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Case Number 629,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

ROBERT A. CORWIN, MARGARET DEMAURO, ERIC GREENE, PIPEFITTERS LOCAL UNION NO. 120 PENSION FUND, and POMPANO BEACH POLICE & FIREFIGHTERS' RETIREMENT SYSTEM, Plaintiffs Below, Appellants, v. KKR FINANCIAL HOLDINGS LLC, TRACY COLLINS, ROBERT L. EDWARDS, CRAIG J. FARR, VINCENT PAUL FINIGAN, JR., PAUL M. HAZEN, R. GLENN HUBBARD, ROSS J. KARI, ELY L. LICHT, DEBORAH H. MCANENY, SCOTT C. NUTTALL, SCOTT RYLES, WILLY STROTHOTTE, KKR & CO. L.P., KKR FUND HOLDINGS L.P., and COPAL MERGER SUB LLC, Defendants Below, Appellees.	No. 629, 2014 Court Below: Court of Chancery of the State of Delaware, Consol. C.A. No. 9210-CB

APPELLANTS' REPLY BRIEF

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

OTHER AUTHORITIES

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN CONCLUDING THAT KKR CANNOT, AS A MATTER OF LAW, CONTROL KFN

A. DEFENDANTS CONTROLLED EVERY ASPECT OF KFN

Defendants insist that KKR – no matter how overwhelming its day-to-day control over the management and business affairs of KFN – cannot be a controlling stockholder because it does not have sufficient voting power to *de facto* control the election of KFN board members. Def. Br. at 9-14.[1] This Court has never imposed such a bright line rule, nor should it. The test for finding fiduciary duties arising from corporate control is a disjunctive, fact-intensive inquiry into whether the stockholder has (1) a "majority interest" *or* (2) "exercises control over the business affairs of the corporation." *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113-14 (Del. 1994) (citations omitted). While Plaintiffs ask the Court to apply that well-established test, Defendants ask the Court to ignore the unique facts establishing KKR's absolute control and, on a motion to dismiss, adopt a broad sweeping legal principle divorced from those facts.[2] Defendants' argument

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[1] References to Appellees' Answering Brief appear as "Def. Br. at __."

[2] Defendants cite *In re Cysive, Inc. S'holder Litig.*, 836 A.2d 531 (Del. Ch. 2003) for the proposition that an alleged controller "must" have sufficient voting power to be the dominant force in an election. Def. Br. at 9-10. The court in *Cysive*, however, merely held that combining the alleged controller's voting stock with that of his subordinate family members resulted in such voting control which along with other factors, including "day-to-day managerial supremacy," made the stockholder a controller. *Id*. at 552.

presumes that voting domination over a corporate board is the exclusive method for establishing actual control. This Court has never so held.[3]

Plaintiffs allege that KKR completely controlled the KFN Board, including with regard to the Transaction itself, because among other things KKR completely controlled access to, and the contents of, all necessary information to properly evaluate KKR's offer. Moreover, KKR had the contractual right to end the relationship with KFN, which would have rendered KFN defunct and its Board irrelevant. *See* A30 ¶¶45-46, A49 ¶102, A58 ¶¶131-33.[4] Such dominance, leverage, and dependency sufficiently establish KKR's controlling status as to KFN.

KKR voluntarily established its absolute contractual control over KFN, a result that no arms-length negotiations could have produced. While KKR may have had its business reasons for setting up KFN as an effectively captive, but publicly funded, financing division, KKR must live with the legal consequences of that arrangement, including the imposition of controlling person fiduciary duties

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[3] *In re Zhongpin Inc. S'holder Litig.*, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014) did not hold that a claim of actual control "required" allegations of board domination, as Defendants suggest. Def. Br. at 13. The court merely quoted *In re Alloy, Inc. S'holder Litig.*, 2011 WL 4863716 (Del. Ch. Oct. 13, 2011), where the plaintiff did not make any such allegations. *Zhongpin*, 2014 WL 6735457 at *7 n.23. *Zhongpin* specifically held that "the Court does not take an unduly restrictive view of the avenues through which a controller obtains corporate influence." *Id*. at *8.

