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June 2, 2005

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Re: Amalgamated Bank v. UICI
C.A. No. 884-N
Date Submitted: February 22, 2005

Dear Counsel:

Plaintiff Amalgamated Bank ("Amalgamated") brought this action under 8 *Del. C.* § 220[1] to inspect the books and records of UICI, a Delaware corporation in which it is a shareholder. The parties have worked diligently to narrow the issues

[1] "Any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's books and records, and to make copies and extracts from . . . [the corporation's] books and records." 8 *Del. C.* § 220(b)(1).

requiring judicial resolution.[2] This is the Court's decision following trial on a record consisting of documents.

In its demand letter,[3] Amalgamated set forth its purposes for inspection as follows:

> (1) to enable [Amalgamated] to investigate whether [UICI's] directors: (a) breached their fiduciary duties in connection with any related party transactions, or (b) otherwise acted unlawfully to the detriment of shareholders; and (2) to enable [Amalgamated] to evaluate whether a valid basis exists to bring a shareholder action to challenge the [UICI's] related party transactions, Board member actions or otherwise seek shareholder redress.[4]

Amalgamated has identified numerous related party transactions between UICI and Ronald Jensen, founder and chairman of UICI, his children, and various entities controlled by Jensen or his children. Also, other officers and directors of UICI have engaged in separate transactions with UICI. Over the last several years, these transactions, according to Amalgamated, have amounted to tens of millions of dollars. Amalgamated further contends that these transactions have been lucrative for Jensen and his family and confederates.

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[2] UICI has provided Amalgamated, without judicial intervention, with a substantial quantity of documents.
[3] PX 4 (the "Demand Letter").
[4] Pretrial Order, ¶ 52.

A shareholder seeking inspection of a corporation's books and records must demonstrate a "proper purpose."[5] By 8 *Del. C.* § 220(b), a "proper purpose" is defined as one "reasonably related to such person's interest as a stockholder." The scope of the inspection must be limited to those books and records that are "reasonably required to satisfy the purpose of the demand."[6] Invocation of the statutory right to inspect corporate books and records, however, "does not open the door to wide ranging discovery that would be available in support of litigation."[7] UICI concedes that investigating potential breaches of fiduciary duty associated with related party transactions constitutes a proper purpose under 8 *Del. C.* § 220.[8]

Three issues are presented for resolution: (1) whether a shareholder may gain access to books and records involving related party transactions where any action seeking redress for breaches of fiduciary duty associated with those transactions may be barred by the applicable statute of limitations or the doctrines

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[5] *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *4 (Del. Ch. Aug. 30, 2004).
[6] *Marathon Partners, L.P. v. M & F Worldwide Corp.*, 2004 WL 1728604, at *9 (Del. Ch. July 30, 2004).
[7] *Saito v. McKesson HBOC, Inc.* 806 A.2d 113, 114 (Del. 2002).
[8] UICI argues that a catch-all phrase such as "or otherwise seek shareholder redress" is insufficient to set forth a proper purpose under 8 *Del. C.* § 220. It will turn out that resolution of this contention is unnecessary.

of collateral estoppel or *res judicata*; (2) whether the corporation may limit review of board minutes by a shareholder investigating related party transactions implicating the duties of loyalty and good faith to items directly involving the transactions under scrutiny or whether a broader access to the minutes is necessary for proper assessment of board independence and compliance with fiduciary obligations; and (3) whether a corporation may condition its compliance with Section 220 upon a confidentiality agreement that requires the requesting shareholder to maintain as confidential all nonpublic information which is provided to it.[9]

I. *AFFIRMATIVE DEFENSES TO POTENTIAL FIDUCIARY DUTY CLAIMS—STATUTE OF LIMITATIONS, COLLATERAL ESTOPPEL, AND RES JUDICATA—IN THE CONTEXT OF A SECTION 220 ACTION*

Documents sought by Amalgamated date back to 1997.[10] They involve transactions which may be beyond the applicable statute of limitations and may be immune from further judicial scrutiny through invocation by UICI's directors of the doctrines of collateral estoppel and *res judicata* based upon derivative and class

[9] UICI does not dispute that Amalgamated's demand satisfied the requirements of Section 220(c)(1) & (2).

