# DELAWARE CORPORATE LAW BULLETIN

## Chancery Court Finds *Corwin* Applicable to Merger Transaction Negotiated with 33.5% Stockholder

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*Chancery Court Determines that large "minority blockholder" did not exhibit sufficient indicia of control to defeat application of Corwin*

### INTRODUCTION

The Delaware Court of Chancery ("*Chancery Court*") continues to refine the analysis underlying the landmark 2015 decision of the Delaware Supreme Court in *Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015) ("*Corwin*"). Under *Corwin*, the business judgment standard of review applies where a corporate acquisition is approved by a majority vote of disinterested stockholders. In that case, if defendant directors can establish that the stockholder vote approving the acquisition was both (1) uncoerced and (2) fully informed, then, absent a sufficient pleading of waste, a postclosing damages action will be dismissed at the pleading stage. Importantly, however, *Corwin* is not applicable in the case of an acquisition in which a controlling stockholder cashes out the shares owned by the public stockholders.

Accordingly, one important element in establishing the availability of the *Corwin* "cleansing" device is to establish that the acquirer does not control the target company. This generally is straightforward when the acquirer owns at least 50 percent of the outstanding stock of the target company, but not so much when the acquirer is a large minority blockholder—owning *less than 50 percent* of the outstanding stock of the target company. For instance, in *Van der Fluit v. Yates*, C.A. No. 12553-VCMR, 2017 WL 5953515 (Del. Ch. Nov. 20, 2017) ("*Van der Fluit*"), Vice Chancellor Tamika Montgomery-Reeves determined that two top executives, cofounders of the company who together owned 30 percent of the outstanding stock, were *not* controlling stockholders for *Corwin* purposes. In so ruling, the Vice Chancellor distinguished two earlier decisions relied upon by plaintiff, one of which featured stockholders owning a total of 71.19 percent of the outstanding stock, and another which featured a significant stockholder who had a subordinate on the board, was related to certain company executives, exhibited managerial dominance, and had the potential for dominant control in any contested election. (For a discussion of *Van der Fluit*, see Robert S. Reder & Elizabeth F. Shore, *Chancery Court Holds that Defendant Directors' Failure to Disclose Material Facts Defeated Application of Corwin*, 72 VAND. L. REV. EN BANC 41 (2018)).

The question whether a large minority blockholder controlled a public company arose again in *In Re Rouse Properties, Inc. Fiduciary Litig.*, C.A. No. 12194-VCS, 2018 WL 1226015 (Del. Ch. Mar. 9, 2018) ("*Rouse*"). In *Rouse*, Vice Chancellor Joseph R. Slights recognized that:

> In this post-*Corwin*, post-*MFW* world, a pattern has emerged in post-closing challenges to corporate acquisitions . . . where a less-than-majority blockholder sits on either side of the transaction, but the corporation in which the blockholder owns shares does not recognize him as a controlling stockholder and does not, therefore, attempt to neutralize his presumptively coercive influence.

According to the Vice Chancellor, this pattern has two elements: *First*, "the stockholder plaintiff pleads facts in hopes of supporting a reasonable inference that the minority blockholder is actually a controlling stockholder such that the *MFW* paradigm is implicated and the *Corwin* paradigm is not"; and *Second,* "failing that, the plaintiff pleads facts in hopes of supporting a reasonable inference that the stockholder vote was uninformed or coerced such that *Corwin* does not apply."

The Vice Chancellor's references to "*MFW*" are a shorthand for *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013), aff'd sub nom., *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014). Under *MFW*, when a control stockholder, from the earliest days of a transaction,

conditions a proposed buyout on approval by *both* a special committee of independent directors and an informed vote of a majority of public stockholders, the transaction will be reviewed under the deferential business judgment rule. This burden-shifting device generally will result in dismissal of stockholder challenges at the pleading stage. (For a discussion of a recent Chancery Court application of *MFW*, see Robert S. Reder, *Chancery Court Again Grants Early Dismissal of Litigation Challenging Control Stockholder-Led Buyout*, 72 VAND. L. REV. EN BANC 11 (2018)).

*Rouse* presents a useful analysis of the manner in which Delaware courts will address the now familiar pattern, identified by Vice Chancellor Slights, of a minority blockholder leading a buyout of public stockholders. As such, the Vice Chancellor's opinion builds further on what is now a sizeable body of case law applying and interpreting *Corwin*.