[4] References to Appellants' Opening Brief Appendix appear as "A__."

under Delaware law. Defendants' cases on this point are distinct and largely inapposite, as they involve minority stockholders having nothing approaching the high degree of control that KKR exercised over KFN.[5]

B. KKR CONTROLLED THE INFORMATION ABOUT THE TRANSACTION

Defendants contend that KFN – not KKR – controlled the flow of information relevant to evaluate the Transaction because KFN permitted KKR to use certain nonpublic KFN information in formulating its offer for KFN. Def. Br. at 17-18. This argument is untethered from the Complaint and the realities of KFN's business, as KFN had no management of its own, and instead relied entirely on KKR for management services. Accordingly, the information KKR accessed was at all times in KKR's possession, and KFN was forced to trust that KKR maintained and provided accurate information about KFN. *See, e.g.*, A21-22, A30-31, ¶¶3, 4, 7, 45. Indeed, during oral argument the Chancellor explained: "presumably, when [KFN] wants to get information, it has to go out and get it – but it's reliant on getting it from KKR. It's a pretty unique circumstance." A1333. Counsel for the Individual Defendants had no choice but to agree that "it's an

[5] *See, e.g.*, *In re Sea-Land Corp. S'holders Litig.*, 1987 WL 11283, at *4-5 (Del. Ch. May 22, 1987) (Def. Br. at 11) ("plaintiffs admit in their briefs that [stockholder] did not control the day-to-day affairs of [the corporation]"). Other cases cited by Defendants are distinguished in Appellants' Opening Brief ("Op. Br.") at 16 n.7. Defendants also cite *In re Sanchez Energy Deriv. Litig.*, 2014 WL 6673895 (Del. Ch. Nov. 25, 2014) (Def. Br. at 11-12), which is of limited value as it relies extensively on the opinion challenged here. *See* 2014 WL 6673895 at *8 n. 42 (citing the exact language from the Opinion that is the subject of this appeal).

unusual set of circumstances . . . I haven't seen it before." A1334. There can be no doubt at this stage of the proceedings[6] that KKR controlled the entire flow of information.

Stockholders should not suffer by virtue of the Management Agreement KKR imposed on KFN, assuring KKR virtually all of the control one would expect of a controlling stockholder (but without the economic risk of majority ownership). Having chosen that unusual but advantageous business arrangement and its attendant potential for abuse, KKR must live with the enhanced scrutiny it invited.

C. KKR'S LEVERAGE OVER KFN WAS MORE THAN "THEORETICAL"

Defendants argue that KKR's contractual right to sever its relationship with KFN without cause poses no threat to KFN or its Board because the harm is merely "theoretical" or based on "conjecture." Def. Br. at 18-20. At the pleading stage it is more than reasonable to infer that, as alleged, KFN exists for the sole purpose of servicing KKR (A20, ¶2), and a decision by KKR to terminate the relationship would leave KFN and its Board with no business to conduct or oversee, effectively dissolving the Company. Clearly KKR could leverage its power over KFN in negotiating the Transaction – again necessitating heightened scrutiny.

[6] On review of a motion to dismiss, all well pleaded factual allegations must be accepted as true and reasonable inference drawn in favor of the non-moving party. *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs., LLC*, 27 A.3d 531, 535 (Del. 2011).

Defendants argue that the Management Agreement cannot give KKR control over KFN because "compliance with a valid contract will not give rise to a fiduciary breach." Def. Br. at 15. That argument misconstrues Plaintiffs' entire theory. Just as the mere fact of being a majority shareholder does not constitute a breach of fiduciary duty, Plaintiffs do not allege that merely entering into the Management Agreement and conducting business thereunder breached any duties. Plaintiffs do allege, however, that the control conferred by the Management Agreement subjects the Transaction to the entire fairness standard just as in any other transaction with a controller.[7]

Although KKR had the contractual right to control KFN's operations, and KFN's public investors were on notice to that effect, KKR had no contractual right to purchase KFN at a discounted rate or otherwise use the contract to take self-serving actions to the detriment of KFN stockholders.

