

SEEKING YOUR TRUE PURPOSE? DELAWARE OFFERS GUIDANCE ON SECTION 220 REQUESTS

Following *Corwin v. KKR Financial Holdings* and other Delaware cases that have reinforced the standards that stockholder suits must meet to survive dismissal, would-be litigants have increasingly invoked Section 220 of the Delaware General Corporate Law (“Section 220”) to try to obtain corporate books and records in order to use those materials to bolster claims in subsequent litigation. In *Donnelly v. Keryx Biopharmaceuticals, Inc.*, C.A. No. 2018-0892-SG (Del. Ch. Oct. 24, 2019), the Delaware Court of Chancery revisited the issue of what is a proper purpose under Section 220 and to what extent a stockholder’s purpose must match the purpose stated in her demand letter.

BACKGROUND

Section 220 provides stockholders with a means of inspecting the corporate books and records of a Delaware corporation for a proper purpose so long as specific requirements are met. The statute defines proper purpose as “reasonably related to the party’s interest as a stockholder.” In November 2018, a stockholder of Keryx Biopharmaceuticals, Inc. (“Keryx”) sent a Section 220 demand seeking information about the company’s recent merger with Akebia Therapeutics, Inc. The stated purpose of the demand was to investigate possible breaches of loyalty based on the fairness of the merger price, the potential influence of Keryx’s largest stockholder, bonuses paid to management in connection with the merger, the independence of the board, and improper disclosure. Keryx refused to produce any documents in response, and the stockholder filed a Section 220 action to compel a response.

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In opposing the action, Keryx argued that the court should deny the Section 220 demand because it was made under false pretenses, invoking the Court of Chancery’s decision in *Wilkinson v. A. Schulman, Inc.*, C.A. No. 2017-0138-JTL, 2017 WL 5289553 (Del. Ch. Nov. 13, 2017). In *Schulman*, the court rejected a Section 220 demand after concluding that the stockholder “simply lent his name to [the] lawyer-driven” demand and that the purposes stated in the Section 220 demand differed substantially from the concerns voiced by the demanding stockholder in a deposition. Keryx contended that *Schulman* applied because the demanding stockholder had not read the disclosures that the demand letter claimed were inadequate.

The Court disagreed, explaining that in *Schulman*, there was a “total” misalignment between the stockholder’s concerns (the company’s financial performance) and purpose set forth in the demand letter (the CEO’s stock awards). Here, while there was some misalignment between the demand letter and the stockholder’s deposition, there was also overlap – specifically the stockholder expressed concern about breaches of loyalty in connection with the Akebia deal in both the demand letter and his deposition based upon, among other things, the deal price, the bonuses, potential board conflicts and the largest stockholder’s influence. For this reason, the court found that the stockholder had expressed a proper purpose under Section 220.

OUR VIEW

With the increased prevalence of Section 220 demands, Delaware courts have had occasion to refine the parameters surrounding Section 220. Recent Delaware court decisions have provided more guidance on Section 220, such as the types of materials subject to such demands and the level of confidentiality expected. The Delaware Court of Chancery’s decision in *Keryx* now further clarifies that even if there are differences between demand letter and the stockholder’s stated purpose on deposition, the demand should not necessarily be denied as having been made under false pretenses.

Going forward, we expect plaintiffs to continue using Section 220 requests as a means of challenging boards of directors and management in corporate actions. Although as the Delaware Court of Chancery notes, with the “still-developing nature” of Section 220 case law, companies in good faith may continue to challenge these requests.



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