

How Will Section 220 of the Delaware General Corporation Law Amendments Affect Your Business?

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Agenda

- Overview of Section 220 of the Delaware General Corporation Law
- The 2025 Amendments to Section 220
- The Implications of the 2025 Amendments

What is Section 220?

- Section 220 grants shareholders a qualified right to inspect a corporation's books and records for a "proper purpose."
- This provision serves as a critical accountability mechanism, enabling shareholders to investigate potential wrongdoing, assess valuation, or understand corporate governance practices.
- Courts emphasize that Section 220 requests should be targeted and purpose-driven and often encourage shareholders to use this tool to gather necessary information before initiating derivative lawsuits or other litigation against the corporation or its directors and officers.

Legal Standards

Inspection rights under Section 220 are not unlimited. Shareholders must demonstrate:

- **Proper Purpose:** The request must be reasonably related to the person's interest as a shareholder, such as investigating mismanagement, evaluating directorial independence, or determining valuation.
- **Credible Basis:** The lowest evidentiary standard in Delaware law; shareholders need to show only a credible basis for possible wrongdoing, not conclusive proof.
- **Necessary and Essential:** Requests must be narrowly tailored to documents that are necessary and essential to achieve the stated purpose, rather than expansive fishing expeditions.

Key Precedents

- *Security First v. U.S. Die Casting* (1997): Established the credible basis requirement.
- *Wal-Mart Stores v. IBEW* (2014): Expanded scope beyond formal minutes to include additional materials relevant to oversight.
- *KT4 Partners v. Palantir* (2019): Allowed inspection of electronic communications where companies conducted business informally through email.
- *AmerisourceBergen v. Lebanon County* (2020): Clarified that shareholders need not show that wrongdoing is actionable, only that there is a credible basis for further inquiry.

Issues Leading to the Amendments

- Increasing litigation over the scope and process of Section 220 demands.
- Concerns about overbroad inspection requests and so-called “fishing expeditions,” which impose significant burdens on corporations.
- Disputes regarding the production of electronic communications, such as emails and text messages.
- Actual and threatened reincorporation of Delaware corporations in other states, including Texas and Nevada, due to perceived uncertainty or burdens under Delaware law.

Purpose of Amendments

- To codify key judicial decisions and provide greater clarity regarding the scope of inspection rights under Section 220.
- To reduce uncertainty and prevent perceived abuses of inspection rights by introducing clearer standards and procedural limitations.
- To modernize the statute, including clarifying what constitutes corporate records.
- To reaffirm Delaware's status as the leading forum for corporate law by addressing concerns that could drive corporations to reincorporate elsewhere.

Key Changes: Process & Procedures

- Definition of “Books and Records”
- Temporal Limitations
- Demand Requirements
- Impose Reasonable Confidentiality, Use, and Distributions Restrictions
- Incorporation by Reference
- “Functional Equivalent”
- “Compelling Need” and “Clear and Convincing” Evidence

Expanded Definition of Books and Records

The amendments provide greater specificity by defining what qualifies as “books and records.”

This now includes:

- Charter documents, bylaws, and shareholder agreements.
- Annual and interim financial statements.
- Board and committee minutes, materials distributed to directors, and director questionnaires.
- This expansion codifies case law and ensures corporations cannot avoid production by narrowly construing the statutory language.

Temporal Limitations

- A new provision establishes a presumptive three-year limitation for certain categories of documents, including minutes of shareholder meetings, shareholder communications, and annual financial statements.
- This temporal boundary reduces the burden on corporations and curtails expansive historical requests, though courts may still permit broader discovery if shareholders demonstrate compelling justification.

Procedural Safeguards and Good Faith

- Shareholder demands must be made in good faith and describe their purposes with reasonable particularity.
- The amendments emphasize that requests must directly relate to the articulated purpose, reinforcing the requirement of precision.
- Corporations now have stronger grounds to challenge vague, overly broad, or procedurally deficient demands, encouraging more disciplined shareholder advocacy.