D. *MFW* DOES NOT SUPPORT DISMISSAL OF THE COMPLAINT

Defendants argue that, even if KKR is a controlling stockholder, the Complaint should nevertheless be dismissed because Defendants' conduct supposedly satisfies each of the six preconditions for business judgment scrutiny

[7] *In re Sirius XM S'holder Litig.*, 2013 WL 5411268 (Del. Ch. Sept. 27, 2013) and *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, 2006 WL 2521426, at *1 (Del. Ch. Aug. 25, 2006), cited by Defendants, are easily distinguished. Neither involved a party's power to terminate a contract conferring control over the counterparty's day-to-day operations.

under *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("*MFW*"). Def. Br. at 20-22.[8] Significantly, *MFW* requires Plaintiffs only to plead a reasonably conceivable challenge to one such factor in order to proceed to discovery. *Id*. at 645 ("[i]f a plaintiff can plead a reasonably conceivable set of facts showing that any or all of those enumerated conditions did not exist, that complaint would state a claim for relief that would entitle the plaintiff to proceed and conduct discovery").

Plaintiffs have adequately alleged that Defendants did not satisfy the *MFW* precondition that "the special committee [met] its duty of care in negotiating a fair price." *Id*. As the Complaint sets forth, the Transaction Committee's own financial advisor set a price target of $25 per share for KFN just two months before the Transaction yielded a per share value of only $12.79. A22-23, ¶9. That allegation alone merits discovery. *MFW*, 88 A.2d at 645 n.14 ("allegations about the sufficiency of the price call into question the adequacy of the Special Committee's negotiations, thereby necessitating discovery on all of the new prerequisites to the application of the business judgment rule").

Plaintiffs also allege that KKR-loyal Defendants Hazen and Farr were involved with – and indeed controlled – discussions and negotiations as to whether KKR would modify or waive the Termination Fee, which precluded competing

[8] The six prerequisites are set forth in Appellants' Opening Brief ("Op. Br.") at 28.

offers for KFN. A44, ¶85. As Plaintiffs allege, Hazen "raised" the issue of the Termination Fee with Farr, and "Farr then contacted KKR" and was informed "that KKR was unwilling to modify or eliminate" the provision. *Id.* KFN stockholders cannot have confidence that either Farr or Hazen would have adequately represented their interests, given that (as the Court of Chancery acknowledged) Farr lacked independence because he was "a high level KKR employee" and it is "reasonably conceivable" that Hazen lacked independence as well. Op. Br. Ex. A ("Opinion") at 25.

MFW also requires an independent special committee and a fully-informed stockholder vote (*MFW*, 88 A.3d at 645), which Plaintiffs also challenge. Plaintiffs plead numerous facts showing that "at least half of the directors appointed to the [Transaction] [C]ommittee suffered from disabling conflicts of interest." A23, ¶10; *see also* A41, ¶75 (three of the six members of the Transaction Committee "have significant ties to either KKR or interested KFN directors"); A36-41, ¶¶61-73 (detailing conflicts). Plaintiffs also allege that Defendants failed to disclose numerous material facts necessary for a fully-informed vote. *See, e.g.*, A44, ¶87 ("The Proxy does not disclose what Hazen conveyed to the Transaction Committee . . ."); A58-59, ¶131 ("The Proxy provides

no explanation why KFN . . . did not prepare basic management projections . . .").[9]

Thus, *MFW* does not support dismissal.

[9] Plaintiffs also challenge the majority-of-the-minority provision in the Merger Agreement, another of *MFW*'s prerequisites for business judgment (88 A.3d at 645), because it expressly carves out various entities from the definition of KKR "affiliates," including one KKR strategic partner that holds approximately 25% of KFN's outstanding shares and is unquestionably a KKR affiliate. A48, ¶¶99-100.

