Disney Investor Suit Shows Limit Of Del. Books, Records Law

By **Stephen Kraftschik and Robert Penza** (July 18, 2023)

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Delaware Vice Chancellor Lori Will reaffirmed long-standing principles of Delaware corporate law on June 27 when she found in favor of The Walt Disney Co. in a shareholder books and records suit under Title 8 of the Delaware General Corporation Law, Section 220.[1]

The books and records demand sought company records concerning the highly public spat between Disney and Florida Gov. Ron DeSantis related to Florida H.B. 1557, sometimes referred to as the "Don't Say Gay" bill.

The Delaware Court of Chancery found in Simeone v. The Walt Disney Co. that Disney's actions surrounding H.R. 1557 were protected by Delaware's business judgment rule, explaining that the rule extends to all aspects of corporate strategy, including decisions as to whether and how the company should speak on environmental, social and governance issues, even if those decisions turn out poorly in hindsight.[2]

Background

In February 2022, the Florida House of Representatives approved H.B. 1557, which prohibited "teachers from discussing certain topics related to sexual orientation and gender identity in kindergarten through third grade classrooms," as well as lessons on those same tame topics for older students that are not "age-appropriate or developmentally appropriate."[3]

Disney received public scrutiny for its financial support of H.B. 1557's sponsors, and on March 7, 2022, Disney's then-CEO Robert Chapek circulated an internal memo explaining the company's decision not to publicly oppose the bill.[4] Disney's memo received significant criticism from its employees and creative partners.[5]

In response to the internal and external criticism that it received for its memo and public silence, Disney's board held a special meeting on March 8, 2022, and Chapek spoke at the company's annual stockholder meeting the next day acknowledging that the company's original response "didn't quite get the job done."[6]

H.B. 1557 was signed into law by DeSantis on March 28, 2022, and later that day, in a change of course from its original silence, Disney issued a public statement opposing the bill.[7] Disney's public opposition led Florida politicians to consider revoking Disney's self-governance authority over its lands within the Reedy Creek Improvement District.[8]

On April 22, 2022, DeSantis signed a dissolution bill into law that would strip Disney of its control over the RCID and make the company responsible for certain state taxes. From March to July, Disney's stock price fell nearly 37%, from $145.70 to $91.84 per share.[9]

Shareholder's Books and Records Demand

Under Section 220 of the Delaware General Corporation Law, a shareholder may make a demand to inspect corporate books and records.[10] In order to obtain access to those corporate books and records, a shareholder must articulate a "proper purpose" for the demand and establish that each category of documents sought is "essential" to fulfilling the stated purpose of the inspection.[11]

In July, Kenneth Simeone, a longtime Disney shareholder, sent the company a demand to inspect corporate books and records pursuant to Section 220.[12] The demand asserted that Simeone was concerned that Disney's officers and directors had breached their fiduciary duties by failing to anticipate the effect that Disney's public stance on H.B. 1557 might have on its financial position and stock.[13]

As explained by the court, Simeone's books and records demand asserted one essential purpose for the demand: "investigat[ing] potential wrongdoing, mismanagement and breaches of fiduciary duties … in connection with the Company's decision to publicly oppose [H.B. 1557]."[14]

The books and records demand sought essentially two categories of documents: (1) board-level documents and policies related to Disney's actions concerning H.B. 1557, and (2) written correspondence — i.e., emails — between and among the directors and Chapek related to the bill.[15] Disney produced board-level documents and policies related to the bill and its response to the legislation, but the company declined to produce emails and other communications from the board and Chapek.[16]

Plaintiff Not Entitled to Any Additional Documents

Unsatisfied with Disney's production, Simeone filed suit in the Delaware Court of Chancery seeking the documents that Disney had refused to produce. The court ultimately found, however, that Simeone did not satisfy the requirements to obtain additional documents for three reasons, entering judgment in favor of Disney.

First, the court determined that the purposes stated in Simeone's books and records demands were not his own, but instead the purposes of his counsel who had solicited him to serve the demand.[17]

After H.B. 1557 was signed into law, Simeone was contacted by Paul Jonna, a lawyer for the Thomas More Society, a "public interest law firm championing Life, Family, and Freedom."[18] Jonna represented Simeone in his books and records demand, with the Thomas More Society advancing costs for the litigation.[19]

The court found that the purposes stated in the demand were lawyer-driven and pretextual because Simeone testified at his deposition that his only goal was to identify the individuals responsible for making the decision to publicly oppose H.B. 1557.[20]

The court explained that while Simeone and the Thomas More Society are "entitled to their beliefs" and "entitled to pursue litigation in support of those beliefs," a "Section 220 suit, which is designed to address the plaintiff's interests as a stockholder, is not a vehicle to advance them."[21]

Notably, the court acknowledged that this defense will be available only in "rare circumstances" where the purposes stated in the demand clearly belong to counsel, not the

shareholder himself.[22]

Second, the court determined that the plaintiff's stated purpose of investigating potential wrongdoing or mismanagement related to Disney's public opposition to H.B. 1557 did not constitute a proper purpose under Section 220 because the plaintiff was "critiquing a business decision," rather than "describing potential wrongdoing."[23]