[10] One category does include records from a transaction in 1992.

litigation concluded in October 2001 in Texas.[11] A shareholder seeking access to a corporation's books and records in a Section 220 proceeding bears the burden of demonstrating that such inspection is "necessary, essential, and sufficient" for the shareholder's proper purpose.[12] UICI argues that documents related to transactions that cannot be challenged because of the inevitable assertion of certain affirmative defenses cannot be "necessary, essential, [or] sufficient" for any proper corporate purpose related to the bringing of fiduciary duty claims.

The potential availability of affirmative defenses to withstand fiduciary duty claims cannot solely act to bar a plaintiff under Section 220. First, these are summary proceedings; the factual development necessary to assess fairly the merits of a time-bar affirmative defense, for example, as to each potential claim, is not consistent with the statutory purpose. Second, courts should not be called upon to evaluate the viability of affirmative defenses to causes of actions that have not been, and more importantly may not ever be, asserted. Third, that a claim arising

[11] DX 12. As a general matter, UICI has made available to Amalgamated documents created after October 2000, four years before the delivery of the Demand Letter upon which this action is based. The four-year period was proposed by UICI as one year beyond both the three-year statute of limitations that would typically govern fiduciary duty claims under Delaware law and the date of the judgment upon which the collateral estoppel and *res judicata* defenses would be premised.

[12] *See, e.g., BBC Acquisition Corp. v. Durr-Fillauer Med., Inc.*, 623 A.2d 85, 88 (Del. Ch. 1992).

out of a particular transaction may be barred does not mandate the conclusion that documents relating to that transaction are not "necessary, essential, and sufficient" for a shareholder's proper purpose with respect to more recent transactions. As explained in *Saito*, which concluded that the date on which the stockholder first held stock does not establish a firm cutoff date for Section 220 purposes:

> Even where a stockholder's only purpose is to gather information for a derivative suit, the date of his or her stock purchase should not be used as an automatic "cut-off" date in a § 220 action. First, the potential derivative claim may involve a continuing wrong that both predates and postdates the stockholder's purchase date. In such a case, books and records from the inception of the alleged wrongdoing could be necessary and essential to the stockholder's purpose. Second, the alleged post-purchase date wrongs may have their foundation in events that transpired earlier.[13]

The lesson of *Saito* is simple: when examination of a corporation's books and records is sought for the purpose of evaluating whether to pursue derivative litigation, whether or not a shareholder would be able to pursue a claim based on the information contained in a particular record is not the sole determinative factor in the Court's analysis. Instead, the appropriate inquiry is whether a particular request is necessary to the shareholder's stated, proper purpose. A document that

[13] 806 A.2d at 117.

contributes to the investigation of a continuing wrong or provides background and context to a current, actionable wrong may be relevant and, indeed, necessary to a shareholder's proper purpose regardless of whether the events revealed in the documents are themselves actionable. In sum, an affirmative defense that might successfully meet a claim investigated through a Section 220 inspection does not necessarily preclude access to the pertinent books and records.[14]

On the other hand, the passage of time, as may be measured against a statute of limitations, or the outcome of earlier litigation, as a source of a collateral estoppel or *res judicata* defense, may be relevant to the Court's inquiry as to whether certain corporate books and records are necessary for a shareholder's purpose of evaluating a potential derivative action.[15] For example, as time goes by, it may be that the shareholder's proper need for a corporate record would diminish. Thus, as the Court engages in the assessment of whether a particular document (or

[14] One cannot exclude the possibility that, in a specific factual setting, a time bar defense or a claim or issue preclusion defense would eviscerate any showing that might otherwise be made in an effort to establish a proper shareholder purpose.

[15] Of course, investigating corporate wrongdoing as a prelude to shareholder litigation is not the only proper purpose for inspection under Section 220. For instance, "[stockholders] may seek an audience with the board to discuss proposed reforms or, failing that, they may prepare a stockholder resolution for the next annual meeting, or mount a proxy fight to elect new directors." *Saito*, 806 A.2d at 117.

set of documents) is "necessary, essential, and sufficient," timeliness is an appropriate concern, one to be assessed within the context of the shareholder's asserted purpose.

