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Maryland Trial Court Dismisses Claims Against NHP Directors in Stock-for-Stock Merger with Ventas

In a sweeping ruling filed late last Friday, received Tuesday, Judge Stuart Berger of the Business and Technology Case Management Program of the Circuit Court for Baltimore City granted defendants' motion to dismiss and dismissed with prejudice the Consolidated Amended Complaint attacking the proposed 100% stock-for-stock merger of Nationwide Health Properties, Inc. with and into Ventas, Inc. *In re Nationwide Properties Shareholders Litigation*, No. 24-C-11-001476 (Md. Cir. Ct. May 27, 2011). The Complaint alleged the usual claims of unfair process/inadequate consideration, preclusive transaction-protection measures, misstatements and omissions in the registration statement and personal benefits for directors and officers and sought to enjoin the forthcoming shareholder vote, rescind the merger agreement and recover damages.

At the outset, Judge Berger reiterated that "facts comprising the cause of action must be pleaded with sufficient specificity," including, as required by Maryland Rule of Procedure 2-305, "a clear statement of the facts necessary to constitute a cause of action . . . ." For emphasis, he added: "Bald assertions and mere conclusory charges will not suffice." Referring to "cases where courts have observed a 'cookie-cutter'-like flavor to complaints filed in similar securities litigation," the Judge nevertheless said he would "resist the urge, however tempting, to comment on this apparent trend in securities litigation."

Plaintiffs' fundamental argument was that the Nationwide directors had *Revlon* duties to maximize the value of the transaction for the shareholders based on a decision of the Court of Appeals of Maryland, our highest state court, that directors of a Maryland corporation have common law duties of candor and value-maximization in a "cash-out merger transaction" in addition to their duties of good faith, reasonable belief and ordinary prudence under the Maryland General Corporation Law ("MGCL"). *Shenker v. Laureate Education, Inc.*, 411 Md. 317 (2009). Despite the fact that the Court of Appeals defined a "cash-out" merger synonymously with a "freeze-out" merger in which "the majority shareholder (or shareholders) of the target company seeks to gain ownership of the remaining shares of the target company," *id*. at 326, n.3, plaintiffs sought to impose value-maximization duties on the Nationwide directors, even though the merger was solely stock-for-stock – a position rejected over 20 years ago by the Supreme Court of Delaware in *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989). Judge Berger distinguished the Nationwide-Ventas transaction, where the "Nationwide shareholders will share in the ownership of the combined company and, therefore, in Ventas' future gains," from cash (including cash-out) mergers, where the target company's shareholders are left with no continuing interest in the combined enterprise.

Nevertheless, plaintiffs claimed that the merger, even though "all-stock," was a "change of control" because after the merger (a) Ventas shareholders will own approximately 65% of the combined company's shares and the former Nationwide shareholders only 35%; (b) former Nationwide directors will have only three of 13 seats on the Ventas Board; (c) Debra Cafaro, Ventas' chairman and CEO, will continue in the same capacity; (d) Ventas will be treated as the acquirer for accounting purposes; (e) Ventas will continue to maintain its corporate headquarters in Chicago; and (f) there would be a change of control for purposes of certain Nationwide employment agreements. Plaintiffs cited *Paramount Communications Inc. v. QVC Network Inc.* 637 A.2d 34 (Del. 1994), apparently as an example of a stock-for-stock merger involving a change of control; but that case involved an acquiror with a controlling shareholder and the consideration was not just stock but a combination of cash and stock. Judge Berger observed that there is no change of control where the stock of the combined company remains in the hands of a large, fluid, disaggregated market. After reviewing each of these facts, the Court found that they were not sufficient and dismissed the value-maximization claim.

Further, Judge Berger noted that, even if the directors had a value-maximization duty, "the governing standard" for it would be "reasonableness" under MGCL Section 2-405.1(a)(3). He specifically noted that the MGCL expressly disclaims any "higher duty or greater scrutiny, including under the common law," for actions of a director in an acquisition or potential acquisition of control. The Court concluded that plaintiffs "have failed to demonstrate that the Nationwide Board acted unreasonably . . . , i.e., [that the Board] failed to obtain the highest value reasonably available." Finally, the Court held: "Where the target company is presented with a choice – a firm, but lower, offer from one bidder and a higher, but speculative, offer from another bidder – the target company may justifiably take the lower offer." *In re Nationwide Properties Shareholders Litigation*, slip op. at 24.

Judge Berger next addressed the claims that the individual defendants had breached their duties to Nationwide's public shareholders by approving "a marginally beneficial merger transaction through an unfair process and for unfair consideration" and "by 'locking-up' the transaction and precluding Nationwide from considering potentially superior acquisition proposals from other companies." *Id.* at 25. After citing the statutory presumption of MGCL Section 2-405.1(e) in favor of any act of a director of a Maryland corporation, *id.* at 26, Judge Berger found no breach of the duty of loyalty, noting that "where directors are confronted with two rational courses of action, their choice of one that later turns out to have been less advantageous to the corporation than the other does not constitute a breach of good faith." *Id.* at 29-30.

The Court then turned to the claims of inadequate consideration under the duty of care, principally based on the Board's alleged termination of negotiations with another bidder, identified as Company A; but the other bidder "never presented the Board with a definitive offer," just a potential range of value for an all-stock merger. Thus, Judge Berger concluded: "Boards are justified in accepting a lower, but firm, offer over one that is higher but more speculative." *Id.* at 33. The Court noted numerous meetings with management, the assistance of a financial advisor and "extensive negotiations with three different companies."

Similarly, the Court found "wholly without merit" claims of unfair process arising out of four "standard" transaction-protection measures – a "no shop" provision, an "information rights" provision, a "matching rights" provision and a termination fee of 2.4% of the transaction value. *Id.* at 34-35.

The Court also dismissed the duty of candor claims, principally aimed at the work of Nationwide's investment banker, JPMorganChase, for failure "to state how any of the alleged omissions are material," declaring that "directors need not disclose everything under the sun," including "consistent and redundant facts," "insignificant details," "reasonable assumptions" and "speculative information." A "fair summary" of the banker's work is enough. *Id.* at 41.

Finally, Judge Berger rejected duty of candor claims seeking more information on "why" the Board decided to pursue a merger with Ventas rather than with Company A, noting that courts in Maryland and Delaware "have determined that such 'why' questions are generally not material." *Id.* at 44. Specifically, the Court found that "Defendants' 133-page preliminary Registration Statement contained more than adequate information concerning the Proposed Transaction" and that "the Board's reasons for discontinuing merger discussions with Company A are not material, and Plaintiffs' claims fail as a matter of law." *Id.* at 45.

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As always, my colleagues and I are available at any time to discuss these or other matters.

Jim Hanks