

[Securities Regulation Daily Wrap Up, FIDUCIARY DUTIES—Del. Ch.: Demand futility must be pleaded even for a part-direct claim, \(Oct. 11, 2016\)](#)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By [Anne Sherry, J.D.](#)

Even if a shareholder's claim that a REIT overpaid for assets was both direct and derivative, the shareholder was required to show why presuit demand was excused, the Delaware Court of Chancery held. The allegations created a reasonable doubt as to three directors' disinterestedness in the transactions because they were fiduciaries both of the REIT and the REIT's controller, but the complaint did not adequately plead facts showing that the controller's interest was material ([Chester County Employees' Retirement Fund v. New Residential Investment Corp.](#), October 7, 2016, Montgomery-Reeves, T.).

The New Residential Corp. stockholder alleged that the board, along with other entities, caused the REIT to overpay for the assets of Home Loan Servicing Solutions, Ltd., in order to advantage commonly owned real estate assets and maximize fees. The plaintiff also sought a declaratory judgment that certain limitations on fiduciary duties and liability in the New Residential management agreement were not valid defenses. This issue was not ripe for adjudication, the court determined, because the fiduciary duty claims had to be dismissed (with leave to replead).

The decision turned on the nature of the plaintiff's claim as direct or derivative under a *Tooley* (Del. 2004) analysis. Additionally, under *Gentile v. Rossette* (Del. 2006), a claim of corporate overpayment may be both direct and derivative when a stockholder that effectively controls a corporation causes it to issue "excessive" shares of stock in exchange for a lesser value of the controller's assets. For the claim to be dual-natured, the exchange must also cause an increase in the percentage of outstanding shares owned by the controlling shareholder, corresponding to a decrease in the share percentage owned by minority shareholders.

In *El Paso Pipeline* (Del. Ch. 2015), however, the chancery court explained that different considerations apply on a motion to dismiss for failure to make presuit demand on the board. In the court's view, Delaware law "can and should" treat a claim as derivative for purposes of the demand requirement, but as direct for purposes of determining whether sell-side investors can continue to pursue a claim post-merger. Assuming that the REIT shareholder claims are dual-natured, the court found that conducting a demand analysis for claims of overpayment "best harmonizes the case law."

Undertaking that analysis, the court held that the plaintiff did not sufficiently plead demand futility. The plaintiff did plead that at least half of the New Residential directors were beholden to the REIT's controller, Fortress. However, the complaint did not go far enough to establish that Fortress had a material interest in the challenged transactions. Although affiliated entities received options and fees in the transaction, the complaint did not allege materiality to Fortress, such as by alleging the percentage of Fortress's ownership of the recipients or the ratio of the alleged benefits to a Fortress financial metric. The complaint also failed to adequately allege how the New Residential directors were incentivized to overpay for the assets. The court dismissed these claims but recognized their potential viability and allowed leave to replead.

The case is [No. 11058-VCMR](#).

Attorneys: Michael Hanrahan (Prickett, Jones & Elliott, P.A.) and Mark A. Topaz (Kessler Topaz Meltzer & Check LLP) for Chester County Employees Retirement Fund. Robert S. Saunders (Skadden, Arps, Slate, Meagher & Flom LLP) and Scott D. Musoff (Skadden, Arps, Slate, Meagher & Flom LLP) for New Residential Investment Corp.

Companies: Chester County Employees Retirement Fund; New Residential Investment Corp.; Fortress Investment Group LLC; FIG LLC; Fortress Operating Entity I LP; Home Loan Servicing Solutions, Ltd.

LitigationEnforcement: CorporateGovernance DirectorsOfficers FiduciaryDuties MergersAcquisitions
DelawareNews