CORPORATE LAW, RETOOLED: HOW BOOKS AND RECORDS REVAMPED JUDICIAL OVERSIGHT

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In a string of landmark corporate law rulings in the mid-2010s (most notably, Corwin v. KKR Financial Holdings*), Delaware's Supreme Court supposedly relaxed the standards of judicial review across a wide range of business transactions. Commentators predicted that this development would render corporate law irrelevant to the regulation of business behavior, thereby insulating managers from accountability and leading to a deterioration in corporate governance. Yet recent empirical studies have refuted the predictions: directors operating under the revamped decisional law still try as hard and get as good results as they did prior to* Corwin*. This Article examines why Delaware's corporate law still matters, even after the supposed relaxation of substantive standards of judicial scrutiny.*

Coming on the heels of Corwin *was another, equally important yet less studied development, namely, the expansion of shareholders' rights to information from the company. Delaware courts have been constantly relaxing their interpretation of a statutory rule (section 220) that grants shareholders a qualified right to inspect the company's books and records. The courts now order in section 220 actions the provision of not just formal documents such as board minutes, but also informal electronic communications such as private emails or LinkedIn messages between directors. Armed with such newfound pre-filing discovery powers, shareholders and their attorneys can use the internal documents to plead with particularity facts about disclosure deficiencies and conflicts of interests, thereby overcoming what once seemed insuperable pleading hurdles.*

The "Books and Records" expansion has thus reshaped corporate litigation and revamped deterrence, with important implications for deal negotiations,

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oversight duties, and much more. By allowing plaintiffs and their attorneys to effectively monitor corporate decision-makers, the expansion of section 220 has mitigated much of the presumed problematic effects of Delaware's dilution of the substantive standards of review.

Corporate law largely operates through section 220 these days. Yet the legal literature has thus far lagged behind in appreciating section 220's impact. This Article makes three contributions in this regard. First, it explains how section 220 rose to prominence. The Article synthesizes seemingly disparate doctrinal developments, whose interactions led to a new, front-loaded version of corporate litigation, where most of the action happens pre-filing. Second, it evaluates the desirability of section 220's expansion. The Article assesses the advantages and disadvantages of shifting to a new, front-loaded equilibrium, concluding that Delaware courts seem to be striking the right balance between keeping the costs of discovery in check and facilitating monitoring of potential corporate wrongdoing. Third, it identifies current trends that may reverse the newfound emphasis on pre-filing investigations. The Article shows that under certain conditions both defendants and plaintiffs may prefer to avoid pre-filing investigations, and offers ways to mitigate this troubling trend. In the process, we revisit longstanding policy debates, such as how to designate the "lead plaintiff" and whether to allow mandatory arbitration clauses.

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INTRODUCTION

In a string of landmark corporate law rulings in the mid-2010s,[1] Delaware's Supreme Court relaxed the standards of judicial review, allowing corporate decision-makers to escape enhanced judicial scrutiny as long as they received a favorable shareholder vote or met other procedural requirements. These rulings, and in particular *Corwin*,[2] sparked a heated debate. One camp decried the decline of judicial scrutiny, predicting it would insulate managers from accountability and lead to deterioration in corporate governance.[3] Another camp lauded the shift from judicial involvement to a market mechanism (the shareholder vote), noting that today's sophisticated institutional investors can fend for themselves.[4] Both camps, however, agreed on one thing: *Corwin*'s outsized influence. The consensus was that *Corwin* is "the most important development in corporate law" in the twenty-first century,[5] and that it would transform corporate law, making it "no longer vital to the regulation of U.S. corporations."[6]

The consensus turned out to be wrong. With the benefit of a five-year retrospect, it is now clear that corporate law is still very much vital. Indeed, empirical studies examining the effect of Delaware corporate

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1 *See* cases cited *infra* notes 52–54 and accompanying text.

2 Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015).

3 *See, e.g.*, Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161 (2019).

4 *See, e.g.*, Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263 (2019).

5 James D. Cox, Tomas J. Mondino & Randall S. Thomas, *Understanding the (Ir)relevance of Shareholder Votes on M&A Deals*, 69 DUKE L.J. 503, 505 n.2 (2019) (compiling references for the consensus).

6 Goshen & Hannes, *supra* note 4, at 265.

law on primary behavior find no change post-*Corwin*.[7] What explains the gap between the predictions about *Corwin's* outsized impact and the on-the-ground evidence of a limited impact? What the commentators missed was that the supposed relaxation of judicial scrutiny would turn out to be just the first step in the recalibration of corporate law. Coming on the heels of the *Corwin* development was a corresponding development in *pre-filing* discovery. Delaware's first step was to raise the pleading bar: by allowing decision-makers to enjoy the deferential business judgment review if they received a favorable shareholder vote, the court made it harder for plaintiffs to survive the motion to dismiss and reach discovery. Delaware's second step was to expand the fact-finding powers that shareholders enjoy before the motion to dismiss stage by providing them with access to broad pre-filing discovery, which makes it easier for plaintiffs to unearth corporate wrongdoing and, in turn, restores the deterrence that used to come from post-filing discovery.

The main operative mechanism here was Delaware General Corporation Law (DGCL) section 220. A once-obscure feature of corporate law, section 220 grants shareholders a qualified right to inspect their company's books and records. Immediately following the *Corwin* development, Delaware courts relaxed their interpretations of section 220 requirements, ordering companies to provide even private email communications between directors and between them and their advisors. The one-two step rulings, therefore, led to a recalibration of corporate litigation, so that it is now heavily front-loaded. Delaware courts used *Corwin* (and *Trulia*, and *C&J Energy*, and *MFW*) to curb the soaring costs of deal litigation; they then facilitated broader usage of pre-filing investigations to maintain the benefits of monitoring by plaintiffs and their attorneys. It is now harder to pursue meritless claims, but still very much possible to pursue meritorious ones.

While practitioners were quick to recognize that corporate law operates through section 220 nowadays,[8] the legal literature has thus far lagged behind.[9] This Article attempts to fill the gap in our

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7 Matthew D. Cain et al., *Does* Revlon *Matter? An Empirical and Theoretical Study*, 108 CALIF. L. REV. 1683 (2020); *see also* Fernán Restrepo, *Judicial Deference, Procedural Protections, and Deal Outcomes in Freezeout Transactions: Evidence from the Effect of* MFW (Working Paper, 2018), https://ssrn.com/abstract=3105169; Matteo Gatti, *Did Delaware Really Kill Corporate Law? Shareholder Protection in a Post-*Corwin *World*, 16 N.Y.U. J.L. & BUS. 345, 353 & n.36 (2020).

8 *See infra* notes 145, 149–50 and accompanying text.

9 To be sure, there are notable exceptions in the works of professors James Cox, George Geis, and Randal Thomas. *See, e.g.*, *infra* notes 11, 188. Yet while no student leaves the basic "Corporations" course without deep appreciation of *Corwin* and its impact, as of this writing almost all students still leave the course without knowing much about section 220 and its impact.

understanding of the section 220 turn by examining three questions: (1) how did we get to this new front-loaded equilibrium, where much of the action in corporate law happens pre-filing? (2) Is the new equilibrium desirable? And, (3) is it sustainable? The Article, thus, first brings together different strands of doctrine to explain what made plaintiffs more willing and able to conduct thorough pre-filing investigations; then assesses whether the benefits from expanding shareholders' inspection rights are likely to outweigh the costs of protracted disputes over rights to information; and finally, points out several trends that could very well reduce the part that pre-filing investigations currently play, and sketches ways to mitigate these trends. The Article proceeds in three parts corresponding to these three questions.

Part I traces the reasons behind the exponential increase in pre-filing investigations via section 220, focusing on two related factors. First, lawmakers sought to curb abusive litigation by heightening the pleading requirements while staying discovery. As a result, plaintiffs who wish to survive the motion to dismiss now have to be able to extract quality information about the misbehavior in question before they even file their complaint. In other words, the demand for pre-filing investigatory tools has significantly increased. Then, Delaware courts made sure that supply meets demand: in a series of recent decisions, they liberalized inspection rights laws. Nowhere is this expansion of section 220 clearer and more impactful than in the "permissible scope" requirement: courts signaled their willingness to order provision of not just formal internal documents such as board minutes, but also informal electronic communications such as private LinkedIn messages between directors. As a result, section 220 has become a potent investigatory tool, allowing plaintiffs to overcome what once seemed insuperable pleading hurdles.

Part II assesses the advantages and disadvantages of the shift to pre-filing investigations and finds it is likely to prove overall desirable from a societal perspective. While the expansion of pre-filing discovery comes with its own set of thorny issues, it was needed to restore deterrence following the *Corwin* development. The expansion of section 220 mitigates the over-screening problem of early dismissals of meritorious claims. It facilitates managerial accountability across a wide range of situations—from negotiating transformational transactions to overseeing legal risks. It helps plaintiffs rebut the presumptive deference to the shareholder vote (overcoming *Corwin*), rebut the presumptive validity of a single-bidder process (overcoming *C&J Energy*), and poke holes in the company's oversight programs (reinvigorating

Caremark).[10] Further, the expansion of section 220 contributes not just to legal deterrence, but also to market (reputational) deterrence. Pre-filing investigations produce a positive externality of quality information on how companies behave. To the extent that such information becomes public, third parties can use it to decide with whom they want to keep doing business and with whom they do not. Part II then emphasizes how Delaware courts have been effectively micromanaging the volume and scope of discovery, so as to strike a delicate balance between keeping the costs in check and incentivizing plaintiff attorneys to vigorously monitor potential corporate wrongdoing.

Part III sounds a more pessimistic note, questioning the sustainability of the new pre-filing equilibrium. Precisely because pre-filing investigations have become so potent, companies have been attempting to limit their effectiveness, such as by signing shareholders to waivers or conditioning provision of documents on confidentiality. And because pre-filing investigations generate a positive externality (quality information on corporate behavior), plaintiffs do not internalize all the benefits: they may agree too quickly to confidentiality, or rush to file outside Delaware, where they can file quickly without investing in investigations. This Part sketches ways to stop this troubling trend. I then conclude with a big-picture observation on the constant recalibration of corporate law.

I. HOW DID PRE-FILING INVESTIGATIONS RISE TO PROMINENCE?

Section 220 actions have increased thirteenfold from 1981–1994 to 2004–2018.[11] The usage of section 220 has only intensified since then, with practitioners now widely acknowledging it as a crucial part of today's corporate law. The primary purpose behind most of these new section 220 actions is to investigate potential wrongdoing, en route to filing subsequent lawsuits.[12] In other words, section 220 rose to

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10 While this Article focuses on section 220's impact on deal negotiation, I elaborate in a separate article on implications for director oversight duties. Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. L. REV. (forthcoming 2021).

11 *See* James D. Cox et al., *The Paradox of Delaware's "Tools at Hand" Doctrine: An Empirical Investigation*, 75 BUS. LAW. 2123 (2020).

12 *Id.* Section 220 plays a role not only as a precursor to subsequent litigation, but also in other, internal corporate governance disputes, such as executive compensation disputes and proxy contests. *See* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law,"* 63 EMORY L.J. 1383, 1459 (2014). My focus here is on the more prominent and more impactful usage of section 220 these days, namely, as a pre-filing investigatory tool.

prominence as a pre-filing investigatory tool. What explains this exponential increase in pre-filing investigations? This Part locates two corresponding factors as the answer.

First, lawmakers sought to curb abusive litigation by heightening the pleading requirements while staying discovery. As a result, plaintiffs who wish to survive the motion to dismiss now have to be able to extract quality information about the misbehavior in question before they even file their complaint. In other words, the demand for pre-filing investigatory tools has significantly increased (Subsection A elaborates). Then, Delaware courts made sure that supply meets demand: in a series of decisions, they liberalized inspection rights laws, allowing plaintiffs to use section 220 in more cases, and to extract a broader scope of internal documents, including even private emails and LinkedIn messages (Subsection B). Section 220 has, therefore, become a potent tool to which plaintiffs frequently resort, and its usage is reshaping corporate litigation.

A. *Step One: Front-Loading Litigation*

Over a span of twenty years, several different types of shareholder litigation—securities class actions, derivative actions, and deal litigation—have gradually converged into the same, front-loaded equilibrium, whereby plaintiffs face heightened pleading standards without access to discovery. While the front-loading of shareholder litigation may have been implemented in different stages, it rested roughly on the same rationale: lawmakers wished to curb abusive litigation and stop the race to the courthouse. That is, lawmakers tried to disincentivize plaintiff attorneys from filing first and investigating later (if at all).

By raising the pleading bar and staying discovery, lawmakers put a premium on plaintiffs' ability to investigate before they file. This Section traces the doctrinal developments that have raised the pleading bar in shareholder litigation, starting from securities class actions in the 1990s (Subsection 1) and continuing to derivative actions in the 2000s (Subsection 2) and deal litigation in the mid-2010s (Subsection 3). While plaintiffs in securities litigation were disallowed from using their inspection rights (as section 220 is not available in federal courts) and have had to resort to other investigatory techniques, plaintiffs in corporate litigation have adopted section 220 as their pre-filing investigatory tool of choice.

1. Securities Litigation

In securities class actions, the main event comes early: the motion to dismiss.[13] Following backlash over abusive securities litigation in the early 1990s,[14] the 1995 Private Securities Litigation Reform Act (PSLRA) instituted a combination of heightened pleading standards with a stay on discovery.[15] Plaintiffs have to plead facts with particularity, showing a strong inference of scienter.[16] And such facts about the defendant's state of mind must be pled without the benefit of discovery. As a result, virtually all defendants file motions to dismiss, and plaintiffs have a tough time surviving such motions.[17]

The combination of heightened pleading standards and stayed discovery generated two interelated effects: it reduced the number of lawsuits filed, while pushing plaintiff attorneys to raise their game and conduct more pre-filing investigations in the lawsuits that they did file.[18] Plaintiffs in securities litigation are now said to possess much more information in the motion to dismiss stage, relative to plaintiffs in other cases, and are forced to plead their allegations in an "awesomely detailed" way.[19] But, unlike plaintiffs in corporate litigation, plaintiffs in securities litigation cannot use section 220 actions, since the law blocks their usage in federal courts.[20] They therefore have to resort to alternative investigatory tools.

Most commonly, to overcome the pleading hurdles, plaintiff attorneys hire a private investigator who attempts to *solicit whistleblowers*, by finding current and former employees willing to

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13 Stephen J. Choi & A. C. Pritchard, *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of* Tellabs, 28 J.L. ECON. & ORG. 850, 851 (2012); Gideon Mark, *Confidential Witness Interviews in Securities Litigation*, 96 N.C. L. REV. 789, 794 (2018).

14 John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1376 (2012).

15 15 U.S.C. §§ 77z-1(b), 78u-4(b)(3)(B).

16 Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 314, 324 (2007).

17 James D. Cox & Randall S. Thomas, *Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law*, 6 EUR. CO. & FIN. L. REV. 164, 169 (2009).

18 Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 74 n.40 (2008). *But see* Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 929 (2003).

19 Geoffrey P. Miller, *Pleading After* Tellabs, 2009 WIS. L. REV. 507, 532 (2009).

20 The Securities Litigation Uniform Standards Act of 1998 (SLUSA) precludes securities class actions from being litigated in state courts, thereby limiting the ability to use state-backed rights to inspect the books. Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.). The Delaware Court of Chancery explicitly disallowed the filing of a section 220 request to assist the requesting shareholder in her pleading in federal courts. *See, e.g.*, Beiser v. PMC-Sierra, Inc., No. 3893-VCL, 2009 WL 483321, at *3 (Del. Ch. Feb. 26, 2009).

share damning inside information on the behavior of defendants.[21] Indeed, reliance on "information provided by confidential witnesses" has become almost universal in securities class actions.[22] These inside informants frequently provide information that outside observers are not privy to, providing a peek into who knew what when. To illustrate:[23] in *Tsirekidze v. Syntax-Brillian Corp.*, a former top officer provided details on how defendants cooked the books.[24] In *Silverman v. Motorola, Inc.*, eight former employees explained how the company knowingly omitted facts about technological difficulties.[25] In *Hubbard v. BankAtlantic Bancorp, Inc.*, former bank employees fleshed out claims about shady lending practices.[26]

Yet locating and relying on inside informants is a highly costly investment with uncertain outcomes. These witnesses usually insist that their identity be kept confidential, which may decrease their reliability in the eyes of the courts. There is also the issue of recantation: defendants sometimes manage to find out the identity of and confront these informants, who then recant their initial testimony. The different federal courts have been divided on the issue of how much weight to assign to these confidential informants, and how to deal with recantation.[27] Many plaintiff attorneys have, therefore, preferred to respond to PSLRA and SLUSA by shifting from filing securities lawsuits in federal courts to filing claims of breaches of fiduciary duties in state courts.[28] The problem of a potential litigation explosion, therefore, migrated from the federal courts to Delaware. As the following Subsections show, Delaware eventually reacted to the problem similarly to the PSLRA solution by raising the pleading bar while denying access to discovery. But unlike in securities litigation, in corporate litigation

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21 On the prevalence of relying on confidential informants, see City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp., 952 F. Supp. 2d 633, 637–38 (S.D.N.Y. 2013); Michael J. Kaufman & John M. Wunderlich, *Resolving the Continuing Controversy Regarding Confidential Informants in Private Securities Fraud Litigation*, 19 CORNELL J.L. & PUB. POL'Y. 637, 639–40 (2010).