II. THE CHALLENGED TRANSACTION IS SUBJECT TO ENHANCED *REVLON* REVIEW AND THE COMPLAINT STATES A NON-EXCULPATED CLAIM

A. PLAINTIFFS PROPERLY RAISED THEIR *REVLON* ARGUMENT BELOW

Defendants argue that Plaintiffs' *Revlon* argument is barred by Rule 8 because "plaintiffs never argued that enhanced scrutiny applied in the proceedings below." Def. Br. at 23. Defendants are wrong. *First*, Defendants' argument is a red herring. Even if Defendants were correct that Plaintiffs did not adequately raise their *Revlon* argument below (and they are not), the Court should nevertheless consider the *Revlon* argument because the Court of Chancery discussed and ruled on it. Defendants ignore established law that, when the court below addresses an issue *sua sponte*, that issue is properly considered on appeal. *See, e.g.*, *Reddy v. MBKS Co., Ltd.*, 945 A.2d 1080, 1086 (Del. 2008) (where the Vice Chancellor ruled on an issue *sua sponte*, "[b]ecause the parties were not heard on this specific issue, it serves the 'interests of justice' for us to consider [the] claim, as Supreme Court Rule 8 permits"); *Lawson v. Preston L. McIlvaine Constr. Co., Inc.*, 552 A.2d 858 (Del. 1988) ("Because the trial judge, *sua sponte*, addressed the merits of the . . . claim, the question . . . is . . . properly before this Court on appeal.").

Second, Count I of the Complaint alleges that the Individual Defendants violated their duties "by agreeing to the Proposed Transaction, which does not provide a fair or ***value maximizing*** price to the Company's public stockholders."

A64, ¶153. That language raises the question, under *Revlon*, whether the Individual Defendants breached their duties by failing to "maximize[] . . . the company's value at a sale for the stockholders' benefit." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). Moreover, Defendants selectively quote from Plaintiffs' motion to dismiss opposition brief in the Court of Chancery by noting that Plaintiffs wrote that "this is not a traditional *Revlon* case" (Def. Br. at 23) while ignoring that Plaintiffs' statement was in response to Defendants' argument concerning whether KFN directors "utterly failed to attempt to obtain the best sale price" and part of an argument concerning "a flawed sales process that was not designed to maximize shareholder value" (*see* Plaintiffs' Answering Brief in Opposition to Defendants' Motion to Dismiss, at A1179) – *i.e.*, a classic *Revlon* argument.

Third, the Court should consider Plaintiffs' *Revlon* argument on appeal because the Court of Chancery rejected that argument on a plainly erroneous basis. The Court of Chancery based its decision on the flawed finding that the acquirer (KKR) is a "widely-held, publicly traded" company rather than what it is – a limited partnership controlled by its managing partner. Opinion at 13; A61, ¶¶138-40. Because the lower court's ruling is based on a "material defect[] which [is] apparent on the face of the record; which [is] basic, serious, and fundamental in [its] character, and which . . . clearly show[s] manifest injustice," the Court should

consider Plaintiffs' *Revlon* argument on appeal in the "interests of justice." *Smith v. Del. St. Univ.*, 47 A.3d 472, 479 (Del. 2012). Had the Court of Chancery correctly applied *Revlon* enhanced scrutiny in light of KFN's status as a controlled entity, KFN's stockholders would have received the protections they are due under the law. *See* Op. Br. at 20-21.

B. THE COMPLAINT STATES A NON-EXCULPATED *REVLON* CLAIM

There is no dispute that a *Revlon* claim seeking damages from the Individual Defendants may lie where "Plaintiffs have successfully pleaded a failure to act loyally (or in good faith), which would preclude reliance on the . . . provision." *In re NYMEX S'holder Litig.*, 2009 WL 3206051, at *6 (Del. Ch. Sept. 30, 2009). Contrary to Defendants' suggestion, Plaintiffs have in no way abandoned their claim that the KFN Board failed to act independently when negotiating the transaction, and Plaintiffs have at all times alleged and argued "that KKR or [individuals] associated with it dominated the Transaction Committee or the KFN Board." Def. Br. at 25. Even if KKR did not control KFN (which it did), *Revlon* applies as discussed in Plaintiffs' opening brief. Indeed, Plaintiffs allege:

- the KFN Board and Transaction Committee relied entirely on KKR for all information relevant to the Transaction (A30, ¶¶45-46; A49, ¶102; A58, ¶¶131-33);
- the KFN Board and Transaction Committee permitted the clearly conflicted Defendants Hazen, Farr, and Hubbard, each of whom was employed by, affiliated with, and/or beholden to KKR, to negotiate the Transaction (A26-27, ¶¶22, 24-25; A42-43, ¶¶80-82); and

- the KFN Board and Transaction Committee specifically allowed and empowered the conflicted Hazen to negotiate with KKR on the key impediment to a third-party bidder emerging, a waiver of KKR's Termination Fee (A44, ¶ 85).

Where, as here, directors with a motive to benefit a counterparty agree to onerous deal protections that materially disadvantage shareholders, a *Revlon* claim may lie based on breaches of the duty of loyalty. *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 501 A.2d 1239, 1250 (Del. Ch. 1985) (enjoining transaction based on duty of loyalty breaches in light of "concessions . . . to the detriment of Revlon's shareholders. . . . [T]he element of loyalty may turn, as it does here, in the selection of a . . . bargaining device that is not proportionate to the objective needs of the shareholders but merely serves the convenience of the directors.").

Further, Defendants must live with the consequences, under the *Revlon* analysis, of voluntarily agreeing to a contract with KKR (including the Termination Fee) that tied the KFN Board's hands with regard to exploring alternatives. Beyond the conflicts set forth above, KFN's directors utterly abdicated their responsibility to KFN's public stockholders. They agreed to the Termination Fee, but ensured the Termination Fee would remain in force, preventing competitive bidding, and depriving shareholders of the ability to receive the best price for their shares. This behavior was disloyal and constituted bad faith. *See, e.g.*, *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009) ("bad

faith will be found if a fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties") (quotation marks omitted); *Frank v. Elgamal*, 2014 WL 957550, at *22 (Del. Ch. Mar. 10, 2014) ("An otherwise independent and disinterested director may exhibit bad faith if he intentionally facilitates a transaction to the benefit of an interested party at the expense of – and with an indifference toward his duties to – the minority stockholders."); *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813, 830 (Del. Ch. 2011) (discussing directors' duty to "try in good faith . . . to get the best available transaction for the shareholders").

Here, the process was driven and conducted, unchecked, by interested individuals, a far cry from the cases Defendants cite where bad faith claims were dismissed. *See In re Comverge, Inc. S'holders Litig.*, 2014 WL 6686570, at *9, 13 (Del. Ch. Nov. 25, 2014) (only one of ten directors "raise[d] any doubt about his disinterestedness and independence" and there was no allegation that director dominated or controlled the Board, which "engaged in an over 18-month strategic process," "widely canvassed the market," and "considered alternatives to selling the entire company"); *In re BioClinica, Inc. S'holder Litig.*, 2013 WL 5631233, at *2, 5 (Del. Ch. Oct. 16, 2013) (no allegation that interested directors controlled negotiations; financial advisor contacted seventeen potential private equity bidders and four strategic bidders, several of which executed non-disclosure agreements

and met with company management); *Wayne Cnty. Employees' Ret. Sys. v. Corti*, 2009 WL 2219260, at *15 (Del. Ch. July 24, 2009) (no bad faith where company evaluated seventeen potential acquisition targets before entering into merger agreement, plaintiff did not challenge deal protections, and board "regularly evaluated financial reports and analysis" to evaluate proposed transaction); *In re Morton's Rest. Group S'holders Litig.*, 74 A.3d 656, 665-69 (Del. Ch. 2013) (no domination or control over negotiations; board "canvassed the market for a suitable buyer" over nine months, including contacting 137 potential buyers, executing 52 confidentiality agreements, and entering into exclusivity agreement with alternate bidder).[10]

[10] *See also NYMEX*, 2009 WL 3206051, at *6 (as opposed to the KKR-employed and affiliated KFN directors, "this is not an instance where certain relationships raised some concern [even if] not sufficient doubt to sustain a challenge to director independence"); *In re Plains Exploration & Prod. Co. S'holder Litig.*, 2013 WL 1909124, at *4-6 (Del. Ch. May 9, 2013) (lead negotiator was only non-independent member of eight-member board and, "acting on the Board's behalf, walked away – at least for a time – from the . . . transaction"; deal protections were "not onerous" and did not preclude competing bids); *C&J Energy Servs., Inc. v. City of Miami Gen. Emps' & Sanitation Emps.' Ret. Trust*, 2014 WL 7243153, at *16 (Del. Dec. 19, 2014) ("in this case, there was no barrier to the emergence of another bidder and more than adequate time for such a bidder to emerge").

