

Court Decision Helps REITs Strategize for Successful Acquisitions in the Face of Shareholder Litigation

Decision of note for REITs contemplating asset acquisitions involving stock consideration that requires stockholder approval, even if the transaction does not effect a change-in-control.

Background

Following the announcement of the sale of a public company, stockholders with minimal holdings now routinely file litigation seeking an injunction of the stockholder vote, in hopes that a company will bow to the pressure to settle, given the stakes. See *City Trading Fund v. Nye*, No. 651668, 2015 WL 93894 at 22 (observing the “ubiquity and multiplicity of merger lawsuits, colloquially known as a ‘merger tax,’” which are “filed only a relatively short time before the shareholder vote”). In recent years, this trend has expanded to other corporate acquisitions, even those that do not involve the sale or change-in-control of a public company, as long as the transaction requires a stockholder vote.

On December 8, 2014, Maryland REIT Hudson Pacific Properties, Inc. (Hudson) announced that it had entered into a US\$3.5 billion asset purchase agreement to acquire 26 office buildings and two development parcels from the Blackstone Group L.P. (Blackstone) in exchange for approximately US\$1.75 billion in cash and equity securities of the Company and its operating partnership subsidiary with an aggregate value of approximately US\$1.75 billion. The transaction required the approval of Hudson’s stockholders under New York Stock Exchange rules because the equity securities to be issued as consideration in the transaction exceeded 20 percent of the total Hudson common stock and operating partnership units outstanding at the time. In public filings describing the transaction, Hudson meticulously explained that the transaction would not give rise to a change-in-control, given the structure of the equity consideration. If approved, the acquisition would result in Blackstone’s owning only 9.8 percent of Hudson’s common stock; the remaining equity consideration to Blackstone would consist of limited partnership units with narrow voting rights. Hudson announced that a special meeting would be held on March 5, 2015, at which its stockholders could vote to approve or reject the transaction.

Hudson filed its Schedule 14A Preliminary Proxy Statement with the US Securities and Exchange Commission on December 22, 2014 and its Schedule 14A Definitive Proxy (the Proxy) on January 20, 2015. The Proxy included extensive disclosures about the complete terms of the purchase agreement, the board’s reasons for approving the transaction, and the fairness opinions of two independent financial advisors.

The Complaint

On January 22, 2015, plaintiff Fundamental Partners filed a putative class action in San Francisco Superior Court, naming as defendants Hudson, Hudson's directors, Blackstone, and a financial advisor. The complaint alleged that the directors' decision to enter into the purchase agreement constituted a breach of their fiduciary duties of care, good faith, and loyalty. Fundamental Partners further contended that Hudson and its directors omitted purportedly material information in the Proxy in violation of their fiduciary duty of disclosure, including information regarding the directors' alleged self-interest, purported conflicts among Hudson's financial advisors, and details relating to the financial advisors' fairness opinions.

The Plaintiff and Its Counsel

There are a few important facts about Fundamental Partners and its regular counsel that are helpful to understanding the full context of this case. In just the three years prior to this suit, Fundamental Partners brought at least four similar lawsuits in California and Maryland, all of which involved mergers and contained breach of fiduciary duty allegations.¹ Just two weeks prior to the filing of this lawsuit, the New York Supreme Court harshly criticized Fundamental Partners' counsel for "advanc[ing] meritless claims directed not at vindicating the rights of real shareholders but at maximizing the chance [the] litigation will settle [for] attorneys' fees that are wholly out of proportion to any real benefit conferred on shareholders." *City Trading Fund*, 2015 WL 93894 at *8-9; see also *id.* at *14 (noting that plaintiff and its counsel's "modus operandi" is to "purchase nominal amounts of shares in publicly traded companies" and "[t]hen, when one of the companies announces a merger [plaintiff and its counsel] file a merger tax lawsuit."). The litigation against Hudson and the other defendants was just such a case.

The Proceedings and The Court's Ruling

Shortly after filing this lawsuit, Fundamental Partners filed for a temporary restraining order, followed by a motion for preliminary injunction seeking — on an *ex parte* basis — to enjoin the stockholder vote. Fundamental Partners scheduled the *ex parte* hearing on its preliminary injunction motion for March 3, 2015, just two days before the scheduled stockholder vote. Although the court heard extensive argument on March 3, the hearing nevertheless carried over into the next day, which was less than 24 hours before the stockholder vote.

On March 4, having carefully considered the briefing and oral argument, the court denied Fundamental Partners' motion for preliminary injunction in its entirety on four independently sufficient grounds.

- First, the court held that Fundamental Partners improperly availed itself of *ex parte* procedures in bringing its motion, finding that Fundamental Partners should not have waited until two days before the stockholder vote to seek to have the matter heard on an expedited basis.
- Second, the court held that Fundamental Partners lacked standing to bring its claim as a stockholder class action because, under Maryland law, claims for breach of fiduciary duty must be brought derivatively on behalf of and in the name of the Company (with one narrow exception, which did not apply here).
- Third, the court held that Fundamental Partners failed to carry its burden on a motion for preliminary injunction because it failed to establish a substantial likelihood of prevailing on the merits of its underlying causes of action: Fundamental Partners failed to overcome the business judgment rule, failed to demonstrate how any of the alleged omissions were material, and failed

to show how any purported omission caused injury to Fundamental Partners or any other stockholder.

- Finally, the court concluded that the balance of harms did not weigh in Fundamental Partners' favor, because it would not suffer any irreparable injury absent a preliminary injunction.

Conclusion

This style of litigation — wherein a plaintiff stockholder with negligible stock holdings files suit and seeks an injunction shortly before the stockholder vote in order to extract a settlement that provides fees to the plaintiffs' attorneys but minimal or no value to stockholders — has become the norm following the announcement of mergers and acquisitions of public companies. Here, Fundamental Partners filed such a suit even though the underlying asset purchase agreement did not effect a sale of the Company or a change-in-control. Appreciating the fact that these cases are being filed regularly against REITs (and other public companies) in an effort to force a settlement, and understanding the substantive bases upon which the court relied in denying Fundamental Partners' injunction in this case, could prove helpful to other REITs that are considering a substantial acquisition involving equity consideration, even if the transaction does not result in a change-in-control.

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¹ See *Fundamental Partners v. Eggemeyer*, No. 3064252, 2014 WL 2157025 (Cal. Ct. App. May 23, 2014), *aff'd*, No. 201300029777 (Cal. Super. Ct. filed Jan. 14, 2013) (breach of fiduciary duty claim dismissed for lack of standing because it should have been brought as a derivative action); *Fundamental Partners v. Baker*, No. RG14733959 (Cal. Super. Ct. filed July 22, 2014) (alleging breach of fiduciary duty and failure to disclose); *Fundamental Partners v. Berg*, No. 1-12-CV-237054 (Cal. Super. Ct. filed Dec. 3, 2012) (same); *Fundamental Partners v. Weaver*, 24-C-14-003651 (Md. Cir. Ct. filed June 12, 2013) (same).