DELAWARE CORPORATE LAW BULLETIN

Chancery Court Declines to Apply *Corwin* to Foreclose a Books and Records Inspection Under DGCL §220

Robert S. Reder[*]
Dylan M. Keegan[**]

Determines, as a matter of law, that Corwin *should not preclude a stockholder's "use of the 'tools as hand' to gather information before filing complaints"*

INTRODUCTION

Section 220 of the Delaware General Corporation Law ("DGCL § 220") allows any stockholder of a Delaware corporation to inspect the books and records of the corporation, regardless of the magnitude of the stockholder's holdings.[1] To take advantage of DGCL § 220, a stockholder must submit a "written demand under oath" stating the purpose of the inspection.[2] If the corporation refuses the stockholder's demand, the stockholder may seek an order from the Delaware Court of Chancery (the "*Chancery Court*") compelling inspection.[3] The stockholder must prove to the Chancery Court that (i) the stockholder is, in fact, a stockholder; (ii) the stockholder has met the form and manner requirements under DGCL § 220; and (iii) the inspection is for a "proper purpose" under Delaware law.[4]

In *Lavin v. West Corporation*[5] ("*Lavin*"), the Chancery Court recently considered whether, even if a stockholder meets the requirements for a successful DGCL § 220 demand, the corporation may nevertheless prevent the inspection by asserting the defense articulated under *Corwin v. KKR Financial Holdings LLC*[6] ("*Corwin*"). In *Corwin*, the Delaware Supreme Court held that when a merger transaction that has been approved by a fully informed, uncoerced majority of disinterested stockholders is the subject of a post-closing damages action, the proper standard of review is the business judgment rule.[7] The invocation of the business judgment rule through stockholder approval, which is very deferential to corporate defendants, serves to "cleanse" breaches of fiduciary duties by directors of a corporation. This "ratchet-down [of] more intrusive judicial review"[8] is intended to help "avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves."[9]

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* Professor of the Practice of Law at Vanderbilt University Law School, has been serving as a consulting attorney at Milbank, Tweed, Hadley & McCloy LLP in New York City since his retirement as a partner in April 2011.

** Vanderbilt University Law School, J.D. Candidate, May 2019.

1. DEL. CODE ANN. tit. 8, § 220 (West 2010).
2. *Id.* § 220(b).
3. *Id.* § 220(c).
4. *Id.*
5. C.A. No. 2017-0547-JRS, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017).
6. 125 A.3d 304 (Del. 2015).
7. *Id.* at 305–06.
8. *Lavin*, 2017 WL 6728702, at *8.
9. *Corwin*, 125 A.3d at 313.

Corwin, decided less than three years ago, has had a significant impact on M&A-related litigation in the Delaware courts.[10] But before *Lavin*, the Delaware courts had not taken up the question whether *Corwin* applied in the context of a DGCL § 220 demand. Vice Chancellor Joseph R. Slights III, writing on a clean slate in *Lavin*, rejected the defendant corporation's argument that *Corwin* should prevent an otherwise proper demand for inspection under DGCL § 220. To accept such an argument, the Vice Chancellor reasoned, would result in the Chancery Court improperly adjudicating merits defenses in the DGCL § 220 context, a premature stage in the litigation to consider a proper *Corwin* defense.[11] The stockholder plaintiff was invoking his right to demand inspection under DGCL § 220 in order to "enhance the quality of his pleading in a circumstance where precise pleading, under [Delaware] law, is at a premium."[12]

I. FACTUAL BACKGROUND

A. West's Business

West Corporation ("*West*") provides worldwide telecommunications through four "reporting segments": Unified Communications ("*UC*"), Safety, Interactive, and Specialized Agent.[13] The UC reporting segment is further divided into two "operating segments": Unified Communications and Telecom ("*UCaaS*") and Conferencing ("*Conferencing*").[14] UC accounts for over sixty percent of West's revenue and operating income, while Conferencing accounts for half of West's revenue.[15] The three other reporting segments each account for 10–12 percent of West's revenue.[16]