III. A STATUTORILY REQUIRED STOCKHOLDER VOTE DOES NOT SHIELD THE TRANSACTION FROM JUDICIAL SCRUTINY

Defendants argue that a fully informed stockholder vote lowers the standard of review of a conflicted transaction that would otherwise be subject to entire fairness review, and that this Court's decision in *Gantler* merely clarified the term "ratification." That is incorrect. Defendants' interpretation of *Gantler* is wholly incompatible with the very facts and result of that case. *Gantler* involved a stockholder challenge to a stock reclassification proposal approved by the corporation's board, where a majority of the board lacked complete independence. *See* Op. Br. at 23-24; *Gantler v. Stephens*, 965 A.2d 695, 714 (Del. 2009). The transaction was also approved by a majority of the corporation's "unaffiliated" public stockholders who had no interest in the proposal in a statutorily required vote. *Gantler*, 965 A.2d at 703. Because of the board's conflicts, the Court recognized that the reclassification "was an interested transaction ***not entitled to business judgment protection***." *Id.* at 714 (emphasis added).

Defendants' argument here suggests that the statutorily required stockholder vote approving the reclassification transaction should nevertheless have lowered the standard of review back to business judgment. But that is exactly what the *Gantler* defendants argued, and this Court rejected:

> The Court of Chancery held that although Count III of the complaint pled facts establishing that the Reclassification Proposal was an interested transaction not entitled to business judgment protection, ***the***

> ***shareholders' fully informed vote "ratifying" that Proposal reinstated the business judgment presumption. That ruling was legally erroneous, for several reasons. First, the ratification doctrine does not apply to transactions where shareholder approval is statutorily required.*** Second, because we have determined that the complaint states a cognizable claim that the Reclassification Proxy was materially misleading . . . that precludes ruling at this procedural juncture, as a matter of law, that the Reclassification was fully informed. Therefore, the approving shareholder vote did not operate as a "ratification" of the challenged conduct in any legally meaningful sense.

Id. (emphasis added).[11]

Defendants make no attempt to – and cannot – reconcile the *Gantler* holding with their argument here. Defendants argue at length that Plaintiffs' reading of *Gantler* contradicts several lower court post-*Gantler* decisions.[12] But Defendants' brief ignores this Court's plain language. For Defendants to prevail, either (i) *Gantler* was wrongly decided and must be overturned; or (ii) this Court simply did not mean what it said when it held that it was "legally erroneous" for the trial court to conclude that a statutorily required stockholder approval of an interested transaction "reinstated the business judgment rule."

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[11] Defendants contend that "[a]s far back as 1979, this Court applied the business judgment standard of review to board action approved by an informed, disinterested electorate," citing *Michelson v. Duncan*, 407 A.2d 211, 224 (Del. 1979). *See* Def. Br. at 29. But *Michelson* involved a ***voluntary*** stockholder vote. *See Michelson*, 407 A.2d at 219, 221; *see also Michelson v. Duncan*, 386 A.2d 1144, 1150 (Del. Ch. 1978) ("defendants sought and received stockholder ratification at the annual meeting held on April 12, 1977.").

[12] *See* Def. Br. at 29-33.

