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THE CLEANSING POWER OF A FULLY INFORMED SHAREHOLDER VOTE

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In *Corwin v. KKR Financial Holdings LLC*,[1] the Delaware Supreme Court reaffirmed the cleansing power of a vote taken by a fully informed, uncoerced majority of disinterested stockholders in defending a challenged transaction. The decision, handed down October 2, is important to M&A practitioners because it can affect the standard of review that courts will apply in litigation attacking merger transactions. Indeed, the significance of *Corwin* has already been felt.

On October 29 in a ruling on another case, Vice Chancellor Donald F. Parsons, Jr. granted defendant Merrill Lynch's motion for reconsideration having previously denied its motion to dismiss an aiding and abetting claim against Merrill Lynch arising from its role as the financial advisor to Zale Corp. in its acquisition by Signet Jewelers.[2] That rehearing and subsequent grant of Merrill's motion based on the *Corwin* holding meant that Merrill was no longer left in the case as the sole defendant whose motion to dismiss was not granted.

Corwin involved a challenge to the stock-for-stock merger between KKR & Co. L.P. (KKR) and KKR Financial Holdings LLC (Financial) in which KKR acquired all of the stock of Financial for 0.51 of a share of KKR stock, which represented a 35% premium to the unaffected market price[3] In a post-closing damages action, the Chancery Court granted defendants' motion to dismiss, ruling that the "voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review" the presumption of which plaintiffs failed to rebut.[4]

On appeal, plaintiffs argued that the Chancery Court erred when it found that KKR was not a controlling stockholder.[5] The Delaware Supreme Court flatly rejected plaintiffs' argument, finding that the Chancery Court "correctly applied the law."[6] Among other facts taken from Chancellor Andre G. Bouchard's "lucid analysis," the Supreme Court reiterated that KKR owned less than 1% of Financial's common stock and had no contractual rights to either appoint any directors or otherwise exercise a veto over any decision made by Financial's board.[7] The Court also noted with approval that Chancellor Bouchard's analysis went deeper than simply looking at share ownership, recognizing that there are situations - not

supported by the facts in *Corwin* - where a combination of "potent voting power" and "management control" can result in "effective control of [a] board" even where majority ownership is lacking."[8]

The Supreme Court found that it did not have to "delve" into Revlon's applicability to the KKR transaction "for a single reason: it does not matter."

Recognizing they were unlikely to prevail in their effort to invoke the "entire fairness" standard of review by demonstrating that KKR was a "controlling stockholder," plaintiffs also argued that the Chancery Court erred in dismissing their complaint because the *Revlon* rule applied requiring "enhanced scrutiny" as the standard of review rather than business judgment.[9] The Supreme Court found that it did not have to "delve" into *Revlon*'s applicability to the KKR transaction "for a single reason: it does not matter."[10] Rather, once the Chancery Court correctly found that the entire fairness standard did not apply, the "analysis of the effect of the uncoerced, informed stockholder vote [was] outcome determinative, even if *Revlon* applied to the merger."

[T]he Court eliminated any uncertainty about the what standard of review will apply in post-closing damages actions challenging mergers not governed by "entire fairness" when there has been a fully informed, uncoereced vote in favor of the transaction by a majority of disinterested stockholders.

In so holding, the Court strongly rejected plaintiffs' suggestion that its earlier decision in *Gantler v. Stephens* required a different result.[11] While acknowledging that *Gantler* could "be read in more than one way," the Court firmly put that issue to rest by "embrac[ing] the Chancellor's well-reasoned decision" that *Gantler* was a "narrow decision focused on defining a specific legal term, 'ratification' and not on the question of what standard of review applies if a transaction not subject to the entire fairness standard is approved by an informed, voluntary vote of disinterested stockholders."[12] Significantly, the Court rebuffed plaintiffs' suggestion that its ruling would undermine stockholder protections extended by the Court in *Unocal*[13] and *Revlon*, pointing out that *Unocal* and *Revlon* "are primarily designed to give. . . the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing."[14] Neither decision was rendered with "post-closing money damages claims in mind" and the standards articulated in those decisions "do not match the gross negligence standard for director due care liability under *Van Gorken.*"[15]

In sum, the importance of *Corwin*, is twofold. First, the Court eliminated any uncertainty about the what standard of review will apply in post-closing damages actions challenging mergers not governed by "entire fairness" when there has been a fully informed, uncoereced vote in favor of the transaction by a majority of disinterested stockholders. The Court's holding will undoubtedly affect the "value" of post-closing damages cases whenever entire fairness does not apply. Second, as a practical matter, it emphasizes the

importance of robust proxy disclosures. As aptly demonstrated by Vice Chancellor Parson's reconsideration in *Zales*, the protection afforded by such disclosures should trump any argument about "what is market," and directors as well as financial advisors and/or their counsel should take care to ensure that any doubts are resolved in favor of more fulsome disclosures if they want to preserve the option of exiting a post-closing damages case on a motion to dismiss.

ENDNOTES:

[1]*Corwin v. KKR Financial Holdings LLC*, No. 629, 2014 (Del. Oct. 2, 2015).

[2]*In re Zale Corporation Stockholders Litigation*, 2015 WL 5853693 (Del. Ch. 2015), *opinion amended on reargument*, 2015 WL 6551418 (Del. Ch. 2015).

[3]*Id.,* at *1. 2015 WL 5772262 (Del. 2015).

[4]*Id.* The business judgment rule creates a presumption that "in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (rejected by, *Kamen v. Kemper Financial Services, Inc.*, 908 F.2d 1338, Fed. Sec. L. Rep. (CCH) P 95363, 17 Fed. R. Serv. 3d 224 (7th Cir. 1990)) and (overruled by, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)). *See Generally, Welch, Micheletti, Morrison & Dargitz Mergers & Acquistions Deal Litigation Under Delaware Corporate Law, Section 4.01 (B)(1)*(1st ed 2015).

[5]*Zale* at *3.

[6]*Id.*

[7]*Id.,* at *1.

[8]*Id.*, at *2.

[9]*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, Fed. Sec. L. Rep. (CCH) P 92525, 66 A.L.R.4th 157 (Del. 1986). *See generally*, Mergers & Acquisitions Deal Litigation, Section 4.01 (B)(3)(b).

[10]*Id.*, at *3.

[11]*Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

[12]*Id.*, at *5.

[13]*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, Fed. Sec. L. Rep. (CCH) P 92046, Fed. Sec. L. Rep. (CCH) P 92077 (Del. 1985). *See generally*, Mergers & Acquisitions Deal Litigation, Section 4.01 (B)(3)(a).

[14]*Id.*, at *6.

[15]*Smith v. Van Gorkom*, 488 A.2d 858, Fed. Sec. L. Rep. (CCH) P 91921, 46 A.L.R.4th 821 (Del. 1985) (overruled by, *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009)).