Although UICI acknowledges that the related party transactions into which Amalgamated seeks to inquire, as a general mater, are properly within the scope of a Section 220 demand, it has objected to inspection of documents from more than four years before the Demand Letter.[16] For example, a questioned set of transactions starts with the Special Investment Risks ("SIR") agreement of January 1, 1997, and includes the SIR agreement of October 1, 2003. The first agreement was executed approximately seven years before the Demand Letter was delivered. Also, the Texas litigation appears to have addressed (and resolved) claims based on the first SIR agreement. However, Amalgamated plausibly argues that an understanding of the 2003 SIR agreement (and the process associated with its approval) depends upon knowledge regarding the adoption the 1997 SIR agreement because the 1997 SIR agreement would provide necessary background and context. Amalgamated's perspective is in accordance with the rationale

[16] Amalgamated's demands at ¶ 3(a)-(e) & (g) of the Demand Letter all seek documents from before October 2000.

articulated in *Saito* that an appreciation of an earlier, but connected, transaction may be essential to a proper perception of a more recent transaction.

As with the SIR transaction, all of the other transactions for which Amalgamated seeks historical (*i.e.*, before October 2000) records[17] are linked, to varying degrees, to possible wrongs occurring when the various affirmative defenses would not be available.[18] Therefore, the documents that Amalgamated seeks are necessary to its stated purpose of investigating related party transactions because "alleged . . . wrongs [not barred by the statute of limitations] may have their foundation in events that transpired earlier."[19]

[17] Some of the transactions for which Amalgamated seeks documents did not involve the Jensen family, but instead involved other UICI directors or officers. This distinction is not critical here because Amalgamated's stated purpose involves "related party transactions," not "Jensen-family transactions." That other directors may have benefited personally from their own "related party" transactions could be viewed, or so a disenchanted shareholder might plausibly argue, as encouraging that director to acquiesce in other related party transactions.

[18] For example, some of these involve amendments to older agreements, while others involve payments that continue to be made based on older agreements. This distinction is not important, as documents concerning all these transactions are relevant to Amalgamated's stated purpose of investigating related party transactions. Furthermore, even if a challenge to the related party transaction itself would be barred by an affirmative defense, an investigation of that transaction may illuminate UICI's board practices and dynamics with regard to other related party transaction. *See infra* Part II.

[19] *Saito*, 806 A.2d at 117.

II. *BOARD MINUTES*

Amalgamated also sought access to the minutes of UICI's board. UICI has provided redacted copies of those minutes; the portions of the minutes dealing with the various related party transactions were not redacted. UICI argues that it is entitled to limit Amalgamated's review of its minutes to those entries directly related to the related party transactions because a review of the balance of the minutes would be beyond the purpose asserted by Amalgamated in its Demand Letter.

Amalgamated's inquiry into related party transactions inherently involves questions regarding the independence (and disinterestedness) of UICI's directors. Because director independence is a "contextual inquiry," potential shareholder plaintiffs have been admonished to employ the Section 220 process to delve into the relationship among board members:

> [H]ad [the shareholder plaintiff] first brought a Section 220 action seeking inspection of [the Company's] books and records, she might have uncovered facts that would have created a reasonable doubt [as to the board's independence]. For example, irregularities or "cronyism" in [the Company's] process of nominating board members might possibly strengthen her claim concerning [the allegedly dominant shareholder's] control over [the Company's] directors. A books and records inspection might have revealed whether the board

> used a nominating committee to select directors and maintained a separation between the director-selection process and management. A books and records inspection might also have revealed whether [the allegedly dominant shareholder] unduly controlled the nominating process or whether the process incorporated procedural safeguards to ensure directors' independence. [The shareholder plaintiff] might also have reviewed the minutes of the board's meetings to determine how the directors handled [the allegedly dominant shareholder's] proposals or conduct in various contexts. Whether or not the result of this exploration might create a reasonable doubt would be sheer speculation at this stage. But the point is that it was within the plaintiff's power to explore these matters and she elected not to make the effort.[20]

In light of this guidance to shareholders contemplating the filing of an action challenging the loyalty and good faith of the directors of a corporation, it is clear that UICI may not limit Amalgamated's inspection of its minutes to only those portions specifically addressing the related party transactions. Instead, Amalgamated is entitled to broad access to the minutes in order to evaluate whether UICI's directors, through their conduct as revealed in those minutes, have satisfied their fiduciary duties.[21]

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[20] *Beam v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004) (footnotes omitted).