22 Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 554, 554 n.15 (2011).

23 For compilations of many more useful examples, see Kaufman & Wunderlich, *supra* note 21, at 640 n.3; Miller, *supra* note 19.

24 Tsirekidze v. Syntax-Brillian Corp., No. CV-07-2204-PHX-FJM, 2009 WL 275405 (D. Ariz. Feb. 4, 2009).

25 Silverman v. Motorola, Inc., No. 07 C 4507, 2008 WL 4360648 (N.D. Ill. Sept. 23, 2008).

26 Hubbard v. BankAtlantic Bancorp, Inc., 625 F. Supp. 2d 1267, 1273–74 (S.D. Fla. 2008).

27 Jed S. Rakoff, *Confidential Informants and Securities Class Actions: Mixed Messages and Motives*, 45 LOY. U. CHI. L.J. 571, 573–74 (2014).

28 Brian Cheffins, John Armour & Bernard Black, *Delaware Corporate Litigation and the Fragmentation of the Plaintiffs' Bar*, 2012 COLUM. BUS. L. REV. 427, 467.

there was a ready-made, effective tool for pre-filing investigations, namely, section 220.

2. Derivative Actions

The first major shift of emphasis toward section 220 as a pre-filing investigatory tool came in the early 2000s, in the context of derivative actions.[29] Similarly to securities class actions, the main event in derivative actions comes before the suit even starts: the demand requirement. To bring a derivative claim, the plaintiff first has to make a demand on the company's board to pursue that claim. To survive the demand-requirement stage, plaintiffs practically need to convince the courts that demand is futile because the company's board cannot be trusted to make the right decision.[30] To do that, plaintiffs have to plead with particularity facts suggesting that directors are either too interested or lacking in independence, perhaps because they are too connected to the decision-makers facing liability, or because the challenged transaction is too far off from a reasonable business judgment for the court to trust their judgment on whether to pursue the lawsuit.[31] Importantly, plaintiffs need to clear the demand-excusal pleading hurdle without having the benefit of discovery.[32]

With regard to director independence and disinterestedness, decisions such as *Beam v. Stewart*[33] and *Cornerstone*[34] have gradually raised the pleading bar. *Beam* established a presumption of independence: even in a situation where the controller held ninety-four percent and was friends with the directors, directors were presumed independent until proven otherwise.[35] *Cornerstone* allowed independent, disinterested directors to dismiss complaints against them even when the transaction is subject to enhanced judicial scrutiny.[36] In other words, when independent directors are named in a lawsuit

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[29] Derivative actions are brought by shareholders on behalf of the company. For example, shareholders may sue the company's directors for breaching their monitoring duties in ways that harmed the company.

[30] Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

[31] FED. R. CIV. P. 23.1(b)(3) (as implemented in DEL. R. CH. CT. 23.1); *Aronson*, 473 A.2d at 814; Rales v. Blasband, 634 A.2d 927, 930 (Del. 1993).

[32] Brehm v. Eisner, 746 A.2d 244, 254–55 (Del. 2000); Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands—Reprise*, 28 CARDOZO L. REV. 1287, 1293 (2006).

[33] Beam v. Stewart, 845 A.2d 1040 (Del. 2004).

[34] *In re* Cornerstone Therapeutics Inc. Stockholder Litig., 115 A.3d 1173 (Del. 2015).

[35] *Beam*, 845 A.2d at 1055.

[36] *In re Cornerstone*, 115 A.3d at 1183.

challenging a conflicted transaction, they are still presumed to be protected by the business judgment rule. *Cornerstone* made it so that as long as the company has an exculpatory charter provision (as most do), plaintiffs' only chances to avoid dismissal of their claims against directors is by pleading bad faith.

A similar raising of the bar happened with the second prong, that of examining the merits of the decision. In common failure of oversight claims (often dubbed *Caremark* claims after the leading precedent),[37] for example, the pleading hurdle is a scienter-based, bad faith requirement.[38] To survive the motion to dismiss, plaintiffs have to plead particularized facts showing that the board had actual or constructive knowledge of the misbehavior in question,[39] and they have to make such specific claims about internal knowledge without access to discovery. The courts themselves recognized that showing a culpable state of mind with only public information is an "extremely high burden."[40]

And it was the courts themselves that came up with the solution. Starting in the mid-1990s, Delaware courts began admonishing plaintiffs who failed to use all the "tools at hand" to generate information pre-suit, particularly calling on plaintiffs to use their section 220 rights to inspect the company's books and records.[41] Section 220, the courts insisted, can increase the quality of pleading.[42] Plaintiffs heeded the call and started filing section 220 requests more frequently and more broadly.[43] The usage of section 220 actions to support subsequent derivative suits consequently started rising steadily from the early 2000s to the mid-2010s. But a more dramatic rise was still to come, in the different context of class actions challenging transformational transactions such as mergers.

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37 *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

38 Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006).

39 Wood v. Baum, 953 A.2d 136, 141–43 (Del. 2008).

40 *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 125 (Del. Ch. 2009) ("The presumption of the business judgment rule, the protection of an exculpatory § 102(b)(7) provision and the difficulty of proving a *Caremark* claim together function to place an extremely high burden on a plaintiff to state a claim for personal director liability . . . .").

41 Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996); Rales v. Blasband, 634 A.2d 927, 934 n.10 (Del. 1993); King v. VeriFone Holdings, Inc., 12 A.3d 1140, 1145 (Del. 2011); Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands*, 26 CARDOZO L. REV. 1595, 1601–03 (2005) (compiling references); Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L. REV. 473, 516 n.187 (2013) (same).

42 *See* sources cited *supra* note 41; Freund v. Lucent Techs., Inc., No. Civ.A 18893, 2003 WL 139766, at *4 (Del. Ch. Jan. 9, 2003).

43 For a comprehensive survey of the first wave of section 220 requests, see Radin, *supra* note 32.

3. Deal Litigation

In the mid-2010s, a series of landmark decisions brought pre-filing investigations to the hitherto unchartered territory of deal litigation. Within a span of a little over a year (around 2015), *Corwin*, *MFW*, *Trulia*, *C&J Energy,* and their progeny, transformed the substantive standards of judicial review, reducing the likelihood of court intervention and making it harder for plaintiffs to challenge deals. These cases received instant attention, with many calling them the most important corporate law development in decades.[44] Yet most of the attention focused on whether the reduced role of substantive judicial review was desirable or not. Not enough attention was given to how this supposed revolution in substantive standards (let us dub it "the *Corwin* development") would affect the seemingly procedural yet extremely important issues of discovery, both post- and pre-filing.

Prior to the *Corwin* development, plaintiffs did not need to invest much in pre-filing investigations when challenging transformational transactions. These transactions were subject to enhanced judicial scrutiny,[45] which meant that plaintiffs faced relatively low pleading hurdles. Directors and controlling shareholders were the ones having to convince the court that they pursued the best offer available, and so defendants' chances of dismissing a case in the pleading stage were relatively low. Further, plaintiffs seeking to enjoin a pending deal often had a relatively clear path to expedited discovery.[46]

Such a favorable starting point for plaintiffs eventually led to an explosion in deal litigation, and at some point during the 2000s nuisance claims took over. Almost every deal was litigated within a short period of time from its announcement.[47] Plaintiffs were able to proceed to discovery even when bringing weak claims. And defendants preferred to pay to settle even weak claims rather than go through costly discovery. Fast-filing plaintiffs were therefore able to credibly threaten with the costs of discovery, and extract quick settlements that benefited

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44 Cox, Mondino & Thomas, *supra* note 5.

45 *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Weinberger v. UOP, Inc., 457 A.2d 701, 714 (Del. 1983) (establishing the "entire fairness" standard of review for controllers' self-dealing conduct).

46 *But see* Parsons & Tyler, *supra* note 41, at 498–99 (noting plaintiffs must still "carry the burden of articulating a colorable claim").

47 Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 604–05 (2018); Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 475 (2015).

no one but the nicely compensated lawyers.[48] Delaware courts gradually became aware of this wasteful "deal tax."[49] Eventually, the backlash arrived in the mid-2010s, with a string of decisions by Delaware's Supreme Court that effectively allow defendants to escape enhanced judicial scrutiny and discovery as long as they receive shareholder ratification for the deal in question.

Corwin maintained that the deferential business judgment standard of review applies where a transaction "has been approved by a fully informed, uncoerced majority of the disinterested stockholders."[50] By invoking the business judgment review at the pleading stage, *Corwin* and its progeny operatively means that a favorable shareholder vote cleanses any breach of fiduciary duty that might have been alleged.[51] A similar shift occurred in the decisional law governing controlling shareholders: *MFW* allowed controllers to escape enhanced judicial scrutiny as long as the transaction is negotiated from the outset by an independent board committee and put to a shareholder vote.[52] *Corwin* and *MFW* both apply to claims seeking damages in the post-closing stage of a deal. Two other key rulings completed the overhaul of deal litigation, by addressing the pre-closing stage: *C&J Energy* clarified that the court will not issue an injunction unless an intervening bidder arises.[53] And *Trulia* signaled the end of rubberstamping disclosure-only

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48 Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015); J. Travis Laster, *Changing Attitudes: The Stark Results of Thirty Years of Evolution in Delaware M&A Litigation*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 202, 225 (Sean Griffith, Jessica Erickson, David H. Webber & Verity Winship, eds., 2018).

49 *In re* Cox Commc'ns, Inc., S'holders Litig., 879 A.2d 604, 608 (Del. Ch. 2005) (lamenting the "filing speed . . . Olympics"); *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 959–60, (Del. Ch. 2010); *In re* Trulia, Inc. S'holder Litig., 129 A.3d 884, 894 (Del. Ch. 2016); Laster, *supra* note 48, at 224 ("[T]he very litigation features that made enhanced scrutiny meaningful unfortunately made it easy for plaintiffs to state claims and difficult for the defendants to dispose of weak cases.").

50 Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015). For application of *Corwin* beyond its original context, see *In re* Volcano Corp. S'holder Litig.,143 A.3d 727 (Del. Ch. 2016) (applying *Corwin* to two-step tender offers).

51 Matthew Diller & Joseph R. Slights III, Lecture, Corwin v. KKR Financial Holdings LLC*An "After-Action Report*,*"* 24 FORDHAM J. CORP. & FIN. L. 1, 9 (2018).

52 Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014). The deal has to be approved by the majority of unaffiliated shareholders. For decisions that applied *MFW* beyond its original context of a squeeze-out merger to other transactions involving controllers, see *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., No. 9962-VCL, 2016 WL 301245 (Del. Ch. Jan. 25, 2016); IRA Tr. FBO Bobbie Ahmed v. Crane, No. 12742-CB, 2017 WL 7053964 (Del. Ch. Dec. 11, 2017).

53 C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' and Sanitation Emps.' Ret. Trust, 107 A.3d 1049 (Del. 2014).

settlements,[54] which traditionally come before the deal in question closes, yet they do not require much effort from plaintiffs to uncover new information or otherwise benefit shareholders.[55]

These four key rulings greatly reduced the incentives for plaintiffs to challenge transactions. Plaintiffs now know they are less likely to receive an injunction or disclosure *pre*-closing (because of *C&J Energy* and *Trulia*, respectively) and less likely to receive damages *post*-closing (because of *Corwin*).[56] Pertinently here, the *Corwin* development severely curtailed plaintiffs' access to discovery. Once defendants meet the conditions of *Corwin* or *MFW*, they enjoy the deferential business judgment rule standard, which operationally means that they can dismiss the lawsuit at the pleading stage, prior to discovery.[57] In fact, *Corwin* not only makes it likelier that plaintiffs' claims will be dismissed before they can reach discovery, but also makes plaintiffs not *want* discovery pre-closing: even if they gain access to discovery, defendants can simply issue supplementary disclosure and put the matter to a *Corwin* vote again, effectively terminating the lawsuit.[58] The upshot is that, coupled with *C&J Energy*, which limited plaintiffs' ability to obtain expedited discovery, post-filing discovery lost much of its relevance in deal litigation.[59]

Viewed from this perspective, we can appreciate how the *Corwin* development generated two corresponding effects: the first, well-covered effect was to reduce the volume of deal litigation.[60] The second, less-studied effect was to boost the importance of pre-filing investigations, and, in turn, increase the volume of section 220 litigation. A plaintiff who wishes to survive the motion to dismiss now has to overcome the *Corwin* defense. The plaintiff's best chance to plead around a *Corwin* defense is to show that the shareholder vote was not fully informed, by proving that what corporate insiders knew and what

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54 *In re Trulia*, 129 A.3d at 898.

55 Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 631 (2017).

56 Anabtawi, *supra* note 3, at 197.

57 Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049 (Del. Ch. 1996) (the classic case on how once the business judgment rule applies, the complaint can be dismissed at the pleading stage); Singh v. Attenborough, 137 A.3d 151, 151–52 (Del. 2016) (applying the BJR-as-pleading-hurdle argument to the *Corwin* era: "When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."). On paper, plaintiffs can still survive the motion to dismiss if they manage to plead facts pertaining to a waste claim, but such claims are extremely unlikely to succeed. *Id.*

58 Joel Friedlander, *Confronting the Problem of Fraud on the Board*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 3, 2019), https://corpgov.law.harvard.edu/2019/01/03/confronting-the-problem-of-fraud-on-the-board [https://perma.cc/XU4G-RA9E].

59 Diller & Slights, *supra* note 51, at 19.

60 Cain et al., *supra* note 47, at 621.

they told shareholders was not the same thing. Barring some negligence on the part of the defendants, the only realistic way an outsider can challenge the veracity of proxy statements is by gaining access to internal corporate documents. And the way to extract such damning internal information is by utilizing one's rights as a shareholder to inspect the company's books and records. *Corwin* therefore made pre-filing investigations through section 220 virtually a necessity in deal litigation, just as they always were in *Caremark* litigation.

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This Section can be summarized in two words: *scienter everywhere*. Different types of shareholder lawsuits have de facto converged into requiring that plaintiffs plead particularized facts about what defendants knew and when they knew it. Plaintiffs must show not just that something bad happened, but also that directors knew about it and did not stop it. Such facts are hard to come by through public records alone. The advent of heightened pleading standards has therefore pushed plaintiffs to find ways to extract information from inside the company. In particular, they now increasingly exercise their rights as shareholders to inspect the company's books and records to conduct thorough pre-filing investigations.

But having the will to investigate is not enough; plaintiffs also have to have the way. That is, plaintiffs must have access to powerful pre-filing investigatory tools. As the next Section shows, Delaware supplied just that: by adopting increasingly liberal interpretations of section 220 requirements, Delaware has made it easier for plaintiffs to extract valuable inside information.

B. *Step Two: Liberalizing Section 220*

The ability of plaintiffs to rely on pre-filing investigations hinges on how the law treats these tools. In particular, it depends on the extent to which courts allow the usage of, and rely on information from, inspection rights, inside informants, and other pre-filing methods. In recent years, Delaware courts have been trending toward allowing broader usage of section 220, to the point where it is now a game changer in corporate litigation as we have come to know it.[61]

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[61] Earlier steps of liberalizing section 220 came from the legislature, which in 2003 amended the section so as to extend the right of inspection to beneficial owners and permit inspection of subsidiaries' books. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1468 (2005).