Moreover, Defendants misinterpret *Gantler* by arguing that "because the proxy statement at issue in *Gantler* was held to be materially misleading, the *Gantler* Court had no occasion to consider the legal effect of a fully informed stockholder vote when the vote is statutorily required." *See* Def. Br. at 31. To the contrary, in *Gantler*, this Court expressly rejected the trial court's holding on the ratification issue on each of two independent bases, and used the helpful descriptors "first" and "second" for clarity. *See Gantler*, 965 A.2d at 714. The first basis for this Court's holding, which is relevant here even if the disclosures are treated as adequate, was that "the ratification doctrine does not apply" where, as here, stockholder approval of the transaction was "statutorily required." *Id.* Second, and in any event, the stockholder vote could not be viewed as a "'ratification' of the challenged conduct in any legally meaningful sense" because the "complaint state[d] a cognizable claim that the Reclassification Proxy was materially misleading." *Id.* Defendants may prefer to read past the first part of the Court's holding in *Gantler*, but that is not grounds to ignore it.

Defendants, and the court below, suggest that *Gantler* meant only to clarify the term "ratification" (*see* Def. Br. at 31). That argument ignores the Court's discussion of the various contexts in which "ratification" is used.

One context is statutory, particularly DGCL Section 144's safe harbor provisions (which include a fully informed stockholder vote). *See Gantler*, 965

A.2d at 713-14 & n.54. The term has also been used in two common law contexts, including what the *Gantler* Court termed "classic" ratification, where stockholders are asked to approve board action that could be accomplished without a stockholder vote (providing an "independent layer of shareholder approval"), and situations like the one here, where stockholder approval is legally required to effectuate the transaction. *See id.*

The opinion expressly states that it is not intended to "affect or alter our jurisprudence . . . under 8 *Del. C.* § 144" but is intended to "apply only to the common law doctrine of shareholder ratification." *Id.* at 713 n.54. This leaves only the two common law forms of ratification, and the Court expressly limited the "cleansing" effect of ratification to the "classic" form. Specifically:

> To restore coherence and clarity to this area of our law, we hold that the scope of the shareholder ratification doctrine must be limited to its so-called "classic" form; that is, ***to circumstances where a fully informed shareholder vote approves director action that does not legally require shareholder approval in order to become legally effective. Moreover, the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve.*** With one exception, the "cleansing" effect of such a ratifying shareholder vote is to subject the challenged director action to business judgment review, as opposed to "extinguishing" the claim altogether (*i.e.*, obviating all judicial review of the challenged action).

Id. at 713 (emphasis added).

Despite that language, Defendants argue that a statutorily required stockholder vote can also "cleanse" a transaction. If that is the case, *Gantler*

clarified nothing. Defendants argue that when this Court said that "the scope of the shareholder ratification doctrine must be ***limited*** to its so-called 'classic' form" (*id.* at 713, emphasis added), this was purely semantic and the Court really meant only to "limit" the use of the word "ratification." Plaintiffs disagree and believe that the Court in fact meant what it said.[13]

[13] Defendants also argue that Plaintiffs' position is based on a "misreading" of *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59 (Del. 1995), and argue that *Santa Fe* holds only that "fully informed stockholder approval cannot eliminate judicial review altogether" and "says nothing about the effect of [fully informed stockholder approval] on the level of review applied." *See* Def. Br. at 34. While *Santa Fe* dealt specifically with the question whether stockholder approval "extinguished" certain claims implicating *Revlon* and *Unocal* (see Op. Br. at 26-28), one must remember that *Revlon* and *Unocal* are not themselves "claims" but forms of enhanced judicial scrutiny. *See, e.g.*, J. Travis Laster, *Revlon Is A Standard Of Review: Why It's True And What It Means*, 19 Fordham J. Corp. & Fin. L. 5, 6 (2013); *Revlon*, 506 A.2d at 182; *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). Thus, "extinguishing" a claim implicating enhanced scrutiny under *Revlon* or *Unocal* is akin to lowering the standard of review.

CONCLUSION

Because the Court of Chancery dismissed Plaintiffs' Complaint based on errors of law, the court's Opinion, dated October 14, 2014, must be REVERSED.

Dated: March 16, 2015

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I, Mary S. Thomas, hereby certify that on March 16, 2015, a copy of the foregoing Appellants' Reply Brief was served via File & Serve*Xpress* on the following counsel of record:

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