

CLIENT ALERT

## Delaware Chancery Court Reaffirms Difficulty of Escaping *Corwin* for Non-Controller Merger Challenges

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On March 9, 2018, the Delaware Chancery Court dismissed all claims brought on behalf of a putative class of stockholders of Rouse Properties, Inc., who had sought damages for alleged breaches of fiduciary duty arising out of Rouse's merger with Brookfield Asset Management, Inc.<sup>1</sup> Plaintiffs' theory was that Brookfield, a 33.5% stockholder in Rouse, was a *de facto* controlling stockholder, and the case should therefore be analyzed under the relatively more rigorous requirements of *MFW*,<sup>2</sup> rather than the more forgiving standard under *Corwin*.<sup>3</sup> In the alternative, plaintiffs contended that the *Corwin* cleansing mechanism was unavailable to defendants because material nondisclosures in the proxy statement rendered the stockholder vote approving the merger coerced and uninformed. In his 66-page decision, Vice Chancellor Joseph R. Slights III ruled that Brookfield was not a controlling stockholder, and that plaintiffs failed to adequately allege any material misrepresentation or establish that the vote of 82.44% of Rouse's unaffiliated shares to approve the transaction was coerced. Accordingly, the court held that the transaction was entitled to business judgment deference under *Corwin*. The decision is notable for its reaffirmation that, without credible allegations that a large blockholder interfered in the transaction approval process or had obvious day-to-day power over the target, claims premised on the blockholder's *de facto* control will be subject to dismissal at the pleadings stage.

<sup>1</sup> *In re Rouse Properties, Inc. Fiduciary Litigation*, C.A. No. 12194-VCS (March 9, 2018).

<sup>2</sup> *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).

<sup>3</sup> *In re KKR Fin. Hldgs. LLC S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014), *aff'd sub nom.*, *Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304 (Del. 2015).

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On January 16, 2016, Brookfield made an unsolicited proposal to acquire all outstanding Rouse common stock for \$17 per share. In response, a five-person special committee was formed, comprised of all Rouse board members except the three directors designated by Brookfield. Between the time the initial proposal was made and the execution of the merger agreement approximately six weeks later, the special committee engaged in extensive negotiations with Brookfield, pushing for and receiving a number of concessions—including a condition, initially rejected by Brookfield, that any transaction be subject to approval by a majority of Rouse’s non-Brookfield stockholders—and an increase in the merger consideration to \$18.25 per share. On June 23, 2016, 82.44% of Rouse’s unaffiliated shares voted in favor of the transaction and the deal closed shortly thereafter.

The court rejected plaintiffs’ claim that Brookfield, with 33.5% of the company’s stock, three out of eight board seats, and an ability to influence (but not control) the CEO’s compensation, was a *de facto* controller. Dealing first with the potential applicability of the *MFW* standard, the court held that, in order to support “the rare reasonable inference that a stockholder with less than 50% ownership is nevertheless a controlling stockholder,” a plaintiff must show that the purchaser “actually dominated and controlled” either 1) the challenged transaction, or 2) a majority of the board generally. The *Rouse* complaint failed to plead facts sufficient to support either theory.

Plaintiffs alleged that Brookfield dominated and controlled Rouse’s special committee because two of its five members may have been placed on the Rouse board by a Brookfield affiliate. These allegations were insufficient, the court concluded, because Delaware law is clear that a director’s independence is not compromised simply by virtue of being nominated to a board by an interested stockholder. Even if a lack of independence could be inferred for two of the special committee members, the court continued, that “cannot transform Brookfield from minority blockholder to controlling stockholder.” Plaintiffs still must plead facts that allow a reasonable inference that Brookfield “dominate[d] the corporate decision-making process,” which they failed to do here.

Plaintiffs also alleged that Brookfield controlled Rouse more generally, as evidenced by Brookfield’s significant ownership interest and the fact that Rouse saw the need to create the special committee in the first place. The court rejected this theory as well, noting that Brookfield’s 33.5% stake “is not impressive on its own,” and Brookfield “possessed no contractual right to appoint directors and could not unilaterally replace the board.” Thus, *Rouse* was “far removed” from other Delaware cases where “day-to-day managerial supremacy” demonstrated actual control by a non-majority stockholder. In addition, the court also rejected the somewhat backward logic of plaintiffs’ allegations with respect to the creation of the special committee, expressing approval for Rouse’s use of *MFW*-encouraged protections even in a non-majority deal. To hold otherwise, the court observed, “might discourage fiduciaries from employing these important measures for fear they might unwittingly signal that they perceive a minority blockholder with whom they are dealing to be a controller.”

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Given plaintiffs' failure to plead that Brookfield was a controlling stockholder, they could not avoid *Corwin* business judgment deference absent allegations that the stockholder approval vote was either coerced or uninformed. The complaint fell short on this score as well. With respect to coercion, the court noted that the complaint failed to allege coercion of any type:

- There was no "inherent coercion," as occurs in transactions involving controlling stockholders, because Brookfield was not a controller.
- "Structural coercion," which arises when a board improperly structures the vote so that stockholders are required to base their decision on factors beyond economic merit, was not alleged in the complaint.
- "Situational coercion" was also not a concern. Because the Rouse proxy statement included all relevant financial data, there was no basis to conclude that the stockholders' vote was based on ignorance or mistaken belief as to their shares' value.

Nor did the complaint adequately allege that the stockholder vote was uninformed. To satisfy that requirement, a plaintiff must demonstrate "a material deficiency" in the disclosure document; a failure to disclose information that merely "might be helpful" does not suffice. The *Rouse* plaintiffs alleged disclosure problems related to, among other items, financial projections and potential conflicts of interest. Vice Chancellor Slight determined that the disclosed financial data was "more than adequate," the proxy statement contained the precise conflict disclosure that plaintiffs claimed was missing, and, generally speaking, plaintiffs' disclosure demands amounted to "insignificant detail."

*Rouse* demonstrates that a non-majority blockholder that lacks company control and remains at an arm's length from the deal will not be considered a controller in post-merger challenges. The decision is also an important illustration of steps that a board can take to maintain the protections of *Corwin* in non-majority deals, and a strong reminder to potential plaintiffs that the pathways to successful post-merger litigation in Delaware Chancery Court continue to narrow.

If you have any questions about the *Rouse* decision or stockholder actions generally, please contact the following attorneys or the attorney with whom you regularly work.

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