The best illustration comes from *Corwin's* immediate aftermath. To understand *Corwin's* impact on corporate behavior, you have to read it with its section 220 progeny, such as the 2017 *Lavin*[62] and the 2019 *KT4 Partners* cases.[63] In 2015, *Corwin* supposedly revolutionized corporate law by shifting from judicial scrutiny to the shareholder vote as the shareholder protection mechanism of choice. This shift, in turn, incentivized plaintiffs to investigate the veracity of the information provided to shareholders so as to show that the vote was not fully informed (and therefore could not be counted on).[64]

In 2017, *Lavin* explicitly opened the door for plaintiffs to conduct such investigations effectively, allowing them to use section 220 to extract internal corporate communications relevant to the *Corwin* vote. The defendants in *Lavin* claimed that by securing a favorable shareholder vote, they cleansed any alleged breach of fiduciary duty, thereby rendering section 220 requests without proper purpose. Section 220 is available only for investigating actionable, non-exculpated wrongdoing, or so the defendants argued;[65] and if a *Corwin* vote cleanses wrongdoing, there is no point in investigating for curiosity's sake. Yet the *Lavin* court insisted that even a ratifying shareholder vote does not absolve the company from having to produce documents in section 220 actions.[66]

Then, in 2019, *KT4 Partners* kicked the doors wide open by broadening the scope of the inside information that has to be provided to include not only formal, hard-copy documents, such as board minutes, but also informal, electronic communications, such as private emails exchanged among the company's managers and between them and their third-party advisors.[67]

It is hard to overstate the importance of expanding the scope of section 220 to informal, electronic communications.[68] Formal documents such as board minutes are usually drafted after the fact, by paper-trail-generating lawyers. Informal electronic communications in social media and emails are done in real time and are usually less carefully edited. Gaining access to such informal communications significantly enhances the chances of plaintiffs to show a mismatch between what insiders discussed among themselves and what they told

62 Lavin v. West Corp., No. 2017-0547-JRS, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017).

63 KT4 Partners LLC v. Palantir Techs. Inc., 203 A.3d 738 (Del. 2019).

64 Gatti, *supra* note 7, at 382–85.

65 Delaware's Courts since clarified that this is not the case. AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 437 (Del. 2020).

66 *Lavin*, 2017 WL 6728702, at *7.

67 *KT4 Partners LLC*, 203 A.3d at 756–58.

68 For the practitioner's viewpoint, see Friedlander, *supra* note 58.

the outside world, thereby defeating the *Corwin* defense and getting past the motion to dismiss.

In other words, Delaware bootstrapped the *Corwin* ruling by broadening its interpretation of the proper purpose (in *Lavin*) and scope (in *KT4 Partners*) of section 220. The rest of this Section shows that *Lavin* and *KT4 Partners* are not isolated instances but rather reflective of a broader trend.

1. Liberalizing the Proper Purpose Requirement

Companies commonly do not acquiesce to shareholders' section 220 demands: they refuse to provide all or part of the documents or provide only heavily redacted documents. The demanding shareholder can then file a section 220 action requesting the court to order the company to provide said documents. The court's decision on whether the shareholder was within her (inspection) rights usually boils down to two prongs: proper *purpose* and *scope*.[69]

A "proper purpose" is one that is "reasonably related to the party's interest as a stockholder." It is well established that investigating wrongdoing and mismanagement qualifies as such.[70] Yet merely speculating that wrongdoing occurred is not enough. The demanding shareholder rather has to show a *credible basis* for her allegations of wrongdoing before she gains access to internal documents.[71] General allegations or mere disagreements with a business decision, in the absence of evidence from which the court may infer a possible breach of fiduciary duty, will not cut it.[72] The credible basis standard requires *some* evidence that an actionable wrongdoing occurred. But how much is "some," exactly? Not much, apparently: while the credible basis standard is not insubstantial, Delaware courts frequently refer to it as "the lowest possible burden of proof" under Delaware law.[73] Hearsay, circumstantial evidence, and logic may suffice to meet it.[74]

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69 Section 220 also contains other, more technical requirements, such as (1) being a stockholder, and (2) complying with formalistic requirements as to how the request has to be submitted (a written demand under oath). DEL. CODE ANN. tit. 8, § 220(b)–(c) (2010).

70 Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117, 121 (Del. 2006). Similarly, investigating directors' independence and disinterestedness for purposes of showing demand futility is a proper purpose. Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 777–78 (Del. Ch. 2016).

71 Thomas & Betts Corp. v. Leviton Mfg. Co., 681 A.2d 1026, 1031 (Del. 1996).

72 *Seinfeld*, 909 A.2d at 123, 125.

73 *Id.* at 123.

74 *Id.* at 118–23; *Amalgamated Bank*, 132 A.3d at 778; Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW, 95 A.3d 1264, 1273 (Del. 2014); Radin, *supra* note 41, at 1612.

Importantly, even when the plaintiffs' chances of winning the substantive claim on its merits are slim, the courts let plaintiffs use section 220 to extract information and try to establish their claim (and potentially reveal other types of breaches). And while it was once thought that only actionable (read: non-exculpated) wrongdoing is considered a proper purpose for investigations, by 2020 the courts clarified that any credible suspicion of wrongdoing at the company level (regardless of whether directors are exculpated) could justify inspection.[75]

To illustrate with another timely example, consider the section 220 litigation over the Facebook-Cambridge Analytica scandal.[76] When investigative reporters broke the story about how Facebook had been monetizing users' data without their consent, the company's stock price dropped dramatically.[77] Shareholders sought to investigate a potential failure to monitor privacy breaches by the company's directors (a *Caremark* claim).[78] To that end, shareholders filed a section 220 action to inspect internal communications of Facebook's top managers regarding privacy issues. The company fought back, claiming that shareholders' chances of overcoming the *Caremark* pleading hurdle by showing bad faith and winning their failure-to-monitor claims were slim. The court acknowledged that a *Caremark* claim is indeed the most difficult for plaintiffs to win on, yet insisted that this, in itself, does not alter the minimal burden governing section 220 requests.[79] The *Lavin* example discussed above follows a similar logic: the court recognized that the plaintiffs' chances of winning on the merits were low, but insisted that *Corwin* was a merit-based defense that did not interfere with plaintiffs' rights to extract inside information from the company.

Delaware courts have thus been interpreting the "proper purpose" requirement broadly, in ways that accommodate robust pre-filing investigations. Yet meeting the "proper purpose" requirement is only half the battle. To determine whether section 220 investigations will truly be effective in flushing out wrongdoing, one still needs to answer

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75 AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 437 (Del. 2020).

76 *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842 (Del. Ch. May 30, 2019).

77 *Id.* at *1–2.

78 Specifically, Facebook was under an FTC consent decree, putting it on notice regarding how it treats user privacy. The shareholders demanded books and records to investigate whether Facebook's business model was in fact predicated on ignoring the FTC consent decree and monetizing user data.

79 *In re Facebook*, 2019 WL 2320842, at *2. Also favoring the plaintiffs was the fact that they could claim failure to monitor legal risks, rather than business risks. *See generally* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013 (2019).

the "permissible scope" question: what types of documents can shareholders inspect in order to achieve the purported purpose?

2. Broadening the Permissible Scope

In section 220 actions, the plaintiff bears the burden of showing that each document she requests is necessary and essential for meeting her stated purpose.[80] "Necessary and essential" here means only those documents that address the crux of the purpose and contain information that cannot be found elsewhere.[81] The courts emphasized that shareholders cannot use section 220 for a wide-ranging discovery[82] and, instead, need to request with "rifled precision" only the specific documents that relate to the purpose.[83] In post-filing discovery, full discovery is the rule and defendants bear the burden of proving that a specific document should be excluded. In pre-filing discovery, by contrast, plaintiffs are the ones having to bear the burden regarding each category of documents they request.

With the "scope" prong as well, we witness a clear trend of liberalization: Delaware courts now allow pre-filing discovery of more types of documents. The first wave of broadening the scope requirement came when courts started routinely ordering provision of a wide swath of documents that could implicate the alleged wrongdoing, such as board minutes and spreadsheets.[84] The locus of section 220 discovery shifted from providing technical documents, such as stock listing materials, to providing access to internal company communications, broadly defined. The fuller the access to internal company communications, the higher the chances that shareholders could uncover wrongdoing. Receiving board minutes can be helpful, but receiving spreadsheets and materials prepared for board meetings can be even more helpful.

The second wave of broadening the scope requirement is ongoing as of this writing, and it concerns what may be the most critical issue in corporate litigation nowadays: access to electronic forms of internal communications.[85] The basic question is whether shareholders'

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[80] Saito v. McKesson HBOC, Inc., 806 A.2d 113, 116 (Del. 2002).

[81] Wal-Mart Stores, Inc. v. Ind. Electric Workers Pension Tr. Fund IBEW, 95 A.3d 1264, 1271 (Del. 2014).

[82] *Saito*, 806 A.2d at 114.

[83] Brehm v. Eisner, 746 A.2d 244, 266 (Del. 2000); Radin, *supra* note 41, at 1599–1600, 1617.

[84] For an earlier example of the scope of documents usually provided, see Radin, *supra* note 41, at 1626–28.

[85] Friedlander, *supra* note 55, at 648 (asserting no issue is more important nowadays than pre-filing access to emails).

inspection rights apply just to classic, hard-copy company "books and records," or also to informal modes of communications, such as messages exchanged in the private LinkedIn accounts of two directors. Delaware seems to be trending toward the latter interpretation. Electronically stored information (ESI), including emails and text messages, is now fair game in section 220 actions. As long as the messages implicate a company issue, shareholders are entitled to inspect them, regardless of the medium.[86] And it does not matter whether the texts were sent through a firm's phone or email server or through a private email or social media account. In that respect, the current trend in interpreting "scope" more broadly parallels the one in interpreting "purpose:" it facilitates robust pre-filing investigations.

To illustrate, consider the following three examples, all involving widely covered disputes. In *Facebook*, Mark Zuckerberg and Sheryl Sandberg were ordered to produce emails relating to data privacy issues. In *Papa John's*, two private equity directors had to produce private LinkedIn messages in which they exchanged views on the process of ousting the company's founder.[87] In *Yahoo*, Marissa Mayer had to produce her private emails pertaining to the hiring of her former Google colleague to a top position at Yahoo.[88] Other examples abound, and we discuss many throughout this Article.[89]

To be sure, the courts do not order provision of electronic communications automatically or wholesale. And future defendants will undoubtedly attempt to distinguish and narrow the abovementioned rulings, arguing they apply only to the specific circumstances at hand: in *KT4 Partners*, the company did not have proper formal documentation of board meetings, and so informal documents were necessary; *Papa John*'s implicated issues of *directors'* rights to information, which are broader than shareholders' rights;[90] and so on. Yet the accumulation of cases in which ESI *was* provided and, perhaps more importantly, the courts' reasoning suggests a clear trend. In *KT4 Partners*, former Chief Justice Strine made the broad declaration that Delaware is committed to continue developing the permissible scope of section 220, to keep up with how executives

86 *See* Mudrick Cap. Mgmt., L.P. v. Globalstar, Inc., No. 2018-0351-TMR, 2018 WL 3625680 (Del. Ch. July 30, 2018) (ordering production of internal emails to investigate flaws in the deal process).

87 Schnatter v. Papa John's Int'l, Inc., No. 2018-0542-AGB, 2019 WL 194634 (Del. Ch. Jan. 15, 2019).

88 Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 792 (Del. Ch. 2016).

89 *See, e.g.*, KT4 Partners LLC v. Palantir Techs. Inc., 203 A.3d 738 (Del. 2019); case cited *infra* note 134 and accompanying text.

90 When a director demands to inspect the company's books and records (under section 220(d)), the company is the one bearing the burden to prove improper purpose.

communicate nowadays.[91] Similarly, in *Papa John's*, Chancellor Bouchard stated that not including e-communications would be defeating the purpose of section 220 in today's world, and that every means of communication a director uses to discuss corporate matters should now be considered fair game.[92] "A corporate record retains its character regardless of the medium used to create it," the court clarified, and in a world where people communicate through social media or emails, these mediums become a legitimate subject of inspection.[93]

On the other hand, the broadening of the interpretation of the scope requirement to informal modes of communication is no guarantee of provision: plaintiffs hardly get whatever "books and records" they request. In most cases, the court rather micro-manages the categories of information that companies have to provide, striking down some categories as overboard while allowing others. The court may not order provision of informal modes of communications (private emails) if they are merely duplicative of information coming from formal modes (board-level documents).[94] To say that the courts have expanded the "scope" requirement is therefore not the same as saying that the courts now write a blank check for plaintiffs to extract whatever information they want. Delaware courts rather carefully weigh the incremental contribution of each set of documents against the costs of expanding discovery. Part II below revisits this point, arguing that Delaware courts' ability to broaden the scope without going overboard makes section 220 an effective solution to the challenges of corporate litigation.

3. Qualifying Privileges and Confidentiality

The court's interpretations of the purpose and scope of a section 220 action are not the only determinants of effective section 220 investigations. Other issues that play a significant role include how to treat attorney-client privilege claims on behalf of defendants refusing to provide documents, whether to condition the provision of documents on confidentiality, the extent to which the court should probe into the motivations of the inspection request, and fee shifting. On these

91 *KT4 Partners*, 203 A.3d at 753.

92 *Papa John's*, 2019 WL 194634, at *16.

93 Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp., No. 2017-0910-MTZ, 2019 WL 479082, at *17 (Del. Ch. Jan. 25, 2019) (citing Amalgamated Bank, 132 A.3d at 793).

94 *Id.* at *18; *In re* UnitedHealth Grp., Inc. Section 220 Litig., No. 2017-0681-TMR, 2018 WL 1110849, at *9–10 (Del. Ch. Feb. 28, 2018).

questions as well, Delaware's courts have been trending toward facilitating more robust section 220 investigations.

Consider first the issue of confidentiality. Traditionally, when courts order provision of documents in section 220 actions, they condition it on confidentiality. In August 2019, Delaware's Supreme Court clarified that we should stop treating confidentiality as the default.[95] Emphasizing that there is *no* presumption of confidentiality, the court stated that previous Court of Chancery decisions that made such a presumption simply misapplied a since-remanded decision in the *Disney* litigation.[96] Even in specific cases where the courts exercise discretion and do order confidentiality, the Supreme Court continued, they should do so only for a definite period: indefinite confidentiality should be the exception and not the rule.[97] As Part II below shows, less confidentiality in section 220 materials translates to more deterrence, albeit in an indirect way (generating a "reputational" sanction by drawing media attention to the wrongdoing in question).

A second issue that underwent changes is the weight given to the common attorney-client privilege claims on behalf of the defendants. Delaware's Supreme Court's *Wal-Mart* decision made a clear step toward qualifying such claims.[98] The story started when investigative reporters unearthed a sprawling bribery scheme at Wal-Mart's subsidiary in Mexico. An institutional investor then filed a section 220 request to investigate potential mishandling on the part of Wal-Mart's directors: whether there was a cover up, how much they knew in real time, whether they could have done more to stop it, and so on. Wal-Mart responded by providing the shareholder with 3,000 documents, but heavily redacted most of them. In court, the company claimed that attorney-client privilege justified the mass redactions. Delaware's Supreme Court rejected their claim, by officially adopting an exception to the attorney-client privilege in derivative suits brought on behalf of the company against fiduciaries (a "*Garner*" exception).[99] Strikingly, Delaware adopted and applied the *Garner* exception not in regular, plenary proceedings (as other courts had done), but rather in pre-filing proceedings. Scholars were quick to criticize the application of *Garner*

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95 Tiger v. Boast Apparel, Inc., 214 A.3d 933 (Del. 2019).

96 *Id.* at 938.

97 *Id.* at 939.

98 Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW, 95 A.3d 1264 (Del. 2014).

99 *Id.* at 1278–80; Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970).

in section 220 actions,[100] but the upshot for our purposes is clear: the *Wal-Mart* ruling is another indication of an increased willingness to allow effective pre-filing investigations.[101] Similar developments have occurred with other types of privilege claims, such as self-critical analysis.[102]

Yet another central issue in section 220 litigation is how to treat claims of ulterior motives on the part of the demanding shareholder. Defendants commonly maintain that plaintiffs not only fail to show proper purpose, but—in fact—have an *im*proper purpose in seeking to utilize the inside information they will receive to the detriment of the company. One avenue is by claiming that the demand is entirely lawyer-driven: the shareholder merely lends his name, but the real purpose behind the demand is to advance the lawyer's narrow interests (extract a fee).[103] Another avenue is by claiming that the shareholder has an ulterior motive, an *im*proper purpose negating her proper purpose, such as seeking a competitive advantage by gaining access to inside information.[104] On both accounts, Delaware courts provided decisions in 2019 that narrowed the possibility for defendants to refuse section 220 demands.

In *Donnelly v. Keryx Biopharmaceuticals, Inc.*,[105] for example, defendants pointed out a misalignment between what the shareholder plaintiff said in his deposition and what his lawyer wrote in the demand letter.[106] The lawyer emphasized the need to investigate the veracity of the disclosures the company made prior to the merger in question, while the plaintiff admitted he had not even read the disclosures, and would have opposed the merger regardless, based on fairness concerns.[107] The court distinguished this from previous rulings that struck down section 220 actions for being lawyer-driven, clarifying that as long as the plaintiff expresses *some* proper purpose (in this case, a

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100 *See, e.g.*, Sabrina M. Hendershot, Comment, *Boards Beware: Delaware "*Garners*" Support for Fiduciary Exception to Attorney-Client Privilege in Section 220 Suits*, 40 DEL. J. CORP. L. 677 (2016).