## I. FACTUAL BACKGROUND

Rouse Properties Inc. ("*Rouse*") "was a real estate investment trust ("REIT") . . . [that] operated a portfolio of 36 malls and retail centers across 21 states." On January 16, 2016, Rouse received an unsolicited offer from its largest stockholder, Brookfield Asset Management, Inc. ("*Brookfield*"), to purchase all outstanding shares not owned by Brookfield for a cash price of $17 per share. At the time, Brookfield owned 33.5 percent of the outstanding Rouse shares. Of Rouse's seven-person board of directors (the "*Board*"), Brookfield had three representatives and nominated the other four as "independent directors." In the years prior to delivery of the offer letter, Brookfield had engaged in several arguably less than arm's-length transactions with Rouse.

In response to Brookfield's offer letter, the Board formed a special committee of the four "independent" directors who were not representatives of Brookfield (the "*Committee*"). The Committee "was vested with full authority to negotiate with Brookfield or consider other strategic alternatives." In the next five weeks, the Committee retained legal counsel and a financial advisor and "convened fourteen meetings." A series of counteroffers followed in which the Committee was able to negotiate an increase in Brookfield's offer to $18.25 per share, together with a commitment that approval of the transaction by Rouse stockholders would require a "majority of the minority" vote. Before finalizing the transaction, the Committee directed its advisors to seek alternative offers but, after a robust process, no superior proposals emerged.

The negotiations with Brookfield culminated in the signing of a merger agreement on February 25, 2016. The merger agreement contained fairly typical deal protections but gave the Board a fiduciary out to accept a superior proposal subject only to matching rights and a termination fee representing 3.8 percent of the equity value of the transaction. Before approving the merger agreement, the Committee received an opinion from its financial advisor that the purchase price "'was fair, from a financial point of view' to nonaffiliated shareholders." The merger closed on July 6th after receiving the affirmative vote of "82.44% of Rouse's unaffiliated stockholders."

After public announcement of the transaction, two Rouse stockholders filed a class action in the Chancery Court that unsuccessfully sought to enjoin the transaction. Among other things, plaintiffs attacked the purchase price, alleging that "Brookfield's offer came at a time when Rouse's stock price was significantly depressed" and the Board was aware of "quite good" quarterly results that "were not released to the public until . . . after the announcement of the [m]erger."

Once the transaction closed, plaintiffs amended their complaint to seek damages from Brookfield and the four Committee members, alleging breach of fiduciary duty in negotiating and consummating the Brookfield transaction. Specifically, plaintiffs claimed that "notwithstanding its less-than-majority position, Brookfield is Rouse's controlling stockholder owing fiduciary duties of care and loyalty to the minority stockholders." Accordingly, because the Board did not follow the *MFW* paradigm, defendants were not entitled to a pleading stage dismissal of the damages action. Alternatively, plaintiffs claimed that the disclosures provided to Rouse stockholders in connection with their approval of the transaction were both coerced and inadequate, thereby precluding cleansing of the alleged breaches of fiduciary duty under *Corwin*. Brookfield and the director defendants disputed both prongs of plaintiffs' argument and sought dismissal of the damages claim.

## II. VICE CHANCELLOR SLIGHTS' ANALYSIS

Consistent with the pattern he discussed at the outset of his opinion, Vice Chancellor Slights segmented his consideration of defendants' motion to dismiss into two parts: *first*, did Brookfield control Rouse, thereby rendering *Corwin* inapplicable, and *second*, if Brookfield *did not* control Rouse, did the stockholder vote in favor of the merger pass muster under *Corwin*? Answering the first question in the negative and the second in the affirmative, the Vice Chancellor

dismissed plaintiffs' claims against Brookfield and the Committee members.

### *A. Did Brookfield Control Rouse?*

Because, as a minority blockholder owning less than 50 percent of Rouse's outstanding shares, Brookfield did not control Rouse outright, it could be considered a controlling stockholder only if it were found to "*exercis[e] control* over the business affairs of the corporation." This is *not* a low bar because, as the Vice Chancellor explained, a stockholder is not in "'actual control . . . unless it exercises such formidable voting and managerial power that, as a practical matter, it is no differently situated than if it had majority voting control.'" Further, the power wielded by the minority blockholder "'must be so potent that independent directors cannot freely exercise their judgment, fearing retribution from the controlling minority blockholder.'"

In this connection, the Vice Chancellor noted that the determination whether a minority blockholder exercises actual control "is often fact-intensive and, therefore, not always suitable for resolution on a motion to dismiss." However, in those instances in which the pleadings adequately set forth facts implying actual control, defendants' motion to dismiss can be successful.