Confidentiality Restrictions and Redactions

- The amendments explicitly permit corporations to impose confidentiality restrictions on inspected materials and to redact information unrelated to the shareholder's stated purpose.
- While this strengthens corporate protections, it also raises questions about whether redactions could undermine transparency.
- Shareholders may contest unreasonable restrictions, but the statute signals greater judicial deference to corporate concerns.

Use of Records in Litigation

- Inspection materials are now automatically deemed incorporated into any subsequent shareholder litigation.
- This prevents shareholders from selectively citing documents and ensures courts have the full evidentiary context.
- The provision encourages candor while reinforcing the link between Section 220 inspections and derivative litigation strategy.

Functional Equivalents

- Courts may compel production of functional equivalents where formal records are absent.
- For example, if board decisions were made primarily through email or messaging platforms, those records may be discoverable.
- This approach prevents corporations from avoiding disclosure by failing to maintain formal records.

Compelling Need and Clear and Convincing Evidence

- Shareholders must demonstrate a compelling need with clear and convincing evidence before gaining access to these additional categories of records.
- This heightened standard applies to requests for non-traditional or sensitive records.

Limits and Defenses

Corporations can resist Section 220 demands under several circumstances:

- **Requests motivated by pretext**, such as aiding external litigation or advancing a takeover strategy.
- **Procedural deficiencies**, including lack of proper standing or defective demand letters.
- **Overbroad requests**, where the demand exceeds the necessary and essential standard.
- **Improper purpose**, such as demands made for reasons unrelated to the shareholder's interest as a shareholder.
- **Confidentiality and privilege**, including withholding or redacting documents that are privileged or subject to reasonable confidentiality protections.

Practical Implications for Shareholders

- Shareholders now have greater ability to monitor and investigate corporate conduct, as the amendments broaden the types of records available for inspection under Section 220, including not just traditional documents but also electronic communications and other “functional equivalents.”
- New hurdles such as time limits, heightened procedural requirements, and confidentiality provisions.
- Success requires narrowly tailored, evidence-supported demands.

Implications for Corporations

- Corporations gain significant tools to resist or narrow inspections, including temporal limits, procedural defenses, and confidentiality protections.
- These safeguards reduce litigation uncertainty and shield sensitive information.
- However, corporations must remain diligent in recordkeeping, as failure to maintain formal records can open the door to broader inspections through the functional equivalent doctrine.
- Early assessment and documentation are key to managing exposure.

Strategic Considerations

- For **shareholders**:
 - Precision in drafting demands is critical.
 - Gathering pre-demand evidence strengthens the credible basis showing.
 - Clearly articulate the proper purpose and necessity for each category of documents requested under Section 220 .
- For **corporations**:
 - Maintain formal records to avoid expanded obligations and the risk of broader discovery of informal communications.
 - Employ confidentiality and redaction strategically while avoiding overreach that could be challenged in court.
 - Regularly review and update recordkeeping and compliance policies in light of statutory changes.

Broader Policy Implications

- The amendments reflect Delaware's attempt to balance shareholder accountability with corporate autonomy.
- They reaffirm Delaware's reputation for predictable governance while limiting excesses.
- Future litigation will likely focus on disputes over the scope of confidentiality, the application of the functional equivalent doctrine, and whether the three-year limitation adequately balances transparency with efficiency.

Best Practices & Action Steps

- Evaluate and record the independence and good faith of directors involved in any decision, as these are often challenged in litigation.
- Implement a litigation hold on all potentially relevant documents, to avoid spoliation claims.
- Ensure the board's decision-making process is well-documented and follows established procedures.
- Be transparent and professional in all communications with the demanding shareholder to minimize escalation.

Conclusion

- The amendments to Section 220 of the Delaware General Corporation Law clarify shareholder inspection rights.
- Boards and counsel must focus on process, documentation, and transparency to mitigate risk in shareholder disputes.
- Staying proactive and attentive to these changes will help protect the company and its leadership in the evolving legal landscape.

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