B. West's Major Stockholders and Board

Thomas H. Lee Partners, L.P. ("*TH Lee*") and Quadrangle Group LLC ("*Quadrangle*"), who purchased West through a leveraged buyout

10. *See* Robert S. Reder, *Delaware Court Refuses to Invoke* Corwin *to "Cleanse" Alleged Director Misconduct Despite Stockholder Vote Approving Merger*, 70 VAND. L. REV. EN BANC 199 (2017); Robert S. Reder, *Delaware Chancery Court Extends "Cleansing Effect" of Stockholder Approval Under* KKR *Two-Step Acquisition Structure*, 69 VAND. L. REV. EN BANC 227 (2016); Robert S. Reder & Tiffany M. Burba, *Delaware Courts Confront Question Whether "Cleansing Effect" of* Corwin *Applies to Duty of Loyalty Claims*, 70 VAND. L. REV. EN BANC 187 (2017).

11. *Lavin*, 2017 WL 6728702, at *1.

12. *Id.*

13. *Id.* at *2.

14. *Id.*

15. *Id.*

16. *Id.*

in 2006, subsequently took West public in 2013.[17] This transaction diluted TH Lee and Quadrangle's collective ownership to fifty-three percent.[18]

As part of the going public process, TH Lee and Quadrangle entered into a stockholders agreement with West giving them the right to elect five directors to West's ten-member board if they maintained ownership of certain percentages of West shares.[19] Although TH Lee and Quadrangle began to unwind their ownership interests, including through two secondary offerings in 2015 as a result of which "West's stock price dropped substantially," they maintained sufficient ownership interest to continue to control half the board.[20]

C. Strategic Alternatives and Bidder Selection

In September 2015, TH Lee and Quadrangle began receiving inquiries from potential purchasers of one or more of West's reporting segments.[21] The West board of directors (the "*Board*") announced in November 2016 that it was considering strategic alternatives. The Board's financial advisor contacted fifty-five potential bidders, and West executed confidentiality agreements with thirty.[22]

In January 2017, West instructed its financial advisor to "focus" on a sale of the entire company, rather than one or more reporting segments.[23] West subsequently received two offers for groups of its segments: one party offered to purchase all of West's reporting segments, except UC, for between $2.4 and $2.6 billion, and another party offered to purchase the Interactive Services and Safety Services reporting segments, as well as certain Specialized Agent Services assets, for $2.36 billion.[24] These two parties, as well as Apollo Global Management ("*Apollo*"), were permitted to conduct further due diligence through West's data room.[25]

The Board then began negotiating a deal exclusively with Apollo. West and Apollo signed an agreement on May 9, 2017, providing for Apollo to purchase the entire company for $23.50 per share in cash via a merger transaction (the "*Merger*"),[26] representing $5.2 billion in

17. *Id.* at *3.
18. *Id.*
19. *Id.*
20. *Id.* at *4.
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.* at *5.
26. *Id.*

enterprise value. The Merger agreement's no-shop provision permitted West to terminate only in favor of a "Superior Proposal" to acquire at least seventy percent of West's assets, revenue, or shares,[27] effectively preventing West from entertaining an offer for any of its individual reporting segments, even if that offer was more favorable than Apollo's.

D. Lavin's Section 220 Demand

West circulated its proxy materials seeking approval of the Merger in June.[28] On July 26th, approximately eighty-six percent of the West shares were voted at a meeting to approve the Merger, 99.8 percent of which were cast in favor.[29] As part of the transaction, West's senior management received "golden parachutes" totaling well over $20 million and each West non-employee director received "a $100,000 cash award in addition to accelerated vesting of restricted stock units worth approximately $100,000."[30]

Just prior to the stockholder meeting, Mark Lavin, a West stockholder,[31] sent West a demand to inspect thirteen categories of books and records under DGCL § 220.[32] Lavin's stated purpose was to " 'determine whether wrongdoing and mismanagement had taken place' " in connection with the Board's approval of the Merger and " 'to investigate the independence and disinterestedness' of the Company's directors."[33] West rejected Lavin's demand, alleging that Lavin did not present "a credible basis for suspecting wrongdoing" and therefore lacked a proper purpose under DGCL § 220.[34] Lavin then filed suit in the Chancery Court to compel the inspection.[35]