Next, the Vice Chancellor set out the two "pathways" a plaintiff can follow to successfully plead that a minority blockholder is in control: it either "(1) actually dominated and controlled the corporation, its board or the deciding committee with respect to the challenged transaction; or (2) . . . the majority of the board generally." The Vice Chancellor rejected plaintiffs' attempt to pursue either of these pathways.

#### 1. Brookfield Did Not Control the Committee's Deliberations

Vice Chancellor Slights considered a number of factors in rejecting this prong of plaintiff's contentions:

- Plaintiffs' argument that two Committee members lacked independence from Brookfield belied the principle that "the lack of independence of two of the five Committee members cannot transform Brookfield from minority blockholder to controlling stockholder."
- Further, the fact that certain Rouse directors were appointed by Brookfield "is insufficient to call into question the independence of that director."

- Plaintiffs' arguments that the Committee created a "tilted playing field" favoring Brookfield in the sales process are "weak":
    - "The Committee, established at the very outset of the negotiations with Brookfield, was comprised of non-Brookfield directors who were charged with 'all of the Board's power and authority with respect to the [Brookfield] proposal and any alternatives thereto.'"
    - The "Committee was given 'sole discretion' to respond to Brookfield's offer as it saw fit, including the 'power and authority to evaluate, accept, reject and/or negotiate the proposal, explore and solicit other proposals and/or explore, evaluate and effect alternatives to the [Brookfield] proposal, and to cause [Rouse] to take any and all corporate and other actions, and/or enter into any agreements with [Brookfield] or third parties, and/or adopt any measures, in response to or in connection with the [Brookfield] proposal.'"
    - Consistent with its mandate, "the Committee negotiated hard with Brookfield . . . , rebuffed Brookfield's efforts to negotiate post-merger employment with [Rouse's CEO], pushed hard for and achieved a majority of the minority voting condition despite real resistance from Brookfield and negotiated a significant increase in the Merger consideration."
- Brookfield made no threats seeking "to undermine the Committee's authority."
- The financial and legal advisors retained by the Committee had "no disabling conflicts, and certainly none that would suggest that Brookfield exercised actual control over the Committee through the Committee's advisors."
- A retention plan approved by the Board for Rouse employees pending the outcome of the negotiations with Brookfield provided for payment "whether or not Rouse entered into the transaction with Brookfield."
- The "deal protections" in the merger agreement were "negotiated vigorously" with Brookfield, and did "not support a reasonable inference that Brookfield controlled the Committee."

- Rejecting plaintiffs' argument that Brookfield's presence in the bidding process, with its 33.5 percent stake, discouraged competing bids, the Vice Chancellor noted "if 'presence' alone were enough to infer that a minority blockholder was a controller, then that inference would follow every blockholder who sought to acquire the corporation . . . , even if he, in fact, did not otherwise attempt to influence the board or interfere with other potential bids. That is not our law."

2. Brookfield Did Not Control Rouse

Similarly, Vice Chancellor Slights listed a number of factors leading him to reject the notion that Brookfield controlled Rouse itself:

- "Brookfield's 33.5% ownership stake in Rouse is not impressive on its own," particularly in view of the facts that "Brookfield possessed no contractual right to appoint directors and could not unilaterally replace the Board" and "Rouse's charter allowed for removal of directors by stockholders '*only* for cause' and then *only* by a majority vote of all stockholders."
- The Board's establishment of the Committee "to address the fact that three of its members were interested in the Brookfield deal cannot be deemed evidence of Brookfield's control," but rather, "evidence of sound corporate governance."
- Similarly, "the Committee's insistence upon a 'majority of the minority' condition . . . reflects nothing more than persistent hard bargaining for the benefit of unaffiliated stockholders."
- Rouse's public disclosure that Brookfield "'may exert influence over us that may be adverse to our best interests and those of our stockholders' is a far cry from the outright admission that a minority blockholder was the corporation's 'controlling stockholder' that the [Chancery C]ourt deemed persuasive evidence of control" in an earlier decision.
- In contrast to an earlier decision in which a "40% blockholder [who] was the Chairman and CEO of the company, had a subordinate on the company's board and two family members in company executive positions, was, 'by admission, involved in all aspects of the company's business, [and] was the company's creator, and

> . . . inspirational force,' [and] . . . could, in his roles as CEO and 40% blockholder, wield 'his voting power . . . to elect a new slate [of directors] more to his liking without having to attract much, if any support from public stockholders in the event he became 'dissatisfied with the independent directors,'" was determined to be a controlling stockholder, the Rouse plaintiffs "failed to plead facts that allowed a reasonable inference that [Brookfield] exercised 'influence over even the ordinary managerial operations of the company,' much less actual control over a majority of the company's board."