101 To be sure, the courts do not automatically ignore claims of attorney-client privilege. In fact, the *Garner* exception is narrow and exacting. *See, e.g.*, Buttonwood Tree Value Partners, L.P. v. R.L. Polk & Co., No. 9250-VCG, 2018 WL 346036 (Del. Ch. Jan. 10, 2018); Morris v. Spectra Energy Partners, No. 12110-VCG, 2018 WL 2095241 (Del. Ch. May 7, 2018).

102 Radin, *supra* note 41, at 1636.

103 *See, e.g.*, Wilkinson v. A. Schulman, Inc., No. 2017-0138-VCL, 2017 WL 5289553 (Del. Ch. Nov. 13, 2017).

104 *See, e.g.*, Pershing Square, L.P. v. Ceridian Corp., 923 A.2d 810 (Del. Ch. 2007).

105 Donnelly v. Keryx Biopharmaceuticals, Inc., No. 2018-0892-SG, 2019 WL 5446015 (Del. Ch. Oct. 24, 2019).

106 *Id.* at *4.

107 *Id.* Further, defendants argued, the demand letter was drafted from a template used by the lawyer in other cases.

breach of fiduciary duty), misalignments between plaintiff's and lawyer's articulations are not enough to refuse the demand.[108]

In *Senetas Corp.*,[109] to use another example, defendants claimed that the demanding shareholder was a competitor of the company, and wished to gain competitive access to the company's unique technology for use in the shareholder's own company.[110] The court clarified that a defendant cannot rebut a "proper purpose" determination just because the plaintiff supposedly also possesses an ulterior motive. The way to deal with problems of "secondary purposes," the court maintained, is through limiting the scope of documents provided, or insisting on confidentiality, but not through completely refusing to allow investigations.[111]

After the first drafts of this Article were already circulated, additional decisions further cemented the liberal approach to shareholder inspection rights. Most notably, in November 2020, the *Gilead Sciences* court granted leave for plaintiffs to move for their expenses.[112] The court reasoned that the prevalent strategy by companies—to aggressively litigate section 220 demands and obstruct plaintiffs from employing it as a quick and easy pre-filing investigatory tool—calls for fee shifting.[113]

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At the same time that the Delaware courts were supposedly relaxing the substantive standards of review and raising the pleading bar for various kinds of shareholder lawsuits, they were increasing the scope of discovery available to shareholders pre-filing. As a result, corporate litigation is now heavily front-loaded: most of the action happens before a complaint is even filed.

The new front-loaded equilibrium comes with its own set of benefits and costs. Thus far we have analyzed the development in pre-filing discovery from the ground up, adopting a simple supply-and-demand framework: lawmakers sought to make it harder for plaintiffs to file quickly and collect a bounty without putting in meaningful effort;

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108 *Id.*; *see also* Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp., No. 2017-0910-MTZ, 2019 WL 479082 (Del. Ch. Jan. 25, 2019).

109 Senetas Corp. v. DeepRadiology Corp., No. 2019-0170-PWG, 2019 WL 3430481 (Del. Ch. July 30, 2019).

110 *Id.* at *7.

111 *Id.*; *see also* Kortum v. Webasto Sunroofs, Inc., 769 A.2d 113, 124 (Del. Ch. 2000).

112 Pettry v. Gilead Scis., Inc., No. 2020-0132-KSJM, 2020 WL 6870461, at *29–30 (Del. Ch. Nov. 24, 2020)

113 *Id.* at *2.

in response, plaintiffs started investing more in pre-filing investigations, with section 220 being the tool of choice. The next Part takes a broader perspective by examining whether the section 220 development is desirable from a societal perspective. Are the benefits from pre-filing investigations likely to justify the costs of protracted disputes over rights to information?

II. IS THE RISE OF PRE-FILING INVESTIGATIONS DESIRABLE?

Part I described the development of section 220 from a once-obscure feature of corporate law to a frequently used shareholder protection tool.[114] This Part turns to the normative question: is section 220 an *effective* shareholder protection tool? Is the increased emphasis on pre-filing investigations via section 220 desirable from a societal perspective? After all, front-loading the investigations of potential wrongdoing does not come without its costs. Section 220 actions consume sizeable resources of the demanding shareholder, the company, and the courts. The average length of section 220 litigation has now grown to ten months (the median is six months), and the parties now file twice as many pages as they did in such litigation in the 1990s.[115] Beyond the direct costs, expanded section 220 actions also carry the risk of a chilling effect by subjecting companies to "excessive and disruptive, and perhaps nefarious, inquiries,"[116] which, in turn, may promote overinvestment in creating paper trails and underinvestment in taking worthwhile risky business decisions. This Part roughly assesses the tradeoffs and finds the expansion of section 220 is much needed and likely to prove desirable.

Subsection A maintains that the expansion of section 220 was needed to solve the over-screening problem of dismissing meritorious

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114 Practitioners were quick to recognize the importance of section 220 in today's corporate governance landscape. *See, e.g.*, Edward Micheletti, Jenness Parker & Sarah Runnells Martin, *Skadden Discusses Delaware Trends Affecting M&A and Corporate Litigation*, CLS BLUE SKY BLOG, (Mar. 6, 2019), https://clsbluesky.law.columbia.edu/2019/03/06/skadden-discusses-delaware-trends-affecting-ma-and-corporate-litigation [https://perma.cc/3NRD-CZRX]; Melissa Sawyer et al., *Review and Analysis of 2018 U.S. Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 5, 2019), https://corpgov.law.harvard.edu/2019/04/05/review-and-analysis-of-2018-u-s-shareholder-activism [https://perma.cc/A4YX-QEZ8] (noting usage of section 220 has emerged as a new tool in the shareholder activists' arsenal); Roger A. Cooper et al., *The Rise of Books and Records Demands under Section 220 of the DGCL*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 12, 2019), https://corpgov.law.harvard.edu/2019/04/12/the-rise-of-books-and-records-demands-under-section-220-of-the-dgcl [https://perma.cc/R23H-5D32].

115 Cox et al., *supra* note 11.

116 Donnelly v. Keryx Biopharmaceuticals, Inc., No. 2018-0892-SG, 2019 WL 5446015, at *3 (Del. Ch. Oct. 24, 2019).

claims. It details how section 220 is being used nowadays to monitor and hold managers accountable across a wide range of situations—from negotiating transformational transactions to overseeing legal risks. Section 220 helps plaintiffs rebut the presumptive deference to the shareholder vote (overcoming *Corwin*), rebut the presumptive validity of a single-bidder process (overcoming *C&J Energy*), and poke holes in the company's oversight programs (reinvigorating *Caremark*). Subsection B shows how the expansion of section 220 is likely to contribute not just to legal deterrence, but also to market (reputational) deterrence. Section 220 actions can produce quality inside information on how companies and businesspersons behaved. That information, to the extent it becomes public, affects how market participants treat the parties to the dispute. In other words, section 220 affects behavior indirectly, by shaping defendants' reputation. Subsection C then examines the potential objection that expanding section 220 merely substitutes the enormous costs of post-filing discovery with those of pre-filing discovery. As Subsection C explains, Delaware courts have been effectively micro-managing the volume and scope of discovery, so as to strike a delicate balance between keeping the costs in check and incentivizing plaintiff attorneys to vigorously monitor deals for signs of bias.

Subsection D then synthesizes several big-picture insights into the desirability of the section 220 expansion. The Section highlights recent empirical evidence showing that corporate law's effects on primary behavior have remained the same even after the *Corwin* development, in contrast to what commentators predicted. The reason is that pre-filing investigations have restored the deterrence that used to come from judicial scrutiny and post-filing discovery (albeit in a more cost-effective way, in my opinion). Subsection D also shows how the expansion of section 220 facilitates a more robust shareholder vote, incentivizes more effective bounty hunting on the part of plaintiff attorneys, and is not just good policy but also good law, consistent with basic principles of fiduciary law.

A. *Allowing Effective Early Screening*

Delaware's decisional law has always revolved around solving the early screening challenge of separating meritorious from meritless claims, and doing so in an early enough stage to avoid the costs of

discovery and trial.[117] The *Corwin* development in the mid-2010s upset the balance by reducing the quality of information available to plaintiffs and the courts prior to screening, thereby increasing the risk of over-screening and diluting deterrence. The courts' expansion of section 220 should be read against this background, as restoring balance and allowing effective screening.

1. The Basic Challenge of Shareholder Litigation

A fundamental challenge in any litigation is how to separate the meritorious from the meritless claims. In shareholder litigation, the challenge is compounded by the fact that the screening is done at a very early stage, prior to discovery. The choice to conduct the screening so early is usually justified by two key differences between shareholder litigation and other types of litigation. First, in shareholder litigation there is a big asymmetry in the costs of discovery. Unlike business-to-business litigation (or divorce disputes, or individual torts, and so on), in shareholder litigation the costs of discovery fall mainly on one side, namely, the defendants' side. Second, because shareholder litigation is usually representative litigation (derivative or class actions), there are also more severe agency problems. The interests of those who actively participate do not always align with the interests of the other, passive shareholders. The combination of cost asymmetries and agency problems makes shareholder litigation more susceptible to strike suits and quick settlements that benefit no one but the attorneys.[118] The worry is that plaintiff attorneys will use discovery costs as leverage to extract rents from companies.[119] The lawmakers' solution, as we saw in Part I, was not only to front-load the screening (so that it is done early enough to avoid the costs of discovery) but also to raise the pleading bar.[120]

To use the economic-analysis-of-civil-procedure lingo, such a combination of early screening and requiring specificity in pleading reduces the "direct costs" of the process while increasing the "error costs."[121] That is, the combination saves us the costs of going through

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117 Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 IOWA J. CORP. L. 597 (2017).

118 Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1054 (Del. Ch. 1996).

119 Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation,* 84 NOTRE DAME L. REV. 75, 93 (2008).

120 Hamermesh & Wachter, *supra* note 117, at 600.

121 For a concise summary, see Daniel Klerman, *The Economics of Civil Procedure*, 11 ANN. REV. L. & SOC. SCI. 353 (2015).

discovery and trial (and the chilling effects that come with them), while increasing the costs of dismissing a meritorious claim. It increases the "false negative" errors, in a context where the costs of false negatives are huge: breaches of duties in corporate and securities laws can cause potential harms in the billions.[122] A key challenge for any business court is therefore how not to over-screen, that is, how to maintain deterrence.

In that regard, the *Corwin* development upset Delaware's balance. Delaware had traditionally answered the early screening challenge with a combination of (1) assuring the availability of high-quality information even at an early stage, and (2) having expert judges who could evaluate the strength of cases based on partial information.[123] The *Corwin* development put the first prong in jeopardy by making it less likely that plaintiffs would get expedited discovery and less likely that they would even want expedited discovery. Pleading specific facts about what defendants knew and intended to do with only public information is a nearly insurmountable hurdle. It pushes the pendulum too far toward reducing the direct costs, thereby increasing the error costs and overly diluting deterrence.

The *Corwin* development therefore could not be left unchecked. Part I showed that Delaware tried to check it by expanding section 220. Let us now turn to examine whether section 220 is indeed an effective check.

2. Section 220's Impact on Deal Litigation

Nowhere is the impact of section 220 clearer than in *Corwin* cases. When defendants mount a *Corwin* defense (a cleansing shareholder vote), plaintiffs often resort to using their inspection rights to challenge the preconditions for a *Corwin* defense. Typically, plaintiffs will seek to examine the veracity of the proxy materials sent to shareholders prior to the vote. By extracting internal communications, plaintiffs can try to show that the vote was not fully informed. For example, they can try to find an internal email that contradicts the materials that were sent to shareholders or the board minutes. If the information that the insiders

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122 Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711, 713–14 (1996) (asserting costs of fraud outweigh costs of litigation in our context).

123 This is the main thesis in Hamermesh & Wachter, *supra* note 117. On Delaware's delicate balancing act, see also David A. Skeel, Jr., *The Accidental Elegance of* Aronson v. Lewis, *in* THE ICONIC CASES IN CORPORATE LAW 167 (Jonathan R. Macey ed., 2008).

omitted is "material,"[124] they will not be entitled to a *Corwin* defense,[125] the standard of review will revert to enhanced judicial scrutiny, and plaintiffs' chances for surviving the motion to dismiss will exponentially increase.

To concretize, consider *Morrison v. Berry*.[126] Ray Berry—the founder of The Fresh Market—joined forces with a private equity firm to buy The Fresh Market. A shareholder wishing to challenge the deal used section 220 to unearth internal email communications revealing that Berry was in fact committed to this specific bidder, who offered Berry private benefits he probably could not have obtained from other bidders, such as a $25 million payout and a future employment package. Berry did not share the full details with the board in real time, nor did the company's public disclosures (the 14d-9 form). Uncovering this "smoking gun" email rendered the shareholder vote uninformed and the *Corwin* defense inapplicable.

Section 220 is not the only pre-filing investigatory tool that plaintiffs can use to uncover such disclosure deficiencies. Sometimes carefully researching public information can suffice; other times plaintiffs can gain insight from expedited discovery they obtained in previous, pre-closing proceedings. In *Appel v. Berkman*,[127] for example, plaintiffs' research showed that the target company's founder and chairman had strong reservations about a deal, a material fact that the proxy statement failed to reveal. In *KCG Holdings*,[128] plaintiffs used documents they received in a pre-closing lawsuit (that was subsequently dropped) to reveal three glaring omissions: the acquirer had secret dealings with the target's largest shareholder and long-time financial advisor; the CEO initially indicated that the price was too low and only with the help of a hefty retention package was he induced to accept it; and the night before the board approved the suggested price, they revised downwards the company's financial projections, so that the financial advisor's opinion on what constitutes a fair price would fit nicely within the discounted cash-flow analysis.

Further, plaintiffs can use section 220 to plead around *Corwin* not just by showing disclosure deficiencies, but also by showing that the

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124 The test for "materiality" here mirrors other contexts, namely, a fact that significantly alters the mix of information available to stockholders. *See generally* Morrison v. Berry, 191 A.3d 268, 282–83 (Del. 2018).

125 Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015).

126 *Morrison*, 191 A.3d 268.

127 Appel v. Berkman, 180 A.3d 1055 (Del. 2018).

128 Chester Cnty. Emps.' Ret. Fund v. KCG Holdings, Inc., No. 2017-0421-KSJM, 2019 WL 2564093 (Del. Ch. June 21, 2019).

transaction involved a "de facto controller."[129] A shareholder can have less than numerical majority voting power (fifty percent) and still control the board through other levers.[130] If such a de facto controller exists, *Corwin* does not apply, and the ruling precedent becomes the stricter *MFW*, which requires not just a favorable vote but also negotiation by an independent committee. The Tesla-SolarCity merger is a case in point.[131] There, plaintiffs used section 220 to extract documents showing that Elon Musk, albeit only a twenty-two percent shareholder, de facto controlled the board and pushed it to acquire the Musk-related SolarCity. Musk himself pitched the proposed acquisition to the board of Tesla three times; the board did not consider alternative solar power companies; and the majority of the directors who approved the deal were not independent enough of Musk to be able to impartially consider the deal.[132]

Aside from restoring balance to post-closing *Corwin* cases, section 220 has also proved powerful in pre-closing *C&J Energy* cases. *C&J Energy* maintained that a single-bidder sale is reasonable: the target board is not under an obligation to actively shop for bidders, as long as the board is generally receptive and potential bidders can get a fair opportunity.[133] In reality, multiple bidders arise only seldom, and so commentators predicted that *C&J Energy* would practically eliminate the chances of judicial monitoring of pending deals. Yet here as well, section 220 opened up space for effective monitoring by shareholders and their attorneys, by helping them show that the target board was not receptive enough to alternatives to the proposed deal. The *Calgon Carbon* case illustrates this.[134] There, the court ordered the provision of internal documents to shed light on concerns that the target company's officers and directors were too "enticed with promises of retention, compensation, or other rewards," which led them to "set up an

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129 *Corwin*, 125 A.3d at 306–07; *see generally* Ann M. Lipton, *After* Corwin*: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977 (2019).

130 *In re* Zhongpin Inc. S'holders Litig., No. 7393-VCN, 2014 WL 6735457, at *6 (Del. Ch. Nov. 26, 2014).