II. VICE CHANCELLOR SLIGHTS' ANALYSIS

Vice Chancellor Slights began his analysis by summarizing Lavin's argument that "West's directors . . . favored a less valuable sale of [West] over a more valuable sale of its parts."[36] Specifically, Lavin contended that:

> The evidence supports an inference that (1) the Board knew that the most value-maximizing option was a sale of the Company's business segments; (2) a more valuable

27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.* at *2.
32. *Id.* at *6.
33. *Id.*
34. *Id.*
35. *Id.*
36. *Id.*

> sale of the segments was possible given that multiple bidders made substantial offers for each of West's segments; and (3) unlike a sale of the Company, a sale of segments would not provide personal benefits for the directors and senior management, nor would it provide TH Lee and Quadrangle with much needed liquidity.[37]

Lavin also alleged a conflict of interest on the part of West's financial advisor in favor of the Apollo transaction. Based upon the evidence, Lavin argued, the Board "may have favored an inadequate bidder,"[38] thereby breaching its duties under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

In its defense, West reiterated its position that Lavin lacked a proper purpose and added that, regardless, West's "disinterested" stockholders' approval of the Merger "in a fully informed, uncoerced vote" had " 'cleansed' any purported breaches of fiduciary duty" on the part of the Board for purposes of "the so-called *Corwin* doctrine."[39] If this were the case, the analysis would end in favor of West.

Vice Chancellor Slights was not persuaded by this argument. In finding that Lavin had presented a "credible basis from which the Court can infer that West's directors and officers may have breached their fiduciary duties in favoring a sale of the Company as opposed to a sale of its segments," the Vice Chancellor rejected West's argument that " '*Corwin* provides the framework' for determining whether Lavin has met his burden to justify inspection."[40]

A. The Section 220 Standard

As noted above, DGCL § 220 allows a stockholder to "inspect the corporation's books and records for any 'proper purpose' reasonably related to the stockholder's 'interest as a stockholder.' "[41] Vice Chancellor Slights wrote that the "desire to investigate mismanagement or wrongdoing is a proper purpose."[42] The stockholder's burden of proof is "a *credible basis* from which the court can infer that mismanagement, waste or wrongdoing may have occurred."[43] The stockholder need only present "some evidence" of wrongdoing to meet this low standard.

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37. *Id.*
38. *Id.*
39. *Id.* at *1.
40. *Id.* at *7.
41. *Id.*
42. *Id.* (citing Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117, 121 (Del. 2006)).
43. *Id.* (emphasis added).

B. Corwin in the Section 220 Context

Vice Chancellor Slights distilled the principle of *Corwin*: "that a voluntary, fully informed vote of disinterested stockholders to approve a transaction not involving a controlling stockholder will trigger the business judgment rule standard of review."[44] *Corwin* is all about burden shifting: when a defendant avails itself of the *Corwin* defense it is protected from "more intrusive judicial review."[45] But the burden shift in *Corwin* takes place at the pleading stage, while a DGCL § 220 demand is a pre-pleading measure that can be used to perfect a formal complaint before it is filed. Without the ability to utilize DGCL § 220, the Vice Chancellor was concerned "stockholder plaintiff[s] will . . . face significant challenges to meet . . . pleading burden[s] in anticipation of a *Corwin* defense if all [they have] in hand to prepare . . . complaint[s] are the public filings of the company whose board of directors" is being sued.[46] To the Vice Chancellor, Lavin was "wisely" utilizing DGCL § 220 as one of the "tools at hand" to prepare a properly filed complaint, which would ultimately be filed subject to the heightened *Corwin* pleading standard.[47]