### *B. Did the Stockholder Vote Satisfy Corwin?*

Having determined Brookfield did not control Rouse, Vice Chancellor Slights turned to the question whether the Rouse stockholder vote satisfied the two prongs of *Corwin*, that is, was the vote was *both* uncoerced *and* fully informed?

#### 1. Stockholder Vote Not Coerced

Plaintiffs alleged "the stockholder vote was coerced as a result of the timing of the Brookfield offer coupled with the Board's decision not to disclose favorable financials until after announcement of the Merger." The Vice Chancellor noted three varieties of coercion in the *Corwin* context: (1) *Inherent coercion* arising "in transactions involving conflicted controlling stockholders", (2) *Structural coercion* occurring "when the Board structures the vote in a manner that requires stockholders to base their decision on factors extraneous to the economic merits of the transaction at issue.", or (3) *Situational coercion* arising "where 'stockholders are being asked to tender shares [or vote] in ignorance or mistaken belief as to the value of the shares.'"

For two discussions of "coercion" in the *Corwin* context, see Robert S. Reder & Victoria L. Romvary, *Delaware Court Determines Corwin Not Available to "Cleanse" Alleged Director Misconduct Due to "Structurally Coercive" Stockholder Vote*, 71 VAND. L. REV. EN BANC 131 (2018); and Robert S. Reder, *Delaware Court Refuses to Invoke Corwin to "Cleanse" Alleged Director Misconduct Despite Stockholder Vote Approving Merger*, 70 VAND. L. REV. EN BANC 199 (2017)).

According to the Vice Chancellor, plaintiffs' contention concerning the timing of the transaction smacked of *situational coercion* in that, allegedly, "the Board (and Brookfield) knew that Rouse's trading price was temporarily depressed when the Brookfield proposal

came across the transom . . . and that the stock price would be lifted from the trough as soon as Q4 2015 financial results were released to the market." The Vice Chancellor quickly rejected this argument due to a fatal flaw: regardless of the timing of the offer and its announcement, Rouse stockholders received up-to-date financial results *almost four months before* the stockholder vote. On that basis, he concluded "no coercion here."

2. Stockholder Vote Fully Informed

Next, the Vice Chancellor discussed the standards for plaintiffs to establish that a vote was not fully informed under *Corwin*. Simply stated, "Delaware corporations are obliged to provide full and fair disclosure of 'all material information within the board's control.'" The key question is "whether 'there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote,' not whether the information at issue 'might be helpful.'"

Plaintiffs attacked four aspects of the disclosures made to Rouse stockholders in connection with their vote, all of which were rejected by the Vice Chancellor:

- With regard to financial projections given to the stockholders, "more than adequate financial data" was included "to enable stockholders to assess the value of their shares and the quality of the [financial advisor's] work."
- With regard to the financial advisor's fairness opinion, information alleged by plaintiffs to have been omitted "reflect the type of additional information that stockholders might find 'interesting,' but not the type of core information that would be material to their decision of whether to approve the Merger."
- Financial advisor conflicts of interest were adequately described to stockholders in the disclosure materials.
- Similarly, the retention plan adopted for employees pending the outcome of the discussions with Brookfield were adequately described to stockholders in the disclosure materials.

CONCLUSION

*Rouse* presents a useful roadmap for dealmakers and their advisors in structuring corporate acquisitions by large minority

blockholders, as well as the related disclosures that need to be made to the rest of the stockholders:

*First*, by contrasting aspects of Brookfield's relationship with Rouse to those of other minority blockholders previously determined by the Chancery Court to be in a control position, the Vice Chancellor made it clear that stock ownership alone is not a deciding factor. Rather, the abilities to make changes in the composition of the board of directors and to impact managerial decisions are much more important. And the target company board can favorably impact the court's determination by scrupulously avoiding a "tilting" of the playing field in favor of the minority blockholder.

*Second*, if a minority blockholder can avoid being characterized as a controlling stockholder, plaintiffs face a high bar when seeking to defeat application of *Corwin*. The Chancery Court will be reluctant to require additional disclosures where stockholders already have been given all material information. Further, allegations of coercion must be accompanied by a convincing showing that stockholders did not have a fair opportunity to consider the merits of the transaction at hand.