In holding that the plaintiff had not established a "credible basis" [24] from which the court could infer wrongdoing, it recognized that "choosing to speak (or not speak) on public policy issues is an ordinary business decision," but one that "exemplifies the challenges a corporation faces when addressing divisive topics — particularly ones external to its business."[25]

The court found that the Disney board's consideration of "employee concerns" and other "interests of corporate stakeholders" was "'rationally related' to building long-term value,"[26] and that the board thus "held the sort of deliberations that a board should undertake when the corporation's voice is used on matters of social significance."[27]

Third, the court held that even if the plaintiff had demonstrated a proper purpose, he had not proven that any of the additional documents he sought beyond what Disney had voluntarily produced would be essential to the stated purpose.[28]

Specifically, the court — following Delaware Supreme Court precedent — found that because Disney had maintained and produced board-level materials — e.g., minutes — the plaintiff did not need the emails and other communications sought.[29]

Key Takeaways

The court's decision confirms that the board of a Delaware corporation has broad discretion to take all rationally related factors into account when deciding if and how the corporation will speak on social or political issues, and its decisions in that regard will be insulated from judicial review under Delaware's business judgment rule.

Indeed, the decision shows that boards can and should weigh the concerns of other stakeholders in the company — e.g., employee morale, corporate culture and relationships with creative partners — when using a company's voice on socially significant matters.[30]

While Section 220 remains an important tool to obtain access to corporate books and records related to a shareholder's proper purpose in investigating potential wrongdoing or mismanagement, Delaware judges will not allow Section 220 and their courts to become a forum to scrutinize disagreements about board-directed corporate speech on ESG issues.

Practice Pointers

The court's decision in Simeone offers several practice pointers that boards and counsel should keep in mind when dealing with matters of corporate speech and requests for books and records under Section 220:

(1) Board-directed corporate speech, including that which in hindsight turned out poorly, is entitled to the protections of Delaware's business judgment rule.

(2) Boards should consider the impact that decisions on corporate speech will have on nonstockholder interests — e.g., employee morale, corporate culture and relationships with

creative partners — which in turn may have a long-term impact on stockholders.

(3) Maintaining formal records — i.e., minutes — of board actions will help insulate the company from being required to produce informal directors and officers communications, such as emails, in response to a books and records demand.

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[1] Simeone v. The Walt Disney Co., C.A. No. 2022-1120-LWW (Del. Ch. June 27, 2023).

[2] Id. at 2 ("Given the diversity of viewpoints held by directors, management, stockholders, and other stakeholders, corporate speech on external policy matters brings both risks and opportunities. The board is empowered to weigh these competing considerations and decide whether it is in the corporation's best interest to act (or not act).").

[3] Id. at 3-4.

[4] Id. at 4-5.

[5] Id. at 5.

[6] Id. at 5-6.

[7] Id. at 8.

[8] Id. at 9.

[9] Id. at 10-11.

[10] 8 Del. C. § 220.

[11] Id. at 18 (quoting Thomas & Betts Corp. v. Leviton Mfg. Co. Inc., 681 A.2d 1026, 1028 (Del. 1996) and Lebanon Cnty. Emps.' Ret. Fund v. AmerisourceBergen Corp., 2020 WL 132752, at *6 (Del. Ch. Jan. 13, 2020), aff'd, 243 A.3d 417 (Del. 2020)).

[12] Id. at 11.

[13] Id. at 11-12.

[14] Id. at 22.

[15] See id. at 32.

[16] Id. at 32.

[17] Id. at 19-21.

[18] Id. at 20.

[19] Id. at 20.

[20] Id. at 20-21.

[21] Id. at 21.

[22] Id. at 21.

[23] Id. at 24.

[24] Under § 220, a shareholder cannot establish investigating potential wrongdoing as a proper purpose based only on bare allegations of wrongdoing, but instead must present some evidence to suggest a "credible basis" to infer wrongdoing. Id. at 23 (quoting AmerisourceBergen, 243 A.3d at 426).

[25] Id. at 25 (citing Elizabeth Pollman, The Making and Meaning of ESG 1 (U. Pa. Carey L. Sch. Inst. L. & Econ., Research Paper No. 22-23), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857).

[26] Id. at 27 (quoting Revlon Inc. v. MacAndrews & Forbes Hldgs. Inc., 506 A.2d 173, 182 (Del. 1986)).

[27] Id. at 26 (citing Leo E. Strine, Jr., Good Corporate Citizenship We Can All Get Behind? Toward a Principled, Non-Ideological Approach to Making Money the Right Way, 78 Bus. Law. 329, 366 (2023); Lucian A. Bebchuk & Robert J. Jackson, Jr., Corporate Political Speech: Who Decides?, 124 Harv. L. Rev. 83, 87-89, 101-102 (2010)).

[28] Id. at 31-32.

[29] Id. at 32-33 ("The Delaware Supreme Court has instructed that 'the Court of Chancery should not order emails to be produced when other materials (e.g., traditional board-level materials, such as minutes) would accomplish the petitioner's proper purposes.' … The [Disney] Board maintained formal records of its actions, and the relevant records were provided to the plaintiff." (quoting KT4 P'rs LLC v. Palantir Techs. Inc., 203 A.3d 738, 752-53 (Del. 2019))).

[30] Id. at 26-30.