131 *In re* Tesla Motors, Inc. S'holder Litig., No. 12711-VCS, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

132 Interestingly, once plaintiffs got past the motion to dismiss through the "de facto controller" exception, they were able to unearth further information in post-filing discovery, indicating that material details about SolarCity were omitted from the proxy sent to Tesla's shareholders before they voted on the merger. *Id.*

133 C&J Energy Servs., Inc. v. Miami General Emps.' & Sanitation Emps.' Ret. Trust, 107 A.3d 1049, 1070 (Del. 2014).

134 Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp., No. 2017-0910-MTZ, 2019 WL 479082 (Del. Ch. Jan. 25, 2019).

artificially restrictive deal process to lock in personal benefits."[135] The *Calgon Carbon* court recognized that hard-copy books and records, such as board minutes and letters between the companies, were unlikely to shed light on such allegations. The court therefore ordered also the provision of the personal emails of the management. Armed with these internal documents, shareholders were able to well plead facts indicating that the incumbents were practically beholden to the single bidder in question.

Finally, the expansion of section 220 has also restored balance in the context of transactions the company makes with its controller. In other words, aside from overcoming *Corwin* and *C&J Energy*, section 220 can help plaintiffs overcome *MFW*. Delaware's Supreme Court's *MFW* decision itself paved the way, nudging shareholders to use their inspection rights to challenge the six enumerated conditions for an *MFW* defense.[136] Subsequent cases have provided a blueprint for how to do so. For example, in two recent cases shareholders successfully challenged the *timing* of setting up *MFW* protections. An *MFW* defense applies only when the controller has "self-disabled" (that is, submitted the deal to negotiation through an independent committee and a majority-of-minority approval) from the outset.[137] In *Olenik* plaintiffs used section 220,[138] and in *Zhongpin* plaintiffs carefully researched public disclosures, to convince the court that *MFW* protections were not established up front, thereby surviving the motion to dismiss.[139]

The upshot is that section 220 plays a key role in deal litigation nowadays. The courts have allowed shareholders to extract a wide swath of internal documents, making it easier for plaintiffs to show discrepancies between what insiders knew and what they told the outside world in order to render *Corwin* inapplicable. And as the next Subsection shows, the impact of section 220's expansion did not stop at overcoming seemingly insuperable pleading hurdles in deal litigation, but went on to do so in derivative litigation as well.

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135 *Id.* at *11.

136 Kahn v. M & F Worldwide Corp., 88 A.3d 635, 645–46, 645 n.15 (Del. 2014).

137 Flood v. Synutra Int'l, Inc., 195 A.3d 754, 763 (Del. 2018). As noted above, Delaware has extended the *MFW* framework beyond its original context of a freezeout transaction, to include also transactions with the controller that are not transformational. In these contexts, plaintiffs usually bring a derivate action (because the harm is to the company), a topic to which we return in the next Subsection.

138 Olenik v. Lodzinski, 208 A.3d 704, 715 (Del. 2019).

139 *In re* Zhongpin, Inc. Stockholders Litig., No. 7393-VCN, 2014 WL 6735457, at *10 (Del. Ch. Nov. 26, 2014).

3. Section 220's Impact on Derivative Actions

Section 220 can help plaintiffs overcome the demand-excusal requirement in derivative actions, either by showing that the majority of the board lacks independence, or by showing that the decision in question is not protected by the business judgment rule.

Consider the issue of board independence first. Subsection I.A.3 above detailed the raising of the pleading bar in this context, culminating in the 2015 *Cornerstone* decision. Post-2015, the expansion of pre-filing investigations brought back balance, allowing plaintiffs to unearth intricate webs of ties that make putatively independent directors less likely to be trusted to make an impartial decision about the misbehavior in question.[140] Section 220 can allow plaintiffs to rebut the *Beam* presumption of independence, by documenting concrete connections and levers between the board and the decision-makers that go beyond thin social ties.[141] The recent case involving Oracle's purchase of NetSuite[142] (of which Oracle's Larry Ellison owned thirty-nine percent) provides a blueprint. The plaintiffs were able to convince the court that (1) Larry Ellison, albeit "only" a twenty-eight percent shareholder, had an outsized influence on Oracle's decision to acquire NetSuite, and that (2) Oracle's putatively independent directors were not in fact independent of Ellison; one was dependent on Ellison for future consulting services, another was dependent on Ellison as a potential acquirer of venture capital firms with which he was involved, and so on. These ongoing relationships, the court agreed, could prevent the directors from making an objective decision about whether to sue Ellison.

A similar development happened in regard to *Cornerstone*. *Cornerstone* supposedly limits the liability threat for independent directors approving a conflicted transaction. Yet here, as well as in the courts, it left room for monitoring through pre-filing investigations. Chancellor Bouchard's recent decision in *BGC Partners*[143] is a case in point. There, plaintiffs used public documents and section 220-generated internal documents to show that some directors had lucrative directorship opportunities in other companies owned by the controller,

140 For a recent empirical study documenting how such intricate web of ties create a too-friendly board environment, see Da Lin, *Beyond Beholden*, 44 J. CORP. L. 515 (2019).

141 The *Beam* court explicitly admonished plaintiffs for failing to use section 220 for that purpose. Veasey & Di Guglielmo, *supra* note 61, at 1467 & n.285.

142 *In re* Oracle Corp. Derivative Litig., No. 2017-0337-SG, 2019 WL 6522297 (Del. Ch. Dec. 4, 2019).

143 *In re* BGC Partners, Inc. Derivative Litig., No. 2018-0722-AGB, 2019 WL 4745121 (Del. Ch. Sep. 30, 2019).

other directors were a part of an academic institution to which the controller was a major benefactor, and so on.[144]

Practitioners were quick to realize the impact of such section-220-driven decisions: law firms started sending memos to their clients, warning them that "the court may be more inclined now than in the past to find outside directors non-independent in the demand futility."[145]

The second way to excuse demand is by convincing the court that the majority of the board faces a substantial likelihood of personal liability. Part I above demonstrated the difficulty in pleading such a claim in the failure-of-oversight context. The court itself acknowledged that such a claim is the most difficult for plaintiffs to win on.[146] Yet here as well, 2019 was a watershed moment: section 220 actions generated information that allowed plaintiffs to well plead facts invoking one of two *Caremark* prongs, namely, suggesting a complete dearth of board-level monitoring, or conscious disregard of red flags.[147]

In June of 2019, the Blue Bell case (*Marchand v. Barnhill*)[148] illustrated how plaintiffs can use section 220 to well plead facts by invoking *Caremark's* first prong, namely, that directors failed to implement a reporting system. The story revolved around Blue Bell Creameries' listeria outbreak. One of the largest ice-cream manufacturers in the U.S., Blue Bell had a line of ice cream products contaminated, causing three deaths and massive recalls. Shareholders sought to investigate a potential failure of oversight on the part of the directors and filed a section 220 request. They were then able to comb through the company's board minutes, showing that directors never even discussed food safety issues. Other internal documents showed that discussions and warnings of food safety problems existed in house, but for some reason they never made it to the board level. This was enough to convince Chief Justice Strine to deny the motion to dismiss.

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144 *See* Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (a putatively independent director is biased in favor of the controller because the latter mentored him throughout his career and made a donation to an academic institute to honor the name of the director).

145 *See, e.g.*, Gail Weinstein, Brian T. Mangino & Andrew J. Colosimo, *Conflicted Controllers, the "800-Pound Gorillas": Part II*—BGC, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 7, 2019), https://corpgov.law.harvard.edu/2019/11/07/conflicted-controllers-the-800-pound-gorillas-part-ii-bgc [https://perma.cc/5L92-ML9S].

146 *In re* Caremark Int'l Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996). On the conventional view that winning a *Caremark* claim on the merits is virtually impossible, see also Claire A. Hill, Caremark *as Soft Law*, 90 TEMP. L. REV. 681 (2018); Ezra Wasserman Mitchell, Caremark*'s Hidden Promise*, 51 LOY. L.A. L. REV. 239 (2018).

147 I elaborate on the section 220 turn in *Caremark* litigation in a separate project. Shapira, *supra* note 10.

148 *Marchand*, 212 A.3d 805.

Then in October of 2019, the *Clovis* case completed the picture, showing how section 220 can help plaintiffs well plead facts by invoking the second *Caremark* prong, namely, that directors did not respond to red flags. Clovis Oncology's fate rested on the successful development of a sole, promising drug for lung cancer therapy. When the drug's trial results did not go as hoped, the company failed to accurately report to the regulator and market the true efficacy of the drug. Shareholders sought to investigate knowledge of wrongdoing on the part of Clovis' directors and used section 220 to show that directors repeatedly ignored indications that the company was violating regulatory requirements (FDA protocols). There was a clear mismatch between the (damning) information the board received in house and the (rosy) information the company disclosed to the public.

As with the development regarding director independence, the section 220 application to *Caremark* claims quickly attracted practitioners' attention. All the large law firms sent memos to their clients, warning of a "stricter *Caremark* era" that is upon us.[149] Importantly, the law firms' memos advised boards to start working harder on implementing and conducting periodic reviews of a well-integrated legal compliance program, as well as maintaining a better paper trail, making sure that the board minutes demonstrate that the board received appropriate information about the key issues the company faces.[150] Overall, it seems that with oversight duties as well, section 220 has the power to transform what some have considered "a toothless tiger"[151] into a meaningful duty that impacts primary behavior.[152]

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149 Francis Pileggi, *Directors may face oversight liability for not properly monitoring key drug's clinical trial*, DEL. CORP. & COM. LITIG. BLOG (Oct. 16, 2019), https://www.delawarelitigation.com/2019/10/articles/chancery-court-updates/directors-may-face-oversight-liability-for-not-properly-monitoring-key-drugs-clinical-trial [https://perma.cc/6PQB-Q54J].

150 *See, e.g.*, Gail Weinstein, Warren S. de Wied & Philip Richter, Caremark *Liability for Regulatory Compliance Oversight*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 8, 2019), https://corpgov.law.harvard.edu/2019/07/08/caremark-liability-for-regulatory-compliance-oversight [https://perma.cc/VM5W-ZQ62]; Louis L. Goldberg, Joseph A. Hall, John B. Meade, Byron B. Rooney & Andrew Ditchfield, *Davis Polk Discusses Recent Delaware Decisions on Director Oversight*, CLS BLUE SKY BLOG (Dec. 2, 2019), https://clsbluesky.law.columbia.edu/2019/12/02/davis-polk-discusses-recent-delaware-decisions-on-director-oversight [https://perma.cc/2SFK-KFFA].

151 *See, e.g.*, Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability Within the Corporate Power Puzzle*, 35 DEL. J. CORP. L. 199, 215–16 (2010).

152 For a full-blown account on "the new *Caremark* era," see Shapira, *supra* note 10.

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This Section made the case that the expansion of section 220 restored deterrence in various scenarios of potential managerial misconduct. A potential objection would be that we have too easily equated surviving the motion to dismiss with deterrence. The fact that a successful section 220 action leads to a successful pleading does not mean that the case will ultimately be decided in favor of the plaintiffs, and so we cannot jump to the conclusion that it will deter defendants, or so the objection goes. In fact, such an objection misconstrues how corporate law works (deters). Corporate legal scholarship has long grappled with the apparent lack of legal sanctions, recognizing that corporate decision-makers practically never pay out of pocket for their misbehavior.[153] Yet deterrence cannot be measured solely on the basis of sanctions imposed in verdicts coming after a full trial.

Deterrence here rather comes from paying settlements ex post and planning how to avoid the risks and costs of litigation ex ante. Part of the law's effects on behavior comes from the memos that legal advisors send their clients, explaining how they should behave going forward. We saw examples of such memos at every key section 220 juncture detailed above. Another part of the law's effects on behavior comes from settlement payments. Once section 220 helps plaintiffs survive the motion to dismiss, defendants tend to offer quick and nice settlements, if only to save themselves the costs of going through discovery and depositions. While the costs of paying a settlement are not fully internalized by the decision-makers (insurance companies pick up the tab, and shareholders pay for the increase in premiums),[154] other types of costs cannot be insured, such as the emotional costs (stress, embarrassment) and the reputational costs (having details about your misbehavior dug out and made public for all other market participants to see). In other words, a key aspect in how corporate law shapes behavior is through imposing *non*-legal costs.[155] The expansion of section 220 also restores this type of deterrence—indirect (reputational) deterrence, if you will. The next Subsection elaborates.

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153 Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1055 (2006) (in a span of twenty-five years only thirteen outside directors paid out of pocket); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1791 (2001) (directors are more likely to get struck by lightning than pay damages for breaching their fiduciary duties).

154 *See, e.g.*, Chen Lin, Micah S. Officer, Rui Wang & Hong Zou, *Directors' and Officers' Liability Insurance and Loan Spreads*, 110 J. FIN. ECON. 37 (2013).

155 *See* Itai Fiegenbaum, *The Controlling Shareholder Enforcement Gap*, 56 AM. BUS. L.J. 583, 628 (2019).

B. *Facilitating Market (Reputational) Discipline*

Pre-filing investigations produce a positive externality of quality information on how companies behave. To the extent that such information becomes public, third parties can use it to decide with whom they want to keep doing business and with whom they do not. Pre-filing investigations thereby affect not just legal deterrence but also *reputational* deterrence.

To appreciate just how much section 220 can affect market discipline, Subsection 1 offers a quick primer on how reputational sanctions work, and Subsection 2 then uses recent section 220 cases to illustrate how the expansion of section 220 affects the process of reputational sanctioning.

1. How Market Discipline Works[156]

The notion of reputational discipline is intuitive: upon hearing bad news about a company, stakeholders will infer that the company's "type" is worse than they realized and accordingly reduce their willingness to do business with the company going forward. The aggregate of diminished business opportunities constitutes the reputational sanction for violating market norms.

Yet in reality, reputational discipline is a much less straightforward, much "noisier" process. Not all companies that behave well earn a good reputation, and not all companies that behave badly tarnish their reputation. For the market to sanction corporate misbehavior—that is, for the company to meaningfully lose future business opportunities—four basic conditions have to be met. First and most basically, news about the misbehavior has to break. Yet bad news in itself does not automatically translate to reputational damage. For *revelation of information* to lead to reputational discipline, three additional conditions have to be met: *diffusion*, *certification*, and *attribution*. Damning information has to be widely diffused so that it reaches a critical mass of stakeholders in order for the reputational sanction to be meaningful. Information that is widely diffused has to be certified as credible for the company's stakeholders to consider it seriously. And even information that is diffused and certified has to be attributed to deep-seated flaws that are likely to reoccur in the future in

156 For a more detailed analysis, see Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 885–92 (2019).

order for the company's stakeholders to update their beliefs and act on them.

In previous work, I showed how each of these stages in the process of market discipline—revelation of information, attribution, certification, and diffusion—are affected by information coming from litigation.[157] At the most basic level, the legal system vests fact-finding powers in private litigants to extract relevant information from their rivals, and therefore provides market players who follow litigation with information to which they previously could not have been privy. The classic example here is internal email communications showing just how big an organizational cover-up was. With *attribution*, the key question is whether stakeholders perceive the bad news to be indicative of the company's future behavior. Litigation can unearth information about the intentionality of the misbehavior in question, or how top management knew about the problem and did little to stop it, in ways that make stakeholders attribute the bad news to deep-seated flaws (a total breakdown of internal checks and balances throughout the corporate hierarchy) that are likely to resurface in the future. With *certification*, the key issue is whether stakeholders trust the source of information. And judicial opinions, especially from the well-respected Delaware judges, are considered a credible source that shapes businesspersons' perceptions. With *diffusion*, litigation matters by shaping the frequency and tenor of media coverage of the issue at hand. Litigation provides journalists with so-called "information subsidies" in the form of pre-packaged, well-documented and detailed, libel-proof bits of information about a newsworthy issue.

Pre-filing investigations through section 220 can affect reputational discipline along all the above-mentioned dimensions. The next Subsection illustrates this by recasting our previous examples.

2. How Section 220 Facilitates Market Discipline

Section 220 actions affect the revelation, diffusion, certification, and attribution of information. The Blue Bell listeria outbreak story is a case in point. Earlier, we used Blue Bell to illustrate how section 220 can increase the chances that defendants will suffer legal sanctions in failure-of-oversight litigation. Yet, arguably more important was section 220 litigation's impact on the *reputational* sanctions for failing to monitor food safety issues. The section 220 litigation altered how the media covered the event, thereby shaping the public perception of what

[157] *See, e.g.*, Roy Shapira, *Law as Source: How the Legal System Facilitates Investigative Journalism*, 37 YALE L. & POL'Y REV. 153 (2018).

and how things went wrong with Blue Bell and, in turn, affecting consumers' willingness to purchase from Blue Bell going forward.

