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Interested directors may not extinguish breach of fiduciary duty claims through merger

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In 2014 two stockholders approached Riverstone alleging that certain officers and directors had breached their fiduciary duties by privately investing in what became a $7.5 billion property management business that the stockholders claimed was a corporate opportunity belonging to Riverstone. The stockholders filed a Section 220 action seeking to compel Riverstone to provide its books and records for inspection. However, on the same day Riverstone's board approved a merger with Greystar Real Estate Partners that extinguished the potential derivative stockholder claim and pursuant to which Greystar agreed not to otherwise pursue the corporate opportunity claim. In response, the stockholders filed a direct claim against the interested Riverstone directors alleging that the directors subject to the derivative suit breached their fiduciary duties in approving the merger, which resulted in an unfair price to the stockholders.

Vice Chancellor Glasscock found that the affected directors could not benefit from the protection of the business judgement rule and that the entire fairness standard applied as the complaint alleged that they derived a material personal financial benefit from the merger not shared with all stockholders – the extinguishment of potentially material derivative claims, which in turn could have brought additional value to Riverstone and therefore its stockholders in the merger. However, the vice chancellor was clear that "[e]ven in the merger context... the stockholders must plead facts that, if true, rebut business judgment and demonstrate a non-exculpated breach of duty", warning that the court should be wary of "conclusory allegations" without particularised facts such as those presented in the instant case. Specifically, the vice chancellor noted that the stockholders had pleaded such particularised facts, showing:

- the existence of a viable claim;
- that the directors were aware of the potential claim at the time of the merger;
- the claim as material to the directors; and
- that the directors were able to negotiate a transaction that extinguished the claim.

In addition, the court reinforced that even where the entire fairness review applies, to survive a motion to dismiss a plaintiff must initially state a claim that alleges some facts suggesting that the transaction in question was unfair, either in process or price – an allegation which, once sufficiently pleaded, must be rebutted by the defendant directors. In the case of the Riverstone stockholders, Glasscock determined that the stockholders sufficiently alleged that the price of the merger could be found to be unfair given the expected value of the derivative claim viewed against the total merger consideration paid to the stockholders.(1)

Consistent with other Delaware precedent, the decision confirms that the extinguishment of claims against directors may be viewed as a material benefit to directors in the transaction context.

For further information on this topic please contact Peter L Welsh at Ropes & Gray LLP's Boston office by telephone (+1 617 951 7000) or email (peter.welsh@ropesgray.com). Alternatively, contact Natalie Logan at Ropes & Gray's San Francisco office by telephone (+1 415 315 6300) or email (natalie.logan@ropesgray.com). The Ropes & Gray website can be accessed at www.ropesgray.com.

Endnotes

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(1) *In re Riverstone National Inc Stockholder Litigation*, Consol CA 9796-VCG (Del Ch July 28 2016).
