August 6, 2014

Wal-Mart v. *IBEW*: Delaware Supreme Court Authorizes Broad "Books and Records" Discovery Under Section 220 of the Delaware General Corporation Law and Adopts *Garner* Exception to Attorney-Client Privilege

SUMMARY

On July 23, 2014, in *Wal-Mart Stores, Inc.* v. *Indiana Electrical Workers Pension Trust Fund IBEW*,[1] the Delaware Supreme Court issued an important decision expanding the scope of shareholder discovery in connection with a "books and records" demand under Section 220 of the Delaware General Corporation Law (8 Del. C. § 220). Although the Court restated the long-standing Delaware law principle that materials sought under Section 220 must be "necessary and essential" to the achievement of a "proper purpose" and that Section 220 discovery must be tailored "with rifled precision," the Court required Wal-Mart to produce a broad array of materials from 12 custodians (and their assistants), including (1) "officer (and lower)-level documents regardless of whether they were ever provided to Wal-Mart's Board of Directors," (2) "documents spanning a seven-year period and extending well after the timeframe at issue," (3) "documents from disaster recovery tapes," and (4) unspecified additional documents "known to exist" by the undefined "Office of the General Counsel."[2]

The Court did not except from this production attorney-client and work product materials, instead adopting for the first time the "*Garner* doctrine," an exception to the attorney-client privilege that entitles stockholders to discovery of privileged material in certain circumstances.[3] The Court held that the doctrine applies both in plenary proceedings in the Delaware state courts and to inspections under Section 220.[4]

Background

Section 220 of the Delaware General Corporation Law states that a shareholder of a Delaware corporation is entitled, "upon written demand under oath stating the proper purpose thereof," to "inspect for any proper purpose . . . [t]he corporation's stock ledger, a list of its stockholders, and its other books and records."[5] The statute defines a "proper purpose" as one "reasonably related to such person's interest as a stockholder,"[6] which Delaware courts previously have held includes (among other things) "investigat[ing] allegedly improper transactions or mismanagement," "investigat[ing] the possibility of an improper transfer of assets out of the corporation," and "obtain[ing] particularized facts needed to adequately allege demand futility."[7]

The *Wal-Mart* action arose out of allegations that the management of Wal-Mart de Mexico, S.A. de C.V. ("WalMex"), a subsidiary of Wal-Mart Stores, Inc., authorized bribes to be paid to certain Mexican officials. The *New York Times* published a lengthy article alleging that Wal-Mart executives were aware of the bribery and had failed to respond appropriately. The article stated that the general counsel of Wal-Mart International initiated an internal, preliminary inquiry into the allegations, which concluded that there was "reasonable suspicion to believe that Mexican and USA laws have been violated." According to the article, Wal-Mart executives thereafter transferred control of the investigation from the general counsel of Wal-Mart International to the general counsel of WalMex, one of the investigation's targets, who allegedly "quickly cleared himself and his fellow Walmex executive[s] of any wrongdoing."

Shortly after the article's publication, the Indiana Electrical Workers Pension Trust Fund ("IBEW"), a Wal-Mart shareholder, demanded under Section 220 that Wal-Mart allow inspection of broad categories of documents relating to the bribery allegations. The purpose of the demand (as stated in IBEW's letter) was to investigate (1) potential mismanagement, (2) possible breaches of fiduciary duty by Wal-Mart or WalMex executives, and (3) whether pre-suit demand on the Wal-Mart board would be futile. Wal-Mart reviewed over 160,000 documents and produced over 3,000 documents in response to the demand, including Board and Audit Committee materials and documents concerning Wal-Mart's compliance program, but declined to provide documents it determined were neither "necessary" nor "essential" to the stated purposes or were privileged. IBEW subsequently filed a Complaint in the Delaware Court of Chancery pursuant to Section 220 alleging various deficiencies in Wal-Mart's production.

On October 15, 2013, then-Chancellor Leo E. Strine, Jr., who recently was confirmed as Chief Justice of the Delaware Supreme Court (and was not part of the panel considering *Wal-Mart*), ordered Wal-Mart to produce an expansive set of documents relating to the underlying allegations of bribery and Wal-Mart's ensuing investigation from 12 custodians (including non-director personnel) spanning a seven-year time period. The decision required Wal-Mart to produce responsive emails not only from current folders but also from backup tapes.[8] Critically, Chancellor Strine also held that responsive documents otherwise protected from disclosure by the attorney-client privilege or the work product doctrine must be produced

as well, subject to IBEW's agreement to "take appropriate steps to protect the confidentiality of [Wal-Mart's] privileged documents."[9] The order also stated that production of these materials to IBEW did not "result in a waiver of any of [Wal-Mart's] applicable privileges."[10]