For a food company, a food-safety crisis with three deaths comes with the risk of inflicting substantial reputational sanctions. After all, no one wants to buy ice cream from a manufacturer who has little regard for contamination problems. We therefore expect that bad news will diminish the company's future business opportunities. The question is how many future business opportunities the company will lose exactly. The size of the reputational sanction depends on how the company's stakeholders perceive the bad news; whether they attribute it to a one-off honest mistake, or to a deep-seated problem.[158] Companies know this, of course, and they attempt to manage the public perception in the wake of crisis by controlling how the event is framed in the media.

With Blue Bell, the company actually "won" in protecting its reputation following the bad news. An academic study that analyzed the content of media coverage of the debacle concluded that Blue Bell managed to dictate the framing and tenor of media coverage, thereby curtailing the initial reputational fallout.[159] The raw numbers do not lie; after the bad news broke in 2015, in 2016, Blue Bell was already back at being the fifth leading ice cream manufacturer in the U.S.[160]

Then, the section 220 action happened. By culling numerous internal documents, shareholders were able to draw inferences that the board ignored issues of food safety. The media quickly picked up the allegations gleaned from the section 220 action, went back to covering the listeria debacle, and changed its tune, this time highlighting the systemic disregard for food safety at Blue Bell. To illustrate, one food safety website reminded its readers that for the board of a food manufacturing company to ignore issues of food safety is very problematic;[161] a business media website spotlighted Chief Justice Strine's assertion that the company's top-level management had been ignoring yellow and red flags for over a decade;[162] and so on. Section

158 Roy Shapira, *Reputation Through Litigation: How the Legal System Shapes Behavior by Producing Information*, 91 WASH. L. REV. 1193 (2016).

159 Brandyl Brooks Calley, Courtney Myers, Courtney Gibson & Erica Irlbeck, *A Comparative Content Analysis of News Stories and Press Releases During the 2015 Blue Bell Ice Cream Recall*, 103 J. APPLIED COMMC'NS, issue 3, art. 5 (2019).

160 *Id.*

161 Angela Spivey, Andrew Phillips & Alan Pryor, *The Blue Bell ice cream Listeria outbreak and its fallout*, FOOD SAFETY NEWS (Aug. 1, 2019), https://www.foodsafetynews.com/2019/08/the-blue-bell-ice-cream-listeria-outbreak-and-its-fallout [https://perma.cc/5QM8-ABU6].

162 *See, e.g.*, Allen Pusey, *Stockholder suit against Blue Bell revived*, DALL. BUS. J. (June 24, 2019, 10:35 AM), https://www.bizjournals.com/dallas/news/2019/06/24/stockholder-suit-against-blue-bell-revived.html [https://perma.cc/72T8-EUNJ].

220 became a source of media scrutiny and, by extension, a huge reputational risk for Blue Bell.

Another vivid example comes from the 2019 *Facebook* section 220 litigation.[163] After investigative reporters initially broke the Cambridge Analytica story in 2018, Facebook and its CEO Mark Zuckerberg went on a public campaign to limit the reputational fallout, communicating a newfound commitment to user privacy.[164] We have changed our DNA to a privacy-focused platform, Zuckerberg claimed.[165] But following the section 220 litigation in 2019, major business media outlets and tech blogs were back to emphasizing Facebook's apparent "scant regard for users' privacy."[166] Here as well, the section 220 litigation became a source of colorful quotes which shaped the saliency and tenor of media coverage.

Pre-filing investigations therefore affect the investigated company's and its decision-makers' reputation both by bringing to light new information to which market players were not privy, and by shaping the saliency and framing of existing pieces of information.[167] Section 220 actions keep a problematic issue for the company on top of the media agenda and in stakeholders' minds, increasing the diffusion and credibility of damning information. From Facebook's or Blue Bell's perspective, such negative media coverage is probably much more impactful than any legal sanction it may end up suffering (if any) in the subsequent *Caremark* litigation.[168] And the reputational impact of section 220 is hardly restricted to these two examples; it can be traced

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[163] *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842 (Del. Ch. May 30, 2019).

[164] *See, e.g.*, Julia Carrie Wong, *Mark Zuckerberg apologises for Facebook's 'mistakes' over Cambridge Analytica*, THE GUARDIAN (Mar. 22, 2018, 2:53 AM), https://www.theguardian.com/technology/2018/mar/21/mark-zuckerberg-response-facebook-cambridge-analytica [https://perma.cc/BE6B-BL6H].

[165] *See, e.g.*, Julia Carrie Wong, *Zuckerberg says Facebook is pivoting to privacy after year of controversies*, THE GUARDIAN (Mar. 6, 2019, 6:12 PM), https://www.theguardian.com/technology/2019/mar/06/mark-zuckerberg-facebook-privacy-vision [https://perma.cc/PAW9-JKVX].

[166] *See, e.g.*, Zak Doffman, *Facebook Loses Court Battle To Keep Internal Privacy Breach Records Private*, FORBES (May 31, 2019, 7:56 PM), https://www.forbes.com/sites/zakdoffman/2019/05/31/facebook-loses-in-court-over-privacy-emails-as-zuckerberg-votes-to-keep-full-control/?sh=2b6e074c560c [https://perma.cc/3YNH-JMAY]; Glyn Moody, *Facebook's Triple Woes Over Cambridge Analytica Data Harvesting Scandal*, TECH DIRT (June 6, 2019, 3:42 AM), https://www.techdirt.com/articles/20190605/07294642339/facebooks-triple-woes-over-cambridge-analytica-data-harvesting-scandal.shtml [https://perma.cc/9EH3-AU5G].

[167] On the different ways in which information from litigation affects reputations, see ROY SHAPIRA, LAW AND REPUTATION: HOW THE LEGAL SYSTEM SHAPES BEHAVIOR BY PRODUCING INFORMATION 35–74 (2020).

[168] *Id.* at 19–31 (on how, in these circumstances, the reputational sanction usually dwarfs the legal sanction).

to the first wave of section 220 investigations, going back to the famous *Disney* case.[169]

It is important to distinguish two channels of reputational impact here. The first is reputational fallout from the unearthing of internal documents. Here, the reputational impact is limited by the tendency to condition provision of documents on confidentiality. To the extent that the court conditions provision of documents on confidentiality, the section 220 request can still affect reputations, but only when the relevant inside information is attached to motions filed with the courts (so that it can be picked up by the media and other intermediaries such as stock analysts, institutional investors, and corporate watchdogs).[170] The second channel of reputational impact is the judges' comments during section 220 actions and decisions. Section 220 actions give Delaware judges an opportunity to provide their (initial) assessment of the behavior in question, which the media often views as noteworthy; recall the media coverage of Chief Justice Strine's colorful criticism of Blue Bell.

There is a broader point at play here. A key function of Delaware corporate law has always been to facilitate non-legal sanctions. Rather than directly interfere with directors' decisions and impose legal sanctions, Delaware judges produce richly detailed narratives of good and bad corporate behavior.[171] Once the morality tales of corporate saints and sinners become publicly available, they unleash all sorts of non-legal forces. In one version, directors hate being dressed down in verdicts because it lowers the esteem in which they are held by colleagues and peers ("external moral sanctions").[172] In another version, directors who are subjected to judicial scolding suffer not so much from the disesteem of others as from their own sense of guilt ("internal moral sanctions").[173] In yet another version, judicial scolding reduces third parties' willingness to do business with the defendant company or

169 The famous *Disney* litigation started after the court sent the plaintiffs to file a section 220 request and submit an amended complaint. The section 220 request generated internal documents that helped the complaint survive the motion to dismiss and shaped subsequent media coverage of the company. Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1 (2015) (analyzing the content of media coverage of the Disney-Michael Ovitz debacle during different stages of the litigation).

170 This is where the development of Delaware's Supreme Court reversing the presumption of confidentiality plays a key role. *See* discussion *supra* Section I.b.3.

171 The two most representative accounts are Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997), and Blair & Stout, *supra* note 153.

172 Rock, *supra* note 171.

173 Blair & Stout, *supra* note 153.

directors ("reputational sanctions").[174] Yet with pleading hurdles such as *Corwin* in place, there may be much "fewer opportunities for Delaware courts to evaluate and opine on" directors' conduct.[175] Section 220 actions bring back to life the above-mentioned non-legal effects by giving judges the opportunity to provide their version of what and how things happened even before the motion to dismiss. The rise of section 220 therefore restores not just direct deterrence but also indirect deterrence by facilitating Delaware's ability to shape norms and reputations in the business community.

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Commentators have lauded the *Corwin* development for letting the market work its magic: we do not need judges to intervene with the benefit of hindsight, when we have vibrant market forces that can discipline corporate misbehavior on their own.[176] But what the "leave things to the market" proponents miss is that part of the market's magic comes from the legal system. The legal and market systems are not independent of each other: they rather feed off each other. Without information from litigation, the market will have a hard time effectively disciplining corporate misbehavior. This is yet another area where the expansion of section 220 has restored balance, and maintained corporate law's salutary effects on corporate behavior.

C. *Keeping Discovery Costs in Check*

An approach allowing expanded pre-filing discovery runs the risk of increasing the direct (process) costs as well as the costs of pushing defendants to settle even unmeritorious cases simply to avoid the costs of discovery. In other words, the more we expand pre-filing discovery, the more likely we are to bring back the harms of post-filing discovery that we have been trying to avoid. Some plaintiffs and their attorneys may be trying to use pre-filing investigations merely as a tool to impose costs on the defendants without good reason, bringing back the dreaded fishing expeditions through the backdoor. The exponential growth in section 220 actions has therefore increased the importance of regulating pre-filing investigations properly. Specifically, pre-filing investigations need to be broad enough to facilitate monitoring of corporate behavior,

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174 Shapira, *supra* note 169.

175 Diller & Slights, *supra* note 51, at 20.

176 *See, e.g.*, Goshen & Hannes, *supra* note 4.

but not too broad so as to become a rent-extracting tool in the hands of some plaintiff attorneys. From this vantage point, Delaware seems to be striking the right balance.

Delaware courts have been carefully managing and limiting the scope of documents available in pre-filing discovery. Unlike in post-filing discovery, where all documents "relevant" to the dispute are discovered,[177] in pre-filing discovery via section 220 only documents that are "necessary and essential" to the specific purpose at hand are discovered. To illustrate, one need simply look at pages 18–19 of the *Facebook* section 220 litigation we mentioned earlier.[178] There, the court methodically assessed whether each type of document was necessary, granting plaintiffs' requests for access to board-level communications concerning data privacy practices (including directors' emails), while denying their requests for board-level correspondence with regulators and third parties as too sweeping.[179]

Delaware courts have therefore shifted from the binary character of discovery costs—whereby defendants either incurred the extreme costs of unlimited discovery or the zero costs of dismissal—to a more staggered, nuanced process. Instead of unwarrantedly escalating the costs of discovery, the courts can stagger the costs of (targeted) discovery as a function of the information asymmetries and the credibility of the allegations at hand. In that sense, the development in Delaware mimics what many civil procedure scholars opined is the optimal solution to the problems stemming from the shift to "plausibility pleading" in civil litigation more generally (following *Twombly* and *Iqbal*): instill a mechanism that provides targeted early discovery as a function of the amount of information available to plaintiffs.[180] Yet the same scholars believed that it is unlikely that we can operationalize such an optimal mechanism, mainly because they did not trust trial judges to effectively implement it.[181] It may be better to limit access to discovery in a clear way, these commentators argued, because trial judges will have trouble determining the optimal amount of documents to disclose in complex cases.

177 DEL. CH. CT. R. 26(b)(1).

178 *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842, *18–19 (Del. Ch. May 30, 2019).

179 For another good illustration, see Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp., No. 2017-0910-MTZ, 2019 WL 479082, at *16–18 (Del. Ch. Jan. 25, 2019).

180 *See, e.g.*, Arthur R. Miller, *From* Conley *to* Twombly *to* Iqbal*: A Double Play on the Federal Rules of Civil Procedure*, 60 DUKE L.J. 1, 108–09 (2010); Colin T. Reardon, Note, *Pleading in the Information Age*, 85 N.Y.U. L. REV. 2170, 2203, 2206 (2010).

181 *See, e.g.*, Samuel Issacharoff & Geoffrey Miller, *An Information-Forcing Approach to the Motion to Dismiss*, 5 J. LEGAL ANALYSIS 437, 446 (2013); Robert G. Bone, Twombly*, Pleading Rules, and the Regulation of Court Access*, 94 IOWA L. REV. 873, 934 (2009).

Normally, we would indeed view such micro-managing from the outset by the judge skeptically. But with Delaware judges, specifically, there is ample reason to view such active judicial supervision more favorably.[182] Given the specialized docket and the small number of judges, Delaware judges accumulate vast experience with common fact patterns in business transaction cases. With experience comes expertise. That expertise allows Delaware judges to have a good idea of where the bodies, if there are any, are buried, and of exactly what kind of documents will be needed, solely on the basis of the plaintiff's request and defendant's response.[183] In other words, Delaware judges are much better positioned to make educated guesses about the strength of cases relative to other trial judges.[184]

Indeed, a look at section 220 decisional law reveals that Delaware courts are careful not to grant pre-filing discovery in ways that could chill business risk-taking. The courts regularly deny section 220 requests that are based on nothing more than bad news about the business without a credible basis to suspect that the bad news was due to wrongdoing. To illustrate, in *Hoeller*, a key customer accounting for twenty percent of the company's revenues terminated its contract with the company.[185] A shareholder sought to avail himself of his inspection rights to investigate the circumstances behind the bad news. The court rejected the request, reemphasizing that claiming mismanagement in the abstract is not enough. Even if bad business decisions were made in handling the key customer that left, this in itself does not constitute a basis for pre-filing investigations in the absence of concrete indications of wrongdoing.

Further, expanding pre-filing discovery is not necessarily bad for defendants. Having a more informed complaint can actually help the court dismiss it early if the information pertains to bad business mistakes rather than breaches of fiduciary duty. Take failure-of-oversight claims, for example. The classic *Stone v. Ritter* is oft-quoted for its clarification of the duty of good faith, but it, too, started as a section 220 case.[186] There, the documents that the plaintiff extracted actually convinced the courts to dismiss the complaint. The background story started when AmSouth Bank had to pay around fifty million

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182 On the conditions under which "managerial judges" can reach the optimal amount of discovery, see generally Joel L. Schrag, *Managerial Judges: An Economic Analysis of the Judicial Management of Legal Discovery*, 30 RAND J. ECON. 305 (1999).

183 *Cf.* Hamermesh & Wachter, *supra* note 117, at 651.

184 *Cf.* Issacharoff & Miller, *supra* note 181, at 448.

185 Hoeller v. Tempur Sealy Int'l, Inc., No. 2018-0336-JRS, 2019 WL 551318 (Del. Ch. Feb. 12, 2019).

186 Stone v. Ritter, 911 A.2d 362 (Del. 2006).

dollars in fines for failing to comply with anti-laundering laws. The plaintiffs incorporated into the complaint board-level policy memos and third-party reports on compliance with bank secrecy regulations, presumably to highlight documented flaws in compliance. Yet the court viewed these internal documents as reflecting the fact that the board discharged its oversight responsibilities and dismissed the case. Using information from section 220 to realize quickly that there is no actionable claim is not necessarily bad for plaintiffs, either; it can help plaintiffs cut their losses early instead of continuing to invest in a lost cause.

Overall, the best way to read our argument about expansion of section 220 is as a relative rather than an absolute one. Yes, the courts have relatively relaxed their interpretation of the "purpose" and "scope" requirements, but they are hardly granting section 220 requests automatically. They rather grant staggered, pinpointed discovery in cases where the incremental investment in discovery justifies the costs.

One final observation that may seem trivial but should be emphasized is that we cannot evaluate the costs of expanding section 220 in a vacuum; we rather have to consider it against the alternatives. One alternative is not to have discovery at all. But this alternative comes with the significant costs of over-screening meritorious cases, thereby diluting deterrence. Another alternative is to let cases proceed to unlimited discovery. But that alternative comes with its own well-documented costs, both direct ones from handling unlimited discovery and indirect ones from chilling worthy business risk-taking. Early screening with effective pre-filing investigations seems like a promising balance when handled by Delaware courts.