[21] That board minutes generally fall within the proper purpose advanced by Amalgamated, of course, does not force the conclusion that no other grounds could have been asserted here or, in a different context, would have been available.

III. *CONFIDENTIALITY AGREEMENT*

Questions involving the confidentiality of books and records produced in response to a demand under Section 220 are vexing. Some documents are deserving of confidential treatment.[22] Sometimes it is easier for a responding corporation to assert confidentiality with a broad brush instead of carefully considering the need to maintain the confidential status of any particular document. The process and timing for resolving the competing interests must accommodate the legitimate concerns of both the corporation and the shareholder submitting the demand. Indeed, shareholders not participating in the Section 220 process have potentially competing interests: they do not want the corporation harmed by inappropriate disclosure of confidential information but they also may benefit from the efforts of the shareholder invoking the Section 220 process.

The question before the Court is perhaps more pedestrian. To facilitate the prompt delivery of Section 220 materials, some framework for preserving confidentiality is necessary until such time as any lingering questions regarding confidentiality are answered through the judicial process. Prompt responses under

[22] *See CM & M Group, Inc. v. Carroll*, 453 A.2d 788, 793-94 (Del. 1982).

Section 220 are required and, accordingly, are to be encouraged. Imposing some restrictions on the shareholder seeking access under Section 220 is necessary if the process is to function efficiently and if the corporation is not to be exposed to an unreasonable risk with respect to efforts to preserve the confidentiality of corporate records deserving of confidential treatment. Thus, it is customary and proper that limits be placed on the disclosure of confidential documents produced in accordance with Section 220. The parties here disagree about the definition of "confidential."[23]

UICI delivered documents to Amalgamated pursuant to the terms of a confidentiality agreement,[24] the form of which has been used for previous Section 220 productions. The parties negotiated; they agreed to disagree; they resolved that certain production would go forward under the confidentiality terms proposed by UICI but that Amalgamated would reserve the right to challenge the definition of confidentiality. It is that challenge which is now before the Court.

[23] The parties have not submitted any books or records to the Court for a determination of whether any particular document should be treated as confidential.
[24] PX 11.

UICI has insisted that Amalgamated retain as confidential all documents which it designates as confidential. A document that has been designated as confidential is only available to Amalgamated and "its representatives and its advisors," essentially its attorneys and experts. The confidentiality agreement required by UICI sets forth the following process for designating documents as confidential:

> The Company agrees that Company Information shall not be designated as Confidential Company Information unless *the Company believes, in good faith, that it constitutes non-public, confidential, proprietary, or commercially or personally sensitive information* that requires the protections provided in this Agreement. The designation of any Company Information as Confidential Company Information shall constitute a representation that such Company Information has been reviewed by an attorney and that there is a valid basis for such designation. In the event that Amalgamated or its counsel takes the position that any particular Confidential Company Information is not qualified for confidential treatment, Amalgamated or its counsel will raise the issue with the Company through counsel. If the matter cannot be resolved through discussions among counsel, the matter may be brought before a Court.[25]

Amalgamated argues that this standard allows UICI to take the position that any information which is nonpublic may be maintained as confidential.[26]

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[25] *Id*. ¶ 3 (emphasis added).

[26] One could argue that the core of the parties' dispute depends upon the comma following nonpublic: is "nonpublic" a separate, stand alone, determinative criterion or does it modify all other criteria that follow?