The Delaware Supreme Court's Decision

The Delaware Supreme Court affirmed the Chancellor's decision in full. The Court first reaffirmed a long line of Delaware decisions holding that, under Section 220, a shareholder may inspect books and records that are "necessary and essential" to the stated "proper purpose"[11] and "courts must circumscribe orders granting inspection 'with rifled precision.'"[12] The Court explained that documents are "necessary and essential" if those documents address the "crux of the shareholder's purpose" and the information "is unavailable from another source."[13] The Court explained that a determination of whether documents are "necessary and essential" is "fact specific and will necessarily depend on the context in which the shareholder's inspection demand arises"[14] and that the "rifled precision" requirement "is not a qualitative limitation on the stockholder's right to obtain *all* documents that are necessary and essential to a proper purpose."[15] Applying these principles, the Court held that the Court of Chancery's Section 220 order represented a proper exercise of that court's considerable discretion.

The Court rejected Wal-Mart's argument that the Chancery Court should not have required it to produce "officer (and lower)-level documents" because those materials could not have been relevant to what the directors knew and therefore not relevant to the demand futility inquiry. The Court stated that IBEW's purpose in making the demand was not only to determine if demand would be futile but also "to investigate the underlying bribery and how the ensuing investigation was handled."[16] In addition, the Court agreed with the Court of Chancery's conclusion that officer-level documents were also material to the futility inquiry because they "may establish director knowledge of the WalMex Investigation by establishing that certain Wal-Mart officers were in a 'reporting relationship' to Wal-Mart directors, that those officers did in fact report to specific directors, and that those officers received key information regarding the WalMex Investigation."[17] The Court also concluded that because "[s]ome of the events relating to the WalMex Investigation occurred over seven years ago," it was not an abuse of discretion for the Court of Chancery to order a search of backup tapes.[18]

The Court also held that the *Garner* doctrine applies in Delaware in the context of both general litigation discovery and Section 220 demands. The Court stated that the *Garner* doctrine "allows stockholders of a corporation to invade the corporation's attorney-client privilege in order to prove fiduciary breaches by those in control of the corporation upon a showing of good cause."[19] The presence or absence of "good cause," in turn, depends on a number of factors, including "the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources," "whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality," and "whether the communication is of advice concerning the litigation

itself."[20] The Court emphasized, however, that the exception is "narrow, exacting, and intended to be very difficult to satisfy."[21] The Court also cautioned that, in connection with the potential production of privileged documents in response to a Section 220 demand, "the necessary and essential inquiry must precede any privilege inquiry."[22]

Applying these principles, the Court ruled that the Court of Chancery did not err in ordering Wal-Mart's production of privileged documents, noting that the production order did not encompass documents containing "advice concerning the litigation itself" (*i.e.*, the Section 220 litigation with the IBEW)[23] but rather advice regarding the alleged payments to Mexican officials and the related internal investigation. The Court also found no error in the Chancery Court's decision to require the production of attorney work product under Chancery Court Rule 26(b)(3), which allows access to non-opinion work product "upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent by other means."[24] Noting that the "good cause" standard under *Garner* and the "substantial need" standard under Rule 26(b)(3) exhibit a significant amount of overlap in their requirements, the Court held that IBEW had met both standards for the same reasons, citing with approval the Chancery Court's observation that "there is a colorable basis that part of the wrongdoing was in the way the investigation itself was conducted" and that it is "very difficult to find those documents by other means."[25]

Implications

- Although the *Wal-Mart* Court stated that it was not breaking new ground and confirmed the "necessary and essential" and "rifled precision" requirements of Section 220, the breadth of the inspection approved by the Court would appear to move the scope of Section 220 discovery much closer to the scope of general litigation discovery than had previously been the case. Given that a Section 220 demand ordinarily precedes the filing of a derivative action, *Wal-Mart* effectively opens up litigation discovery (or something very close to it) even before the shareholder has filed suit and its allegations have been tested by a motion to dismiss.
- A key to how broadly *Wal-Mart* has expanded the scope of Section 220 discovery is how future courts interpret *Wal-Mart*'s holding that investigating "mismanagement" was a sufficient proper purpose to justify the production of documents beyond the director level. While the decision states that officer-level documents are certainly relevant if a "reporting relationship" can be established between those officers and the directors, it did not state that such a reporting relationship is a prerequisite for officer-level documents to be subject to production under Section 220.
- There is nothing in the decision to suggest that the Court has departed from its prior holding that, in order to obtain documents under Section 220 for the purpose of investigating "mismanagement," a shareholder must present at least "some evidence" to suggest a "credible basis" for inferring mismanagement.[26] It is still true, as the Delaware Supreme Court once observed, that "[m]ere curiosity or a desire for a fishing expedition will not suffice."[27] This requirement was satisfied in *Wal-Mart* by a *New York Times* article, and companies involved in high-profile criminal or regulatory investigations should take note.
- The Court's *Garner* and attorney work product rulings are perhaps the most significant aspects of the decision, as they potentially open the door to shareholder discovery in class and derivative litigation of legal advice and attorney work product relating to potential criminal or regulatory

