Skadden

Corwin Doctrine Ruled Inapplicable in Section 220 Litigation

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Since the Delaware Supreme Court decided *Corwin v. KKR Financial Holdings LLC* more than two years ago, there has been an open question as to whether and to what extent the principles affirmed in that decision apply in the context of a Section 220 demand to inspect books and records. In our November 2017 issue of *Insights: The Delaware Edition*, we discussed *Salberg v. Genworth Financial, Inc.*, a case in which the Delaware Court of Chancery appeared to suggest, but did not explicitly hold, that the *Corwin* doctrine would not prevent a stockholder from obtaining books and records pursuant to Section 220 if the stockholder has stated a proper purpose. In *Lavin v. West Corporation*, the Court of Chancery addressed the question directly and held that it would not consider the *Corwin* doctrine when evaluating whether a stockholder seeking to obtain corporate documents to investigate possible wrongdoing in connection with a merger has met the proper purpose requirement of Section 220.

Takeaways

The *Lavin* opinion has important ramifications. While the *Corwin* doctrine provides an important defense in post-closing merger litigation, the Delaware courts continue to explore its limits. *Lavin* held that *Corwin* does not, as a matter of law, prevent a stockholder who can otherwise articulate a credible basis to investigate corporate wrongdoing from obtaining books and records to support a post-closing damages case. In effect, the Court of Chancery bypassed long-standing authority that declined to permit a plaintiff pursuing post-closing breach of fiduciary duty claims for money damages from obtaining discovery until their pleading withstood a motion to dismiss. Instead, the Court of Chancery favored the body of case law under Section 220 that states that plaintiffs in the derivative context should use "the tools at hand" before filing a complaint. The Court of Chancery recognized that "our courts primarily direct that encouragement (or admonition) to stockholders who intend to file derivative complaints where they will allege demand futility," but it explained that "the direction is equally applicable to stockholders who intend to file class action suits challenging transactions approved by a shareholder vote."

Thus, the court endorsed Section 220 as a vehicle available to stockholders pursuing direct breach of fiduciary duty claims for money damages, to obtain documents in order to bolster their eventual complaint.

Background

In *Corwin*, the Delaware Supreme Court clarified that the business judgment rule standard of review applies to a post-closing challenge to a merger that is not subject to entire fairness review if the merger was approved by a fully informed, uncoerced majority of disinterested stockholders. In July 2017,

the Court of Chancery issued its opinion in *Salberg*, which declined in a Section 220 proceeding to apply the *Corwin* doctrine in an attempt by defendants to avoid having the court determine whether plaintiffs had demonstrated good cause to obtain privileged documents under the so-called *Garner* doctrine. As the court found the plaintiffs failed to demonstrate good cause to obtain privilege documents for reasons unrelated to *Corwin*, *Salberg* did not directly address whether a Delaware corporation could rely on the *Corwin* doctrine to defeat a Section 220 demand. The case, however, led many to predict that the Court of Chancery would decline to apply *Corwin* when evaluating whether a stockholder could state a proper purpose when attempting to obtain books and records to investigate potential wrongdoing in connection with a completed merger.

In *Lavin*, the Court of Chancery dispelled any lingering questions regarding the application of *Corwin* in the Section 220 context. The case arose out of a merger between West Corp. and affiliates of Apollo Global Management, wherein Apollo sought to acquire West's outstanding stock for $23.50 per share in cash. Before the West stockholder vote, several lawsuits were filed in federal court alleging that the proxy disclosures that West issued in connection with the merger violated the federal securities laws. Ultimately, West mooted the cases by issuing additional disclosures in a supplemental proxy statement. More than 85 percent of the company's shares thereafter voted in favor of the merger. Shortly before the stockholder vote, West stockholder Lavin made a Section 220 demand to inspect West's books and records to investigate whether "wrongdoing and mismanagement had taken place" in connection with the merger, and also to investigate the "independence and disinterestedness" of the West board. West rejected Lavin's demand, he filed suit and the case went to trial after the merger had closed.

West's primary justification for denying Lavin's Section 220 demand was that Lavin could not demonstrate a credible basis of wrongdoing because the "stockholder vote 'cleansed' any purported breaches of fiduciary duty." West argued that because the merger was approved following a disinterested, fully informed uncoerced stockholder vote, the *Corwin* doctrine would limit any post-closing challenges except for waste claims (which Lavin had not stated as a basis for the inspection). Thus, West argued that since its directors would be successful in a fiduciary duty action obtaining dismissal based on a *Corwin* stockholder ratification theory, Lavin could not state a proper purpose for inspection.

In its post-trial decision, the Court of Chancery unequivocally rejected that argument. Instead, the court ruled that "as a matter of law," *Corwin* will not "stand as an impediment to an otherwise properly supported demand for inspection under Section 220." The court held that doing so "would invite defendants improperly to draw the court into adjudicating merits defenses to potential underlying claims" and would require the court to "prematurely adjudicate a *Corwin* defense when to do so might deprive a putative stockholder plaintiff of the ability to use Section 220 as a means to enhance the quality of his pleading in a circumstance where precise pleading, under our law, is at a premium." The Court of Chancery further noted that "it would be naïve to believe, in most instances, that the stockholder plaintiff will not face significant challenges to meet her pleading burden in anticipation of a *Corwin* defense if all she has in hand to prepare her complaint are the public filings of the company whose board of directors she proposes to sue. ... [T]his court should encourage stockholders, if feasible, to demand books and records before filing their complaints [in class action deal litigation] when they have a credible basis to suspect wrongdoing in connection with a stockholder-approved transaction and good reason to predict that a *Corwin* defense is forthcoming."

After declining to consider the *Corwin* doctrine, the Court of Chancery found that, "[w]ith the low Section 220 evidentiary threshold very much in my mind," the plaintiff provided "'some evidence' that West's directors and officers may have breached their *Revlon* duties [for example, by improperly favoring a sale of the entire company, as opposed to a separate sale of its business segments], possibly in bad faith"; he also stated a proper purpose of wanting to investigate the independence of West's board members. However, the Court of Chancery reduced the categories of documents for production from the 13 demanded to five and noted that, "[w]hen measured against the Proxy, the documents [ordered for production] may also offer some insight into whether the stockholder vote was fully informed as Lavin attempts to meet his pleading burden in anticipation of a *Corwin* defense."