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Corwin v. KKR Financial Holdings LLC

Delaware Supreme Court Affirms That an Uncoerced and Fully Informed Disinterested Stockholder Vote Reduces the Standard of Review in a Merger Without a Controlling Stockholder to Business Judgment

In an [opinion](#)¹ issued on October 2, a unanimous Delaware Supreme Court sitting *en banc* affirmed the Delaware Court of Chancery's dismissal of claims in *In re KKR Financial Holdings LLC Shareholder Litigation*,² in which the Chancery Court held that the business judgment rule is the appropriate standard of review in post-closing damages suits involving mergers that are not subject to the entire fairness standard and that have been approved by a fully informed, uncoerced majority of the disinterested stockholders, even where such a vote is statutorily required.³ As the Delaware Supreme Court stated, "for sound policy reasons" Delaware law has long been reluctant to second-guess the voluntary judgment of a disinterested majority in a transaction not involving a controlling stockholder. The Supreme Court also affirmed the lower Court's finding that the plaintiffs had not adduced facts sufficient to support an inference that KKR was a controlling stockholder because the plaintiffs failed to plead facts demonstrating that KKR, which owned 1% of the target's stock, had the ability to prevent the target's board from exercising its independent judgment in determining whether to approve the proposed merger.⁴

In so holding, the Supreme Court rejected the plaintiffs' argument that even if KKR were not a controlling stockholder and entire fairness therefore did not apply, the Chancery Court erred in not applying enhanced scrutiny review to the actions of the target directors. The Supreme Court stated that even if enhanced scrutiny applied, the uncoerced informed stockholder vote had the effect of restoring business judgment as the standard of judicial review. At the same time, the Supreme Court agreed with the Chancery Court's view that *Gantler v. Stephens*,⁵ a case in which the Supreme Court held that a stockholder vote can have a curative effect where the vote is not statutorily required, did not rob the

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informed stockholder vote of its effect on the standard of judicial review where the vote is statutorily required, but instead was a narrow holding focused on the meaning of the term “ratification.”

In rejecting the plaintiffs’ argument that the lowering of the standard of review through a stockholder ratification vote would undermine the operation of *Revlon*⁶ and *Unocal*,⁷ the Supreme Court stated that *Revlon* and *Unocal* were intended to provide the basis of obtaining pre-closing injunctive relief in merger transactions, and not designed to address post-closing claims for money damages, noting that those standards do not match the gross negligence standard of care established by *Smith v. Van Gorkom*,⁸ and that due care liability is rarely available given the prevalence of exculpatory charter provisions.

Moreover, the Supreme Court observed that the rule articulated in *In re KKR* applies only to fully informed and uncoerced votes of disinterested stockholders so business judgment would not be available if “troubling” material facts about director behavior were not fully disclosed to stockholders.

Lastly, the Supreme Court noted that judicial second-guessing where disinterested stockholders have had the unimpaired and informed opportunity to cast their economic vote would only impose higher litigation costs on stockholders and inhibit business risk-taking for no relative benefit, as well as undermine the logic of the business judgment rule, which “best facilitates wealth creation through the corporate form.”⁹

The *KKR Financial Holdings* decision will make post-closing damages cases more difficult to prove while heightening the Courts’ and plaintiffs’ focus on the adequacy of disclosure to stockholders. Alleged aiders and abettors of breaches of directors’ fiduciary duties, who because of charter provisions that exculpate directors are targets of post-closing damages claims, are likely to be significant beneficiaries of the decision, assuming targets ensure that they are careful about the extent of their public disclosures.

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ENDNOTES

- ¹ *Corwin v. KKR Fin. Holdings*, No. 629, 2014, slip op. (Del. Oct. 2, 2015) [hereinafter *Slip Op.*].
- ² *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014). For a full discussion of the Court of Chancery decision, see our publication, dated October 27, 2014, titled "[*In re KKR Financial Holdings LLC Shareholder Litigation*](#)."
- ³ The Supreme Court noted that this case concerned a merger transaction between a limited partnership and a limited liability company. The parties to the litigation, however, treated the dispute as one governed by the Delaware corporate case law and the Delaware General Corporation Law. The Supreme Court said it "respected the parties' approach" to the case but added that, in cases involving entities other than corporations, "distinctive arguments often arise due to the greater contractual flexibility given to those entities under [Delaware] statutory law." *Slip Op.* at 2, n.3.
- ⁴ *Slip Op.* at 3–4.
- ⁵ 965 A.2d 695 (Del. 2009).
- ⁶ *Revlon v. MacAndrew & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).
- ⁷ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).
- ⁸ 488 A.2d 858 (Del. 1985).
- ⁹ *Slip Op.* at 13.

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