

April 26, 2010

Delaware Supreme Court Renders Expanded Record Holder Definition from Kurz v. Holbrook to be Without Precedential Effect

In its April 21, 2010 decision in Crown EMAK Partners, LLC v. Kurz, the Delaware Supreme Court stated that the Delaware Chancery Court's determination in Kurz v. Holbrook that banks and brokers holding a corporation's shares in "street name" and included on The Depository Trust Company's listing of shares held by its participants would be treated as stockholders of record for purposes of voting or executing stockholder written consents should be regarded as *obiter dictum* and without precedential effect.

Background

The case was brought before the Delaware Supreme Court on appeal from the Delaware Chancery Court's February 9, 2010 decision in Kurz v. Holbrook, which arose out of competing consent solicitations by two stockholder groups of EMAK Worldwide, Inc. ("EMAK"). The first stockholder group, Take Back EMAK, LLC ("TBE"), launched a consent solicitation seeking to remove and elect a number of EMAK directors sufficient to take control of the EMAK board. Shortly prior to the expiration of TBE's consent solicitation, a TBE representative purchased the voting and economic rights of enough restricted EMAK shares from Peter Boutros ("Boutros"), a former employee of EMAK, to ensure that TBE's consent solicitation would have the requisite votes. The second stockholder group, Crown EMAK Partners, LLC ("Crown"), also launched its own consent solicitation seeking to amend EMAK's bylaws to give Crown a majority of the EMAK board. A more complete recitation of the facts of the case can be found in Shearman & Sterling LLP's March 11, 2010 M&A Alert relating to the Chancery Court's decision in Kurz v. Holbrook.

Invalidation of TBE Share Purchase

The Delaware Supreme Court ruled that TBE's last-minute purchase of the voting and economic rights of the shares from Boutros violated a restricted stock agreement between Boutros and EMAK and, therefore, consents in respect of those shares could not be voted in favor of the TBE consent solicitation. As a result, TBE's proposals lacked the votes sufficient to pass and the TBE director nominees were not validly elected to the EMAK board.

Determination of Stockholders of Record

Because the Delaware Supreme Court ruled that TBE's consent solicitation was not successful, the Court did not have to rule on perhaps the most controversial aspect of the Chancery Court's decision – whether The Depository Trust

Company's list of the shares held by each of its participant banks and brokers (the so-called "Cede breakdown") is part of a corporation's stock ledger for purposes of determining the stockholders that are entitled to vote under Section 219(c) of the Delaware General Corporation Law (the "DGCL"). Although the Delaware Chancery Court had expanded the prior understanding of Section 219(c) and determined that the Cede breakdown should be considered part of the stock ledger (therefore permitting participant banks and brokers listed on the Cede breakdown to vote as "stockholders of record" and eliminating the need to obtain an omnibus proxy from The Depository Trust Company), the Delaware Supreme Court stated that the Chancery Court's interpretation of "stock ledger" in Section 219 of the DGCL is *obiter dictum* and without precedential effect. The Court further noted that the human failure to obtain an omnibus proxy in this case is "easily avoided in the future."

Invalidity of Crown Bylaw Amendments

The Delaware Supreme Court also affirmed the rulings of the Chancery Court that the bylaw amendment purportedly adopted through Crown's consent solicitation, which would have shrunk the size of EMAK's board of directors below the number of currently sitting directors, conflicted with the DGCL and therefore was void and that Crown's bylaw amendment providing for the election of a single successor director to replace multiple directors at a special meeting of stockholders also was void under Delaware law.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.