

# Who's the Boss? Minority Stockholders That Exercise Control

In two recent cases, the Delaware Court of Chancery provided informative guidance on when stockholders that hold less than 50% of a corporation's stock are nevertheless considered to be controlling stockholders. This inquiry is critical in the context of a takeover, as transactions with a controlling stockholder may be reviewed under the heightened "entire fairness" standard unless the corporation can demonstrate that it has satisfied the conditions laid out by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*, in which case the transaction will be reviewed under the less stringent "business judgment" standard.

## Background

*In re Rouse Properties, Inc. Fiduciary Litigation* involved a merger between Rouse Properties Inc., and Brookfield Asset Management, Inc., which held 33.5% of Rouse's outstanding shares. Rouse created a special committee composed of directors not affiliated with Brookfield, conducted a lengthy negotiating process with Brookfield (which resulted in an increased offer price) and obtained the approval of over 80% of non-Brookfield stockholders. Following closing, the transaction was challenged by plaintiffs claiming that, among other things, Brookfield was a controlling stockholder and breached the fiduciary duties it owed to the minority stockholders. The court held that Brookfield was not a controlling stockholder because it neither owned more than 50% of Rouse's voting power nor exercised actual control over the business affairs of Rouse. Relevant to this analysis was the fact that Brookfield had no power to elect directors, dissolve the corporation or sell all of its assets. The court also noted that the special committee diligently explored alternative proposals and negotiated firmly with Brookfield, ultimately obtaining not only a higher price but also a "majority of the minority" provision in the merger agreement to protect the Rouse stockholders' interests.

On the other hand, in *In re Tesla Motors, Inc. Stockholder Litigation*, in deciding a motion to dismiss (in which the court is required to accept the allegations of the plaintiffs as true), the court held that Elon Musk, the Chairman and CEO of Tesla Motors, Inc. *may* be a controlling stockholder in relation to Tesla's acquisition of SolarCity Corporation. At the time of the transaction, Mr. Musk held approximately 22% of the outstanding stock of both Tesla and SolarCity, respectively, and was serving in corporate leadership roles in both companies. In addition, according to the allegations of the plaintiffs, Tesla had announced its offer to acquire SolarCity only after several special board meetings where Mr. Musk had advocated for the acquisition. The Plaintiffs also claimed that in the period leading up to signing, Mr. Musk reached out to institutional investors to garner their support and published on Tesla's website his "Master Plan, Part Deux," which promoted the acquisition and revealed that it was being driven by Mr. Musk. Assuming the allegations of the plaintiff stockholders were true (which has not been established at this point), including the allegations that Mr. Musk both proposed the transaction and promoted it to the board, and that a majority of the directors that approved the transaction were beholden to him, the court found that it was "reasonably conceivable" that Mr. Musk controlled the Tesla board in connection with the acquisition. Thus, although not reaching a final determination on the matter, the court held that Mr. Musk *may* be considered a controlling stockholder, and therefore did not grant the defendants' motion to dismiss.

## Our View

With the two cases described above, the Delaware Court of Chancery is providing dealmakers with helpful guidance for successfully navigating potentially challenging situations involving transactions with large stockholders. The importance of creating an independent special committee and insulating the deal process from allegations of improper influence by large stockholders cannot be overstated. While stockholder litigation is a fact of life that will almost invariably need to be addressed in any transaction, we would be happy to discuss in greater detail these and other types of protective measures that can be taken during the transaction process to the benefit of all parties involved.



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