to litigate the merits of potential claims arising from books-and-records investigations. Delaware corporations responded to the rise in Section 220 demands by attacking the basis of the proposed investigations. The arguments, while taking different shapes, essentially suggest that a stockholder fails to state a proper purpose when any claims that might emerge from the books-and-records investigation could not withstand a motion to dismiss.

At least three recent decisions — *Gilead*, an April 2021 post-trial opinion in *Gross v. Biogen, Inc.*, and a January 2020 post-trial opinion in *Lebanon County Employees' Retirement Fund v. AmerisourceBergen Corp.*, which the Delaware Supreme Court affirmed — rejected those arguments, finding such a standard does not comport with the minimal burden that stockholders must carry when seeking books and records to investigate mismanagement or wrongdoing. This is especially true, the Court recently explained, when subsequent litigation is not the sole desired end of the investigation.

Despite the low bar that stockholders must cross to exercise their inspection rights, companies continue to resist stockholder Section 220 demands and instead continue to force stockholders to litigate Section 220 claims through discovery and trial. The Court of Chancery in *Petry* has ascribed that approach to a perception among some defendants “that there are no real downsides to overly aggressive defense campaigns at the Section 220 phase.”

In *Gilead*, however, the Court introduced a downside.

### FEE-SHIFTING IN *GILEAD*

*Gilead* originated with Section 220 demands by five stockholders seeking to investigate a variety of alleged corporate wrongdoing, much of which was already the subject of ongoing litigation and government investigations. After the company refused to produce a single document in response to the demands, each of the stockholders filed separate Section 220 petitions.

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After discovery and trial, the Court granted the stockholders access to all but two limited categories of documents they requested. Emphasizing the low burden that stockholders must meet, the Court found that the plaintiffs had established a credible basis to suspect wrongdoing based solely on allegations pleaded in the ongoing litigation and government investigations. Before closing the post-trial opinion, the Court issued a first warning to other Section 220 defendants by sua sponte granting the *Gilead* stockholders leave to seek attorney fees.

Eight months later, the Court issued a six-page letter opinion awarding plaintiffs attorney fees under the bad faith exception to the American Rule. Notably, the Court found that the company's positions during the litigation, taken together, constituted "glaringly egregious" litigation conduct warranting fee-shifting. Those positions included:

- claiming that plaintiffs failed to establish a "credible basis" — the "lowest possible burden of proof" — despite having produced pleadings in ongoing litigation and congressional testimony;
- claiming that plaintiffs were not entitled to inspection because any claims that would arise therefrom would be dismissed, despite unequivocal case law stating a stockholder need not demonstrate *actionable* wrongdoing or mismanagement;
- pursuing a so-called *Wilkinson* defense—which applies when a stockholder abdicates the Section 220 demand to counsel — despite deposition testimony revealing that the stockholders were knowledgeable about their demands; and
- taking aggressive positions in discovery despite the summary nature of Section 220 proceedings.

While the Court's decision to award fees was based on the aggregate of these positions, the Court left open the possibility that one of the positions, standing alone, could constitute conduct sufficient to shift fees.

### TAKEAWAYS

While the fees decision in *Gilead* does not mark a major shift in the law, it does suggest that the Court may be willing to use fee-shifting to deter overly aggressive Section 220 defendants.

Notably, the Court did not attempt to analyze the propriety of fee-shifting in *Gilead* under existing templates for glaringly egregious litigation conduct, such as the "clear right" standard, which the Court has employed to award fees in, for example, cases where a director seeks to inspect books and records and is denied access. This suggests that the Court may be amenable to expanding the bad-faith exception to a new subset of conduct specific to stockholder Section 220 demands — one that, as the Court explained in the *Gilead* post-trial decision, aims to "recalibrat[e] the risks of Section

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220 litigation.”

Though the Court acknowledged that its decision was based on all of *Gilead's* positions taken together, it expressly left open the possibility that any one of those positions could be considered sufficient to shift fees. And given the recent frequency with which the Court has acknowledged overly aggressive Section 220 defendants, it is likely that stockholders’ lawyers will see this as an invitation to seek fees for dubious arguments in the future.

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