

PANEL COUNSEL

Increasing Scope of “Books and Records” Demands Drives New Insurance Solutions



Directors and officers are subject to scrutiny not only by federal and state regulators. Recent trends underscore that shareholders increasingly demand to inspect companies “books and records” to obtain information, including for alleged wrongdoing by senior management. And the scope of those demands is expanding. This raises significant concerns for directors and officers, and the increase in costs associated with responding to books and records requests has left many wondering if they are covered under their organization’s directors and officers (D&O) liability insurance.

EXPANDING FREQUENCY AND SCOPE

State law in most jurisdictions permits shareholders to review a corporation's books and records for purposes such as valuing their shareholdings or investigating instances of mismanagement. Historically, the corporate secretary or general counsel responded to these requests, which were limited in nature and inexpensive to process. Any associated costs were not covered by D&O insurance.

However, the number of books and records demands has increased over the past 15 years, and the scope has grown exponentially. This is largely driven by court decisions encouraging or requiring shareholders to use "tools at hand" to investigate alleged director and officer misconduct before bringing a lawsuit or facing potential dismissal. This has helped shape such demands into a way to obtain "free" pre-lawsuit discovery. Three recent cases illustrate this trend:

- In July 2014, the Delaware Supreme Court ruled that a *New York Times* article detailing alleged illegal payments by a national retailer to Mexican officials provided justification for shareholders to investigate corporate wrongdoing by seeking a wide range of documents pursuant to Delaware's books and records statute. The court directed the retailer to produce documents that were never considered by the

board of directors to be responsive to a books and records demand, including emails from at least 11 custodians spanning a period of seven years. The court also found that the shareholders had shown good cause to review documents otherwise protected by attorney-client privilege.

- In September 2014, the Delaware Court of Chancery ruled that allegations of possible self-dealing relating to a loan made to a global manufacturer by its controlling shareholder justified shareholder examination of all documents. This included documents and emails concerning not only the loan, a previous loan, and all efforts to seek (or not seek) alternative financing, but also a wide variety of documents concerning the company's business plans, projections, and financial statements.
- In February 2016, the Delaware Court of Chancery ruled in a case involving a multinational technology company that investigating allegedly excessive executive compensation is a proper purpose for a books and records demand and that email and other electronic documents are obtainable in such a situation. Moreover, the court ruled that directors and officers in a company receiving such a demand can be required to produce relevant materials from their personal email accounts.



INSURANCE SOLUTIONS TO ADDRESS EVOLVING RISKS

While the scope of books and records demands — and the associated costs to produce them — have been historically minimal, the landscape appears to be shifting. As court rulings continue to trend in favor of shareholders' requests for access to corporate documents, companies and their directors and officers must be prepared to provide much more expansive productions of documents. These will likely be large in size and also contain information once considered privileged, as well as personal communications shared outside of work. Responding to a wide-ranging demand of this nature can be a costly, difficult, and time-consuming process for any company, best overseen by outside counsel.

Costs of responding to books and records demands may not be covered under traditional public company D&O policies, leaving companies financially exposed. In response, insurers have begun offering coverage options for the expenses associated with responding to these demands.

Books and records coverage typically comes in one of two forms:

- As part of the definition of derivative investigation costs with sublimited coverage. This form is limited in coverage and eradicates the small sublimit also available should a derivative demand follow the books and records demand. However,

sublimited coverage is typically not subject to a retention. In addition, excess D&O insurers may be willing to provide excess sublimited coverage.

- As part of the definition of defense costs with full limits access. Full limits coverage also has its limitations. A company may be subject to a large retention and, should significant costs be incurred in contesting and ultimately responding to a books and records demand, those costs could erode a significant portion of the limits available for future use. However, full limits coverage offers access to more insurance proceeds than sublimited coverage. Other issues must also be considered when adding books and records coverage, including notice issues and "wrongful act" language.

As the trend toward requiring greater access to corporate information continues, the costs associated with providing that access will continue to rise. There are now a number of different options for insuring such costs. Work with your insurance advisor to understand all available options and obtain the best protection for your company and its directors and officers.





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