issues, such as interview summaries generated during the course of an internal investigation and advice from counsel concerning internal investigation findings. Under *Wal-Mart*, discussions between a company and its counsel may now be discoverable by shareholders and their lawyers through Section 220 demands, particularly where (as in *Wal-Mart*) the alleged wrongdoing includes the conduct of the internal investigation itself. *Wal-Mart* does not, however, mean that the production of privileged documents to a shareholder under the *Garner* doctrine will operate as a waiver with respect to third parties (such as government agencies); but companies would be wise to insist on confidentiality agreements governing the production of such materials that make express that the company does not intend to waive any privileges and that restrict further disclosure of such materials by the shareholder.

* * *

Copyright © Sullivan & Cromwell LLP 2014

ENDNOTES

1 No. 13-614 (Del. July 23, 2014).

2 *Id*. at 9, 12.

3 *Garner* v. *Wolfinbarger*, 430 F.2d 1093, 1103-04 (5th Cir. 1970).

4 *Wal-Mart*, slip op. at 27.

5 8 Del. C. § 220(b).

6 *Id*.

7 *City of Westland Police & Fire Ret. Sys.* v. *Axcelis*, 1 A.3d 281, 289 n. 30 (Del. 2010).

8 *Wal-Mart*, slip op. at 9.

9 *Ind. Elec. Workers Pension Trust Fund IBEW* v. *Wal-Mart Stores, Inc.*, No. 7779-CS, at 2 (Del. Ch. Oct. 15, 2013).

10 *Id*.

11 *Wal-Mart*, slip op. at 11-12 (quoting *Saito* v. *McKesson HBOC, Inc.*, 806 A.2d 113, 116 (Del. 2002)).

12 *Id*. at 38 (quoting *Saito*, 806 A.2d at 117 n.10).

13 *Id*. at 12 (quoting *Espinoza* v. *Hewlett-Packard Co.*, 32 A.3d 365, 371-72 (Del. 2011)).

14 *Id*. (quoting *Espinoza*, 32 A.3d at 372).

15 *Id*. at 38 (emphasis in original).

16 *Id*. at 13-17.

17 *Id*. at 16.

18 *Id*. at 19.

19 *Id*. at 22.

20 *Id*. at 22 n.32 (quoting *Garner*, 430 F.2d at 1104).

21 *Id*. at 22, 26-27.

22 *Id*. at 25-27.

23 *Id*. at 30.

24 Del. Ct. Ch. R. 26(b)(3).

25 *Wal-Mart*, slip op. at 29, 31-33.

26 *Seinfeld* v. *Verizon Commc'ns, Inc.*, 909 A.2d 117, 118 (Del. 2006).

27 *Sec. First Corp.* v. *U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 568 (Del. 1997).

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Stefanie S. Trilling (+1-212-558-4752; trillings@sullcrom.com) in our New York office.

CONTACTS

New York		
Nicolas Bourtin	+1-212-558-3920	bourtinn@sullcrom.com
Brian T. Frawley	+1-212-558-4983	frawleyb@sullcrom.com
Robert J. Giuffra Jr.	+1-212-558-3121	giuffrar@sullcrom.com
John L. Hardiman	+1-212-558-4070	hardimanj@sullcrom.com
William B. Monahan	+1-212-558-7375	monahanw@sullcrom.com
Richard C. Pepperman II	+1-212-558-3493	peppermanr@sullcrom.com
Alexander J. Willscher	+1-212-558-4104	willschera@sullcrom.com
Washington, D.C.		
Amanda Flug Davidoff	+1-202-956-7570	davidoffa@sullcrom.com
Los Angeles		
Robert A. Sacks	+1-310-712-6640	sacksr@sullcrom.com
Palo Alto		
Brendan P. Cullen	+1-650-461-5650	cullenb@sullcrom.com