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The Wal-Mart Decision: Just How Big A Blow Did The Delaware Supreme Court Deal To Corporations?

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In a much-anticipated decision, the Delaware Supreme Court recently affirmed a trial court holding that, in limited circumstances, a shareholder can obtain privileged corporate documents relating to a company's internal investigation. While the opinion is groundbreaking in its adoption and affirmation of the "fiduciary exception" to the attorney-client privileged, corporations still retain several layers of protection against disclosure and likely have less reason to fear this decision than a cursory reading might suggest. In *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, the court held that a Walmart shareholder was entitled to review Wal-Mart's privileged internal investigation documents relating to its FCPA investigation. The shareholder sought the documents through a Section 220 inquiry – which permits shareholder inspection of books and records under Delaware state law – by arguing that it needed the documents in order to determine if there had been a breach of fiduciary duty by the company's directors. The shareholder's investigation related to public allegations that Wal-Mart had failed to undertake an adequate investigation of potential violations of the Foreign Corrupt Practices Act in Mexico. The decision is significant for the impact it will have on future attempts by shareholders of Delaware corporate entities to review privileged, corporate documents relating to, among other things, internal investigations. While courts had previously established that the attorney-client privilege is not absolute, this decision expressly expands the so-called "fiduciary exception" articulated in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970) to the Delaware state courts, reinvigorating its holding. In that case, one of the earliest to recognize the exception, the Fifth Circuit held that "where the corporation is in suit against its stockholder on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance." *Garner*, 430 F.2d at 1103-04. The court went on to state that there are "many indicia" that relate to good cause, including *inter alia*, the number of shareholders and stock percentage they represent; the bona fides of the shareholders, the nature of the shareholders' claim and whether it is

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"obviously colorable;" the necessity and availability of the information from other sources; whether the alleged acts are criminal in nature or of "doubtful legality;" and the extent to which the communication is identified as opposed to be sought with "blind fishing" by the shareholder. *Id.* at 1104. After considering these factors on remand the district court found that the shareholder plaintiffs had met the "good cause" standard and compelled the company's president (and former general counsel) to testify about advice he gave the company. In the Wal-Mart decision, the court found that it was appropriate to adopt the *Garner* holding and to extend it to "plenary stockholder/corporation proceedings," including Section 220 proceedings. It cautioned that "in a Section 220 proceeding, the necessary and essential inquiry must precede any privilege inquiry because the necessary and essential inquiry is dispositive of the threshold question – the scope of document production to which the plaintiff is entitled under Section 220." Nevertheless, the court upheld the order directing Wal-Mart to produce privileged documents to the shareholder, including emails and memoranda authored by Wal-Mart's general counsel. The Wal-Mart decision is important for a couple of reasons. First, in addition to adopting the *Garner* doctrine, the Delaware Supreme Court extended it beyond standard stockholder suits to Section 220 inquiries by shareholders, thus establishing precedent for the ability of shareholders of a Delaware corporation to obtain otherwise privileged documents in the name of investigating a potential breach of fiduciary duty. Delaware companies may now see broader requests from shareholders in Section 220 in terms of the scope and type of documents they seek. Second, the court ordered Wal-Mart to turn over documents that Wal-Mart's directors did not create and had never seen, over Wal-Mart's objection that these documents were not relevant to a determination of whether Wal-Mart's directors had breached their fiduciary duties. The court disagreed, stating that "Plaintiffs may establish director knowledge of the WalMex investigation by establishing that certain Wal-Mart officers were in a 'reporting relationship' to Wal-Mart directors, that those officers did in fact report to specific directors, and that those officers received key information regarding the WalMex Investigation." The court noted that it was not creating a presumption of director knowledge of officer-level documents by doing so; rather, it was acknowledging that "a reasonable inference can be established by circumstantial evidence." While the decision is certainly disappointing from a corporate standpoint, the burden placed on Delaware shareholders seeking to obtain corporate documents is still very high, and Delaware corporations still retain the ability to fight disclosure of privileged information at several points. A Section 220 inquiry requires that the shareholder meet certain evidentiary burdens at numerous points in the action, including at the stage where the shareholder must state a proper purpose. In *Pershing Square, L.P. v. Ceridian Corp*. 923 A.2d 810, 816 (Del. Ch. 2007), the court noted:

> Inspection under § 220 may be had only for a proper purpose. A plaintiff who states a proper purpose must also prove that it has some credible evidence sufficient to warrant further investigation. Mere satisfaction of the proper purpose and credible basis for suspicion prongs will not equal automatic entitlement to the materials sought. A plaintiff must also prove that the information it seeks is necessary and essential to satisfy its stated purpose. Finally, a plaintiff who proves all of these may be limited in its use of any information where the information is confidential and release would harm the company.

Id. at 816; *see also Seinfeld v. Verizon Communications, Inc.*, 909 A.2d 117, 121 (Del. 2006) (“In a section 220 action, a stockholder has the burden of proof to demonstrate a proper purpose by a preponderance of the evidence.”).These requirements protect against a shareholder making Section 220 demands of a corporation without significant supporting evidence. Additionally, the *Garner* standard and its multi-factor analysis of what constitutes “good cause” is not a bright line rule. Companies should *not* assume that their privileged internal records, including records of internal investigations, are now subject to disclosure, and should not change their practices regarding the exercise and documentation of the attorney-client privilege and the work product doctrine. The evaluation of whether the shareholder has “good cause” to overcome the privilege is a specific, fact-based analysis that must be undertaken separately in each case. While *Wal-Mart* may signal a troubling movement towards greater transparency for privileged corporate documents, companies should not alter the practice of keeping such investigations privileged. In short, although enterprising plaintiffs may feel emboldened by the Wal-Mart decision, the heavy requirements placed on those plaintiffs in a Section 220 claim are still in place. Shareholders will still be obligated to pierce several lines of defense and face a high burden in order to obtain privileged documents.