D. *Fit with Evidence, Logic of Incentives, and Law*

This Article's main claim can be summarized as follows: "Corporate law is not dead;[187] it is simply recalibrated." And in its new, pre-filing-centered equilibrium, corporate law still affects primary behavior through the threat of unearthing damning information (which, in turn, can generate legal and reputational deterrence).[188] A recent empirical paper that studies the effects of corporate law on

187 The allusion is to Goshen & Hannes' titular claim. *Supra* note 4.

188 *See* George S. Geis, *Information Litigation in Corporate Law*, 71 ALA. L. REV. 407 (2019) (an exception to the dearth of comprehensive accounts of section 220, Geis' account claims the best way to view inspection rights is as mitigating agency costs through forensic review).

primary behavior illustrates the claim perfectly.[189] The study examines the differences in behavior between target boards that are subject to *Revlon* duties and those that are not.[190] It shows that boards acting under *Revlon* try harder and get better results when conducting negotiations for selling the company; they have more bidders, longer negotiations, more third-party interventions, and, eventually, higher premiums on the deals.[191] But for our purposes, the most pertinent finding is that the results hold in Delaware-incorporated companies even *after* the *Corwin* and *C&J Energy* "revolution." While on paper *Corwin* and *C&J Energy* were supposed to dilute the effects of *Revlon*, in reality, they have not. In other words, the study suggests that the shadow of judicial review did not lose its relevance, contrary to what many commentators predicted.[192]

What explains this non-result? The authors of the study point to "implementation." Implementation matters more than the legal standard, they tell us: Delaware courts do "something" right in implementing the standard, and this "something" apparently affects primary behavior even when the standards are seemingly diluted. The criticism directed at *Corwin* and *C&J Energy*, the authors conclude, is therefore exaggerated.

The framework developed here fills in the blanks. It tells us what exactly this "something" is that Delaware is doing differently from other states. It tells us how come *Corwin* and *C&J Energy* did *not* end up insulating boards from accountability. The answer lies in Delaware's continued emphasis on, and facilitation of, the "tools at hand" for investigating potential wrongdoing, including, most notably, its inspection rights laws. Boards and their advisors know that a problematic process can still be exposed, even if shareholders approved the decision: plaintiffs can submit a section 220 request, the court will let them in through the proper purpose prong, and then make managers hand over their private emails and WhatsApp messages—and no post-facto paper trailing will save them. Such section 220 requests can help

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189 Cain et al., *supra* note 7. "*Revlon* duties" refer to the higher scrutiny placed on directors in a certain set of transformational transactions. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

190 Cain et al., *supra* note 7. The authors compared target companies incorporated in Delaware, or in states that have adopted Delaware's *Revlon* ruling, to target companies incorporated in states where *Revlon* duties do not apply.

191 *But cf.* Zachary J. Gubler, *What's the Deal with* Revlon*?*, 96 IND. L.J. (forthcoming 2021) (finding that directors operating under *Revlon* indeed adopt a more robust process, but not necessarily achieve better outcomes).

192 *See, e.g.*, Anabtawi, *supra* note 3, at 200; James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 389 (2018).

plaintiffs defeat seemingly robust pleading hurdles and generate legal and reputational deterrence. Indeed, another recent working paper documents how section 220 actions lead to successful merit-based litigation—plaintiffs that win inspection cases tend to win more frequently in subsequent litigation.[193]

Yet another empirical study documents the same non-result in the *MFW* context of controlled companies.[194] Adopting an *MFW* structure—subjecting the deal to negotiation by a special committee and a majority-of-minority vote—does not cause significant changes in various parameters of the freeze-out deal process or the deal premium. There as well, the empirical findings stand in stark contrast to what commentators predicted would happen. In the aftermath of *MFW*, we were told, "controllers, safe from the prying eyes of plaintiffs' lawyers, are likely to be less careful about protecting the interests of minority shareholders in squeeze-outs."[195] What the (reasonable) prediction did not take into account is the section 220 expansion, which restored balance and deterrence also in the controllers' self-dealing transaction context.

The few empirical studies that address the question directly—that is, examine how corporate law impacts primary behavior—therefore indirectly corroborate our thesis: robust pre-filing investigations can recreate the deterrence that once came from post-filing discovery. As it turned out, following *Corwin,* Delaware courts did not remove themselves from overseeing transactions.[196] We now see that Delaware still oversees transactions, albeit in a different way. Deals still happen in the shadow of corporate law, only now the shadow consists mostly of section 220.

Another reason to think that expanding section 220 was the right call concerns the inability to rely on the shareholder vote as a standalone governance mechanism. The *Corwin* development (the shift from substantive judicial review to a ratifying shareholder vote), if left unchecked, would have put too much weight on the shareholder vote.[197] The evidence shows that shareholders virtually automatically approve complex and conflicted transactions.[198] They rarely vote down mergers,

193 Cox et al., *supra* note 11.

194 *See generally* Restrepo, *supra* note 7.

195 Cox & Thomas, *supra* note 192, at 349.

196 *Contra* Anabtawi, *supra* note 3, at 167.

197 *Id.* at 201–02; Cox, Mondino & Thomas, *supra* note 5.

198 Cox, Mondino, Thomas, *supra* note 5, at 511 & n.24 (compiling references); Franklin A. Gevurtz, *The Shareholder Approval Conundrum*, 60 B.C. L. REV. 1831, 1833 (2019) (same); Matteo Gatti, *Reconsidering the Merger Process: Approval Patterns, Timeline, and Shareholders' Role*, 69 HASTINGS L.J. 835, 853 (2018).

even when in retrospect we know that the deal and its terms were problematic, to say the least.[199] Such stylized facts should not surprise us: shareholders, as a group, face too many institutional limitations to effectively check managerial misconduct. They are susceptible to information asymmetries, coordination problems, and conflicted interests.[200] Outside shareholders know only what insiders choose to reveal in public filings.[201] "[S]hareholders as a group are not positioned to investigate wrongdoing or bargain for better options; they are stuck with the transaction that is presented to them."[202]

Delaware's expansion of section 220 mitigates the flaws of the shareholder vote. It enhances the quality of available information and incentivizes collective action through bounty hunters (plaintiff attorneys). The first step—mitigating information asymmetries—is intuitive. If we decide to put emphasis on market mechanisms of corporate governance, we have to assure full disclosure. To assure full disclosure, we have to supplement the disclosure requirement (on what to include in public filings) with mechanisms for exposing instances where insiders thwarted the purpose of the disclosure requirement by omitting material details or using euphemisms. In other words, to assure full disclosure we need a one-two punch combination: not just an ex ante requirement to disclose every material fact, but also potent ex post enforcement that punishes the defendant if it turns out the defendant omitted a material fact.

In that respect, the expansion of section 220 is not just good policy but also good law. By emphasizing full disclosure, it is consistent with basic principles of fiduciary law. Fiduciary duties in corporate law have always been geared to deal with extreme information asymmetries—those stemming from unobservable and unverifiable information.[203] The way to tackle these information problems has been to impose "a strict, full-disclosure-based accountability regime."[204] To the extent that

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199 Gevurtz, *supra* note 198, at 1835 (compiling examples). Another aspect of *Corwin* that may make the reliance on the shareholder vote unsustainable is that the *Corwin* vote inherently distorts shareholders' choice: it bundles together the vote on approving the merger with the vote on absolving managers of failures in conducting the deal process. Cox, Mondino, Thomas, *supra* note 5, at 513–14.

200 Anabtawi, *supra* note 3, at 201; Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and its Legal Underpinnings* (Harvard L. Sch. John M. Olin Ctr. Discussion, Working Paper No. 1046, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3707249.

201 Anabtawi, *supra* note 3, at 201 ("Management controls the 'narrative' of the deal disclosed in the merger proxy.").

202 Lipton, *supra* note 129, at 2003; Gevurtz, *supra* note 198, at 1879–84.

203 Amir N. Licht, *Motivation, Information, Negotiation: Why Fiduciary Accountability Cannot be Negotiable*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW 159, 171–72 (D. Gordon Smith & Andrew S. Gold, eds., 2018).

204 *Id.* at 179.

the *Corwin*/*MFW* shift toward disclosing everything to the beneficiaries (shareholders) and letting them decide is more consistent with fiduciary law than the previous regime of ex post judicial review of the fairness of deals,[205] so too is the expansion of section 220, which assures that the pre-vote disclosure is indeed full and comprehensible.[206]

Delaware's recalibration helps not just in solving problems where information is too scanty, but also in solving problems where information is too plentiful. *Corwin* created a *proxy overload* problem: as Vice Chancellor Slights commented, it "incentivize[s] directors to overwhelm stockholders with proxy disclosures" full of irrelevant information,[207] so as to raise the processing costs and bury less-favorable bits of information.[208] Allowing effective pre-filing investigations helps in reducing these processing costs: it incentivizes plaintiff attorneys to dig through the materials, separate the relevant from the irrelevant, and locate the buried important facts.

Viewed from this perspective, another justification for Delaware's emphasis on pre-filing investigations is that it promotes effective bounty hunting. A key part of shareholder protection—indeed, some would say the only meaningful part[209]—comes not from shareholders directly fending for themselves, but rather from bounty hunters seeking their bounty and, in the process, indirectly benefiting shareholders. Such indirect investor protection can come from hedge fund activists, investigative reporters, or—pertinently here—plaintiff attorneys. Accordingly, a key challenge for corporate law is how to structure the doctrines so as to assure effective bounty hunting. In practice, this translates to not granting windfalls to lawyers who do not add much to the mix, while nicely rewarding those who pursue monitoring activity that benefits shareholders as a group.[210] Bounty hunters should get to collect their bounty only if other investors gained as a result of their activity. Raising the pleading bar while expanding the scope of pre-filing

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205 Amir N. Licht, *Farewell to Fairness: Towards Retiring Delaware's Entire Fairness Review*, 44 DEL. J. CORP. L. 1, 28–30 (2020).

206 The fiduciary law perspective helps us understand *Lavin*: the courts will give great respect to beneficiaries' consent (here, *Corwin*'s emphasis on the shareholder vote), but they can still insist on full disclosure on the part of the fiduciary. Full disclosure, in other words, is part of the "irreducible core" of fiduciary relationships and cannot be set aside by a *Corwin* defense. *See* Licht, *supra* note 203, at 176–78; Schmidt v. Rosewood Trust Ltd. [2003] UKPC 26, [2003] 2 AC 709 (appeal taken from Isle of Man).

207 Diller & Slights, *supra* note 51, at 26.

208 On the information overload problem, see Appel v. Berkman, 180 A.3d 1055, 1064 (Del. 2018); Werner v. Werner, 267 F.3d 288, 297–99 (3d. Cir. 2001). *See generally* WENDY WAGNER & WILL WALKER, INCOMPREHENSIBLE! (2019).

209 Spamann, *supra* note 200.

210 *Cf.* Parsons & Tyler, *supra* note 41, at 486, 490–91.

investigation holds the promise of doing just that. *Corwin* and *Trulia* made sure that plaintiff attorneys would not get a bounty unless they unearthed valuable information, while *Lavin* and *KT4 Partners* made sure that they *could* unearth valuable information. Now we can get investigations without abusive litigation, a more cost-effective bounty hunting.

Further, Delaware's recalibration holds the promise of increasing the positive role of not just plaintiff attorneys but also defendant attorneys. Prior to the *Corwin* development (more precisely, prior to *Trulia*), defendants grew accustomed to paying a cheap deal insurance in the form of disclosure-only settlements. Transaction counsels therefore had a limited role to play in terms of advocating for a better sale process. Nowadays, when plaintiff attorneys are incentivized to investigate before filing, transaction counsels can credibly implore their clients to do a better job in handling the deal.[211] "If you do not exert effort and do not maintain proper records of your efforts," transaction counsels can now say, "these bad plaintiff attorneys will file a section 220 action and force you to hand over all your private emails and LinkedIn messages."

There is another point at play here, about the salutary effects of paper trails. We saw that after every key section 220 juncture, law firms sent memos to their clients imploring them to start keeping more robust documentation of board discussions and company records. One could respond that such guidance is merely geared at covering tracks, rather than at improving decision-making processes. Yet focusing on a well-documented process is a staple of corporate law and is also good policy: robust documentation can generate real positive effects, such as assuring an issue is not neglected, or elevating the level of deliberation.[212]

Overall, the expansion of section 220 seems to restore much-needed balance to corporate law following the *Corwin* development. The new, front-loaded equilibrium in corporate litigation seems desirable. Yet nothing in what we have been discussing thus far guarantees that the pendulum will stay where it currently stands. In fact, recent trends suggest that the new equilibrium may not be sustainable.

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211 Laster, *supra* note 48, at 225.

212 Amir N. Licht, *Stakeholder Impartiality: A New Classic Approach for the Objectives of the Corporation*, *in* FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur Laby & Jacob Hale Russell, eds., forthcoming 2021). For more on the importance of better record keeping in assuring effective compliance with applicable laws, see Shapira, *supra* note 10.

III. IS THE RISE OF PRE-FILING INVESTIGATIONS SUSTAINABLE?

Part I pointed to a new equilibrium in shareholder litigation, whereby litigation is front-loaded and plaintiffs are incentivized to conduct thorough pre-filing investigations. Part II assessed the impact of front-loading and suggested that it is likely to prove desirable: shifting from post-filing unlimited discovery to pre-filing qualified discovery reduces the costs of shareholder litigation while maintaining its main salutary effects (direct and indirect deterrence). A separate question that we have not yet discussed is whether such a front-loaded equilibrium is sustainable. Note how most of the court decisions (and academic studies) cited throughout this Article have been from the last couple of years. The rise of section 220 is very much a new phenomenon. Could it be the pendulum will keep swinging, and pre-filing investigations will soon lose their prominent role in corporate governance? This Part explains why the decline of pre-filing investigations is a real possibility and suggests ways to stop it.

Precisely because pre-filing investigations have become so effective in deterring misbehavior, companies are now searching for ways to dilute their effects. At the same time, because pre-filing investigations generate positive externalities, plaintiffs do not fully internalize their benefits. This leads to a situation where both parties to a dispute may be running away from pre-filing investigations. Both parties prefer litigation without pre-filing investigations, and the investor community as a group suffers. Subsection A details how companies can contract out of pre-filing investigations or at the minimum condition them on confidentiality to limit the reputational fallout. The Subsection then proposes ways for legislators and courts to limit companies' abilities to contract out. Subsection B spotlights the troubling trend of plaintiff attorneys racing to file outside Delaware, where they are not subject to the "tools at hand" doctrine and can litigate first and investigate later (if at all). Here as well, we discuss ways to limit the flight from section 220, such as using the "lead plaintiff" or "adequate representation" designations as carrots or sticks.

A. *Companies Contract out of Pre-Filing Investigations*

The expanded usage of section 220 has allowed minority shareholders to investigate and hold incumbent decision-makers to account. And precisely because it has been such a potent tool, companies have already started and will likely continue to look for ways

to limit shareholders' inspection rights.[213] Consider the following three channels for companies to limit the legal and reputational sanctions that emanate from pre-filing investigations. Companies can insert contractual provisions that make shareholders give up their inspection rights (or, in securities litigation, disincentivize whistleblowing). Companies can adopt mandatory arbitration provisions in their corporate governance documents, so that the impetus for conducting pre-filing investigations (namely, the filing) becomes irrelevant. And when forced to nevertheless deal with pre-filing investigations, defendant companies can offer plaintiffs a quick settlement conditioned on confidentiality.

First, let us consider the inspection rights waiver option. Companies cannot include inspection rights waivers in their charters or bylaws, as these statutory rights are one of the few *mandatory* features of corporate law. However, companies may be able to limit inspections right by individual contracts. Indeed, a burgeoning practice among growing start-ups is to sign employees on an inspection rights waiver before granting said employees stock options.[214] To be sure, it is not entirely clear that such waivers are legal. As VC Laster recently alluded to in the *Juul* case, there is a long history of Delaware courts rejecting attempts to limit inspection rights.[215] Still, some dicta and commentary and policy considerations leave room to include these waivers as long as they are "clearly and affirmatively expressed."[216] And de facto, companies have been pushing forward with such waivers.[217] A similar development has occurred in the context of pre-filing investigations leading to securities litigation, with whistleblowing waivers replacing inspection rights waivers. There, companies have increasingly included "confidentiality, separation, and severance agreements to preclude or chill the opportunity for employees or former employees to be

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213 Geis, *supra* note 188, at 442–44.

214 Cox et al., *supra* note 11, at 2156.

215 Juul Labs, Inc. v. Grove, 238 A.3d 904, 919 n.14 (Del. Ch. Aug. 13, 2020).

216 *Id.* at 919 n.15; Kortum v. Webasto Sunroofs, Inc., 769 A.2d 113, 125 (Del. Ch. 2000); *see also* Jill E. Fisch, *Appraisal Waivers*, 107 IOWA L. REV. (forthcoming), https://ssrn.com/abstract=3667058 (an analysis of appraisal rights waivers with many parallels to our context); Jill E. Fisch, *Private Ordering and the Role of Shareholder Agreements*, 99 WASH. U. L. REV. (forthcoming 2022), https://ssrn.com/abstract=3667202 (broad-based analysis of the legitimacy and desirability of waiving shareholder rights).