The Vice Chancellor also found an application of *Corwin* in the context of DGCL § 220 problematic for procedural reasons: "Simply stated, *Corwin* does not fit within the limited scope and purpose of a books and records action . . . ."[48] Lavin's inspection demand did not have to establish, as a matter of fact, any wrongdoing or mismanagement by West's directors; rather, "Delaware courts generally do not evaluate the viability of the demand based on the likelihood that the stockholder will succeed in a plenary action."[49] While the Chancery Court had not previously addressed this specific question, Vice Chancellor Slights pointed out that the Chancery Court "has rejected similar attempts to invoke merits-based defenses that turn on doctrinal burden shifting as a basis to defend otherwise properly supported demands for inspection."[50]

To be clear, this finding was not intended to foreclose *Corwin* as an available defense to West at a later stage in the proceeding. West may ultimately "prevail should [it] invoke *Corwin* in a motion to dismiss Lavin's complaint."[51] As such, at the pleading stage, the Board would

44. *Id.* at *8.
45. *Id.*
46. *Id.* at *9.
47. *Id.* at *8–9.
48. *Id.* at *9.
49. *Id.*
50. *Id.* at *10.
51. *Id.*

be afforded business judgment deference. But at the DGCL § 220 demand stage, Lavin is seeking documents which "may enable him to prepare a better complaint. That, in turn, will assist the court in making an informed decision as to whether a viable breach of fiduciary duty claim exists."[52]

C. Lavin's "Proper Purposes" Under Section 220

Having dispensed with the *Corwin* defense, Vice Chancellor Slights turned to the question whether Lavin's demand stated a proper purpose under DGCL § 220. At this stage of the litigation, "Lavin must have presented 'some evidence' of mismanagement or wrongdoing" to succeed.[53]

1. Inference of Wrongdoing

The Vice Chancellor found that Lavin established "evidence provid[ing] a credible basis from which the Court can infer that TH Lee, Quadrangle and West's management may have caused the Board to steer the Merger process in a way that benefited their own interests at the expense of the other shareholders."[54] In this connection, he noted that Lavin's contentions created an inference that (i) "West's directors and officers knew a sale of West's business segments would provide the most value to the shareholders even though the shareholders may not have been able to appreciate the distinction"[55]; (ii) TH Lee and Quadrangle "pushed the Board towards a sale of the Company in furtherance of their own interests to the detriment of West's stockholders"[56]; and (iii) "the directors and high-level officers had financial incentives to approve a sale of the Company even if a sale of its segments offered more value."[57]

This evidence was, in the Vice Chancellor's view, enough to meet the "low Section 220 evidentiary threshold."[58] Lavin need only have presented "some evidence"[59] of "legitimate issues of wrongdoing"[60] to state a "proper purpose" for inspecting West's books and records.

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52. *Id.*
53. *Id.* at *11.
54. *Id.*
55. *Id.*
56. *Id.* at *12.
57. *Id.* at *13.
58. *Id.*
59. *Id.*
60. *Id.* (quoting Sec. First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 568 (Del. 1997).

2. Director Independence

Vice Chancellor Slights also observed that Lavin's stated purpose of investigating director independence was proper.[61] TH Lee and Quadrangle's practical control of the Board was enough to establish this purpose as proper for a DGCL § 220 demand.[62]

D. Scope of Books and Records Production

Vice Chancellor Slights concluded his opinion by finding that the categories of West bosoks and records that Lavin sought to inspect was, in light of his proper purposes, overly broad: "many of Lavin's document demands landed with the precision of buckshot."[63] The Vice Chancellor then designated a subset of Lavin's request as appropriate, encompassing "only those documents that are necessary to enable him to pursue the proper purposes articulated in his inspection demand,"[64] significantly curtailing Lavin's original scope. This proper demand would help Lavin as he "attempts to meet his pleading burden in anticipation of a *Corwin* defense."[65]

CONCLUSION

Vice Chancellor Slights' opinion is instructive for when *Corwin* will become available during the litigation process. Lavin was using DGCL § 220 to gather information in order to build a proper complaint. West could not use *Corwin* to invoke the business judgment rule and prevent Lavin from inspecting its books and records. The opinion does not, however, change how *Corwin* will be applied to Lavin's case at a later stage in the litigation when the defendant directors bring a motion to dismiss.

61. *Id.*
62. *Id.*
63. *Id.* at *14.
64. *Id.*
65. *Id.*