In contrast, Amalgamated has proposed the following definition: "Company Information shall not be designated as confidential unless the Company believes, in good faith, that it constitutes a trade secret or commercially sensitive information that, if published, would harm the Company's ability to compete in the marketplace."[27]

The Court is authorized to impose reasonable conditions on a shareholder's use of corporate records obtained under Section 220.[28] One of the conditions routinely imposed is an obligation to preserve the confidentiality of confidential materials.[29] While it may be tautological, confidential documents are entitled to confidentiality. There must, however, be a reason for insisting upon confidential treatment. It need not be limited to harm to the corporation itself, however, because a corporation's books and records frequently contain, for example, sensitive personal information relating to the various participants in the corporation's activities. Moreover, imposing harm in fact as the standard for maintaining confidentiality would establish too great a burden for the corporation,

[27] PX 9 at 2.
[28] 8 *Del. C.* § 220(c).
[29] *See Disney v. The Walt Disney Co.*, 857 A.2d 444, 447-48 (Del. Ch. 2004), *remanded*, No. 380, 2004 (Del. Mar. 31, 2005) (ORDER).

especially in light of the time constraints on Section 220 compliance. The risk of harm, of whatever nature, must be evaluated on the basis of magnitude and likelihood, an effort that is inherently speculative.

On the other hand, treating all previously nonpublic information as confidential, while perhaps providing a comfortable administrative standard, would avoid the purpose of confidential treatment. That certain information, for whatever reason or for no reason, has not become public may suggest a need for careful consideration of whether confidentiality is appropriate; however, that alone is not sufficient.[30]

Ultimately, the question of whether a document is entitled to confidential treatment requires a balancing of various considerations within a specific context.[31] Unfortunately, no precise formula exists. As to the dispute framed by the parties in

[30] If certain information has become "public," it accomplishes little to designate it as confidential. Although, as a general matter, "public" information is not entitled to confidential treatment, information, otherwise properly treated as confidential, which has been circulated beyond the corporate curtilage, but only to a limited extent, may not be "public" for these purposes.

[31] *See Disney v. The Walt Disney Co.*, No. 380, 2004, at 3 (Del. Mar. 31, 2005) (ORDER) (confidentiality determinations "should address the potential benefits and potential harm from disclosing the documents for [the shareholder's] stated purposes"). In *Disney*, the shareholder's purpose was "to communicate with other stockholders as part of a campaign for better corporate governance at the [company]." *Id*. at 1.

this instance, the Court concludes that nonpublic information is not automatically entitled to confidential treatment.[32] Conversely, the corporation need not be required to show specific harm that would result from disclosure. The better approach here is to treat as confidential that information which UICI believes, in good faith, constitutes confidential, proprietary, or commercially or personally sensitive information that needs the protection of confidential treatment.[33] This, of course, is the product of an effort to resolve a dispute between Amalgamated and UICI. This may not be the proper formulation for other confidentiality disputes arising under Section 220. It certainly remains the better methodology if the parties can agree upon a standard that both ensures the protection of information

[32] In essence, UICI may not, in a manner consistent with Section 220, impose a confidentiality obligation on Amalgamated as to certain books and records simply because they have not previously become public.

[33] Amalgamated (Complaint, ¶ 47) claims that it wants to communicate with other shareholders in order to assess the wisdom of filing a derivative action. Amalgamated, however, did not identify communications with other shareholders as one of its purposes in its demand. Moreover, Amalgamated has not provided plausible reasons as to why it, as a sophisticated investor aided by sophisticated and experienced counsel, needs input from other shareholders in determining whether there is a basis (or need) for pursuing fiduciary duty claims. Of course, the mere assertion of a desire to communicate with other shareholders will not suffice; the shareholder who relies upon inter-shareholder communications as a proper purpose must explain why it is appropriate or necessary in the circumstances.

entitled to confidential treatment and, at the same time, provides a practical framework for the timely production of the books and records.[34]

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Counsel are requested to confer and submit a form of order to implement this letter opinion.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC

[34] If a shareholder is truly focused on bringing a shareholder action, one would assume that the shareholder would not want to get bogged down in a quagmire of confidentiality disputes that would likely delay the filing of the action. A pragmatic solution may be found in *Disney*, 857 A.2d at 448.