217 *See, e.g.*, Rolfe Winkler, *Startup Employees Invoke Obscure Law to Open Up Books*, WALL ST. J. (May 24, 2016, 1:48 PM), https://www.wsj.com/articles/startup-employees-invoke-obscure-law-to-open-up-books-1464082202 [https://perma.cc/2CA3-VM2E] (quoting an executive compensation attorney); *Founders Alert: Be Aware of Stockholder Inspection Rights*, FOUNDERS WORKBENCH (July 21, 2016), https://www.foundersworkbench.com/founders-alert-be-aware-of-stockholder-inspection-rights [https://perma.cc/RR98-AU2B] (an online portal for aspiring founders not only urges founders to include such waivers, but also provides a template).

interviewed by plaintiffs' counsel or investigators during the pre-filing phase of litigation."[218]

A second possibility that may become relevant in the near future is for companies to include mandatory arbitration provisions in their charter or bylaws.[219] Funneling disputes to arbitration should not, on paper, affect shareholders' inspection rights; after all, inspection rights do not depend on subsequent litigation. But in reality, eliminating shareholder litigation would also effectively eliminate the informational benefits of section 220. Eliminating litigation would take away the bounty—the potential financial bonanza down the road—that incentivizes plaintiff attorneys to go through the protracted, costly battles of section 220 demands. Further, the courts have traditionally conditioned granting section 220 requests on confidentiality.[220] As a result, the only time section 220 information escapes confidentiality and becomes available is when the materials from the pre-filing request are filed with the court in subsequent litigation, such as in the initial complaint or attachments to a motion.[221] Funneling disputes to arbitration behind closed doors will therefore reduce the number of section 220 actions and reduce the positive spillovers (reputational deterrence) from those actions that will be filed.

Finally, consider how a company can lose the battle—by being forced to provide documents—but still win the war—by getting the plaintiff to agree to keep the information confidential. As Subsection II.B showed, it is often the diffusion of information and the reputational sanctions it brings that bothers defendants more than the legal outcomes of the case. And as with issues of secrecy in litigation more generally, the problem is that the plaintiff does not internalize all the benefits of making the information public, and so she is likely to agree to confidentiality even when it is not socially desirable.[222] Defendants will be willing to pay more to keep the section 220 material confidential, to reduce the risk of adverse publicity. Plaintiffs will use confidentiality as a bargaining chip; a plaintiff may not care whether or not other market players learn something about defendants, as long as she can receive a hefty award.[223]

Lawmakers who recognize the positive externalities that come with pre-filing investigations (as Part II detailed) should be skeptical of such

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[218] Mark, *supra* note 13, at 822.

[219] Shapira, *supra* note 156.

[220] Disney v. Walt Disney Co., 857 A.2d 444, 448, 450 (Del. Ch. 2004).

[221] Radin, *supra* note 41, at 1643–44.

[222] *See generally* Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997).

[223] *See* Shapira, *supra* note 157, at 204.

contracting-out attempts. Courts could strike down waivers of inspection as running against public policy.[224] Regulators and judges should resist importing the mandatory arbitration trend to shareholder litigation.[225] And judges should not automatically condition provision of documents on confidentiality, as the 2019 *Tiger v. Boast Apparel Inc.* clarified.[226]

B. *Plaintiffs Run Away from the "Tools at Hand" Doctrine*

Defendants are not the only ones looking for ways to limit pre-filing investigations; some plaintiffs may prefer to avoid them as well. After all, section 220 actions have become increasingly lengthy and costly. And because section 220 actions are decided on a highly contextual, case-by-case basis, there is uncertainty regarding their outcomes. While thorough, successful pre-filing investigations generate a positive externality (valuable information on corporate behavior) that benefits all market players, plaintiffs and their attorneys are the ones bearing the costs of this heavy upfront, uncertain investment. If they can get away without investing in pre-filing investigations, plaintiffs would prefer to do so.

Indeed, perhaps the most troubling trend for the future of pre-filing investigations is the migration out of Delaware: plaintiff attorneys are opting to file lawsuits for breaches of fiduciary duties in other states.[227] Filing outside Delaware comes with a chance to bypass Delaware's unique insistence that plaintiffs use the "tools at hand" to investigate before filing.[228] Instead of filing in Delaware, where they have to invest vast resources in pre-filing investigations in the face of opposition by the company and uncertain outcomes, some plaintiffs opt to file elsewhere, where they can more easily get away with pleading

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[224] See, in the context of waivers of whistleblowing (pre-filing investigations in securities litigation), Mark, *supra* note 13, at 822.

[225] Shapira, *supra* note 156.

[226] Tiger v. Boast Apparel Inc., 214 A.3d 933, 935, 939 (Del. 2019).

[227] For empirical evidence on the trend of filing outside Delaware, see Cain et al., *supra* note 47.

[228] On the uniqueness of Delaware in demanding and then being willing to consider pre-filing investigations, see Frank R. Schirripa & Daniel B. Rehns, *Is the Delaware Section 220 Tango Worth the Wait?*, 28 A.B.A. CLASS ACT. & DERV. STS. 13 (2017); Hamermesh & Wachter, *supra* note 117, at 651. For more on Delaware's unique approach to information production, see SHAPIRA, *supra* note 167, at Chap. 3; *see also* Leo E. Strine, Jr., Lawrence A. Hamermesh & Matthew C. Jennejohn, *Putting Stockholders First, Not the First-Filed Complaint*, 69 BUS. LAW. 1 (2013) (describing a race to the bottom to file in a court that makes plaintiffs' lives easier).

based on news clippings and other pre-cooked packages of publicly available information.

The existence of some plaintiff attorneys who race to file outside Delaware may disincentivize pre-filing investigations by others in the plaintiffs' bar and a race to the bottom could ensue.[229] Specifically, the more qualified plaintiffs and attorneys who are intent on thoroughly investigating potential mismanagement may anticipate that they will have to jettison their section 220 demands and rush to intervene in pending cases outside Delaware. In turn, these plaintiffs may decide not to enter into costly and uncertain section 220 battles to begin with.

Given that pre-filing investigations produce a public good, bypassing pre-filing investigations is a public bad. It is good for the plaintiffs who rush to file early, and good for defendants who can strategically settle with lower-quality plaintiffs and thus avoid the prospect of meaningful investigations.[230] But bypassing investigations is bad for the market overall. Instead of providing a bounty to plaintiff attorneys who extract valuable information on the behavior of companies, the file-before-investigating dynamic rewards plaintiff attorneys who are quick to capitalize on public information without adding much to the mix.

There exist several ways to mitigate the race to file without investigating. One solution is to factor plaintiffs' investment in pre-filing investigations when considering "adequate representation" and who should be "lead plaintiff."[231] In order to represent a group of shareholders in a class action, plaintiffs and their attorneys have to meet the "adequate representation" condition. And when multiple complaints are filed over the same misbehavior in question, the court will normally consolidate the cases into a single lawsuit and designate a lead counsel, who receives a larger chunk of the bounty. Historically, the courts have made these determinations based on crude proxies such as who filed first, or who has the biggest stake (that is, which shareholder suffered the greatest loss). Those who filed first enjoyed deference even when they did not invest in using the tools at hand to investigate before they filed.[232] Going forward, the courts should switch to emphasizing the willingness and ability of plaintiffs and their attorneys to conduct thorough pre-filing investigations as a factor to

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229 Parsons & Tyler, *supra* note 41, at 517.

230 Lawrence A. Hamermesh & Jacob J. Fedechko, *Forum Shopping in the Bargain Aisle:* Wal-Mart *and the Role of Adequacy of Representation in Shareholder Litigation*, *in* REPRESENTATIVE SHAREHOLDER LITIGATION, *supra* note 48, at 160; Fiegenbaum, *supra* note 155, at 630.

231 James D. Cox, *Addressing the "Baseless" Shareholder Suit: Mechanisms and Consequences*, *in* REPRESENTATIVE SHAREHOLDER LITIGATION, *supra* note 48, at 121.

232 Hamermesh & Fedechko, *supra* note 230, at 163 n.42 (compiling cases).

consider when determining who should be lead plaintiff, or whether the plaintiffs and their attorneys provide adequate representation.[233]

Indeed, Delaware's Court of Chancery has considered adopting a first-filer presumption of *in*adequacy. A presumption of inadequacy here rests on the principle that a shareholder does not adequately represent the interests of her fellow shareholders if she files immediately after bad news breaks, as it implies that she has not invested enough in thorough investigations.[234] While Delaware's Supreme Court has thus far refused to adopt such a stringent approach, it has recognized the need to deal with the filing-before-investigating trend, and offered a plethora of more nuanced approaches, such as factoring in the thoroughness of the pleading when granting lead plaintiff status, limiting the ability of the fast filer to amend her complaint, and so on.[235]

The same dynamics apply more specifically to the need to utilize section 220 before filing: while the Court of Chancery has suggested a presumption of *in*adequacy,[236] the Supreme Court has not yet been willing to adopt such a sweeping approach,[237] but acknowledged the need to find more nuanced solutions. At least in one common context, namely, *Caremark* litigation, the courts are increasingly willing to assume inadequacy of plaintiffs who do not utilize their inspection rights before filing.[238] The logic is that in failure-of-oversight claims, there is no real need to rush to file, as the claim is about something that has already happened, and there is a real need to investigate thoroughly, as the claim invokes scienter.[239] To be sure, a presumption of inadequacy is just that: a presumption. It can be rebutted, for example, if the plaintiff shows that she did conduct thorough pre-filing investigations, albeit by means other than section 220.[240]

Another method to incentivize plaintiffs to investigate before filing is the "relate back" approach championed by former Chief Justice

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233 Cox et al., *supra* note 11; *see also* Hamermesh & Fedechko, *supra* note 230, at 168 (suggesting factoring plaintiffs' discovery efforts when considering adequate representation); Sean J. Griffith & Anthony Rickey, *Who Collects the Deal Tax, Where, and What Delaware Can Do About It*, *in* REPRESENTATIVE SHAREHOLDER LITIGATION, *supra* note 48, at 150–51 (advocating using the lead plaintiff designation as a carrot to incentivize law firms to go after more substantial cases).

234 King v. VeriFone Holdings, Inc., 994 A.2d 354, 364, n.34 (Del. Ch. 2010); Hamermesh & Fedechko, *supra* note 230 at 160 n.25 (compiling examples).

235 King v. VeriFone Holdings, Inc., 12 A.3d 1140, 1150–52 (Del. 2011).

236 Louisiana Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313 (Del. Ch. 2012).

237 Pyott v. Louisiana Mun. Police Emps.' Ret. Sys., 74 A.3d 612 (Del. 2013).

238 South v. Baker, 62 A.3d 1, 23–24 (Del. Ch. 2012); Cal. State Tchrs.' Ret. Sys. v. Alvarez, 179 A.3d 824, 853 (Del. 2018).

239 Hamermesh & Fedechko, *supra* note 230, at 171.

240 Parsons & Tyler, *supra* note 41, at 523.

Strine.[241] Because being the first to file may still confer an advantage, one way to reward (or not punish) plaintiffs who utilize their inspection rights is by treating the date they submitted their section 220 request as if it was the date they filed a complaint. Yet another proposal championed by Strine is not to allow fast filers to submit a section 220 request *after* they file in hopes of then amending their complaint, thereby discouraging a "sue first, ask questions later" approach.[242] An even more debatable method for incentivizing pre-filing investigations is fee-shifting, whereby the plaintiff pays if the pre-filing investigation doesn't net anything, and the defendant pays otherwise.[243]

Finally, I would be remiss if I did not mention one straightforward way to mitigate plaintiff attorneys' incentives to avoid pre-filing investigations, namely, streamlining the section 220 process.[244] To reiterate: fighting section 220 battles is a lengthy, costly endeavor with uncertain outcomes[245]; and even if you win the battle, you may lose the war, because a less-thorough plaintiffs' attorney may have already filed elsewhere and estopped your claim.[246] Recall that the average delay in section 220 actions is ten months.[247] If we can somehow find a way to drastically reduce the delay and costs associated with section 220 litigation, more plaintiffs are bound to use their inspection rights before filing. In reality, however, streamlining the section 220 process is easier said than done. After all, nowadays much of the assessment of the case happens through the section 220 action. The parties are aware that the section 220 battle will largely determine the outcome of the underlying dispute and pour all their resources into it. We therefore cannot and

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241 *Id.* (compiling references).

242 *See* King v. Verifone Holdings Inc., 994 A.2d 354, 356–57 (Del. Ch. 2010). Again, this bright-line rule was reversed by the Supreme Court, on the ground that such a change should come from the legislator. King v. Verifone Holdings Inc., 12 A.3d 1140, 1151 (Del. 2011). *But see* CHC Invs., LLC v. FirstSun Cap. Bancorp, No. 2018-0610-KSJM, 2019 WL 328414 (Del. Ch. Jan. 24, 2019).

243 *See* Crestview-Oxbow Acquisition v. Oxbow Carbon LLC, No. 2018-0654-JTL, 2019 Del. Ch. LEXIS 548 (Del. Ch. Jan. 15, 2019) (proposing fee shifting, albeit in the context of a limited liability company (LLC)). *See generally* Issacharoff & Miller, *supra* note 181, at 448.

244 Diller & Slights, *supra* note 51, at 29 (Vice Chancellor Slights commenting that "as a court, we have to be mindful of timing issues, and we have to be willing to expedite 220 matters to meet the deal timeline.").

245 For the plaintiff attorney's view see *supra* note 228; Francis Pileggi, *Confidentiality Agreement Not Always Required for Section 220 Demands*, DEL. CORP. & COM. LITIG. BLOG (Aug. 12, 2019), https://www.delawarelitigation.com/2019/08/articles/delaware-supreme-court-updates/confidentiality-agreement-not-always-required-for-section-220-demands [https://perma.cc/U973-ZNZR].

246 *See* Hamermesh & Wachter, *supra* note 117, at 613.

247 *See* Cox et al., *supra* note 11.

should not expect the process to revert to being as technical and concise as it used to be.

Before we conclude, a clarification and reiteration are in order. The migration of cases away from Delaware is not strictly section 220 related. The abovementioned *Trulia* ruling, which made it harder for plaintiff attorneys to collect fees with minimal effort, played a significant role. My point in this section was not to lament the migration of cases in itself. Migration of cases can be a good thing if the migrating cases are of poor quality.[248] What matters for our purposes is the effects of migrating out of Delaware on the quality of monitoring and investigating: the quality of information that is being produced by plaintiff attorneys. To the extent that migration makes it easy for plaintiff attorneys to shirk on their pre-filing investigations and still collect a bounty, it is bad from a societal perspective.

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As the number of inspection cases explodes, the importance of regulating section 220 properly increases. For the foreseeable future, two of the most important challenges that Delaware faces are (1) how to interpret section 220 conditions in ways that balance between deterring misbehavior and not deterring worthy behavior and (2) how to make sure that certain plaintiffs' firms and defendants do not bypass the emphasis on thorough pre-filing investigations, by filing elsewhere or contractually limiting inspection rights. While Delaware seems to be getting (1) right, getting (2) right is still a work in progress.

CONCLUSION

In the 2000s, corporate law litigation came to be dominated by strike suits. Litigation did little good, and so it made sense to recalibrate it.[249] The first step in recalibration was reducing the standards of judicial review and granting more deference to market mechanisms. A string of dramatic decisions in the mid-2010s, spearheaded by *Corwin*, did just that. Commentators held widely opposing views about the desirability of the *Corwin* development, but there was a consensus on its outsized impact. In retrospect, the consensus was wrong. The *Corwin* development was just the first step, which cannot be analyzed in isolation. A second step came on the heels of *Corwin* and included the

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248 *See* Griffith & Rickey, *supra* note 233, at 146.

249 *See* Laster, *supra* note 48, at 226.

expansion of shareholders' inspection rights. The section 220 expansion allowed market players to gain access to valuable inside information pre-filing, thereby facilitating the monitoring and deterrence of corporate misconduct. The rumors of the death of corporate law and Delaware's role in it turned out to be greatly exaggerated. Delaware corporate law is alive, only now it is doing most of its kicking via section 220.

The new, front-loaded equilibrium reflects a balance between the costs of curbing abusive litigation and the benefits of letting plaintiff attorneys monitor managerial misconduct. It requires careful micromanaging by the courts, by dictating the types of documents plaintiffs can and cannot receive. So far Delaware's judges have been up to the task. Granted, the new emphasis on pre-filing investigations comes with its own host of thorny issues. But the alternatives—either relying solely on the shareholder vote or proceeding to unlimited discovery—are worse. Delaware's recent doctrinal developments seem to have struck the right balance between deferring to business judgments and screening frivolous litigation, on the one hand, and facilitating monitoring of problematic corporate behavior, on the other.