

*Hudson v. Prime Retail, Inc.*

In the class action *Hudson v. Prime Retail, Inc.*, 2004 WL 1982383 (Md. Cir. Ct.), the Plaintiffs opposed the cash-out merger of Prime Retail, Inc. (“Prime”), a Maryland corporation, into Prime Outlets Acquisition Group, LLC, a New Jersey limited liability company affiliated with The Lightstone Group, LLC (“Lightstone”). The Plaintiffs alleged that, with respect to the entire process undertaken to consummate the merger, the directors of Prime had breached the duties they owed to the corporation and its stockholders, and that Lightstone had aided and abetted those breaches.

Prime owned and operated several outlet centers. Due to financial distress, it had failed to pay dividends to its three classes of stockholders for a number of years. In attempts to rectify its situation, Prime began selling its outlet centers and exploring other methods of financial recovery. In order to evaluate Prime’s financial position and options, its board of directors appointed a special committee (the “Special Committee”) to evaluate offers. During the course of 2002, the Special Committee, and the financial advisors it engaged, sought out and evaluated a number of recovery options. Ultimately, the Special Committee pursued a buyout bid presented by Lightstone. Subsequently, the Special Committee and the various financial advisors held numerous meetings with preferred stockholders of Prime in order to determine how the proceeds of the merger would be allocated among the various classes of stock. Eventually, the directors and stockholders of each class of stock voted to approve the merger.

In bringing suit to prevent the merger and to challenge the allocation of merger proceeds, the Plaintiffs alleged that the director-defendants breached duties of good faith, loyalty and care which they owed to Prime and its stockholders. The Plaintiffs charged that the directors were not independent, were interested in the transactions they were considering and that they failed to disclose to the stockholders material information about the merger on which the stockholders were to vote.

Prior to reaching its decision on the merits, the Court undertook to provide a review of the duties imposed upon directors, and the standards by which courts review director actions. The Court articulated the duties of a director of a Maryland corporation, codified at Md. Code Ann., Corps. & Ass’ns. § 2-405.1(e) (Repl. Vol. 1999), and the business judgment rule, which creates a presumption that acts of directors satisfy these duties. The Court also defined directors’ duties of loyalty and disclosure, and detailed the procedure for informed stockholder ratification of interested director transactions. Using these clearly stated duties and standards imposed on directors in Maryland, the Court proceeded to analyze and dismiss each count of the Plaintiffs’ complaint.

The Plaintiffs’ first count alleged a breach of fiduciary duty by the defendants, arising out of improper negotiations of the merger by interested directors and diversion of money from stockholders to executives and advisors. The Court disagreed, holding that the Plaintiffs’ complaint lacked factual allegations sufficient to support a claim and that, even assuming what the Plaintiffs alleged was actionable, the informed stockholders’ vote in favor of the merger ratified the directors’ actions and insulated the directors from liability for those acts.

The second count was based on a theory that the directors had not offered a fair price to one class of shareholders because (1) the merger allocation was arrived at other than by a purely economic analysis; (2) conflicts among board members precluded their ability to independently exercise their judgment; (3) the directors had failed to obtain the highest value reasonably available for shares of that class; (4) the merger price included a wrongful diversion of consideration; and (5) the merger price was based on analyses of fair value inconsistent with applicable law. The Court dismissed this count by holding that (i) the proxy statements fully disclosed the basis for the allocations, the methodology of which was ratified by informed stockholder vote; (ii) there were no facts giving rise to a reasonable expectation that the independent judgment of the directors had been compromised; (iii) the directors had no duty to obtain the highest value reasonably available for the shares at issue, and that the methods used to obtain the price obtained were ratified by informed stockholder vote; and (iv) the economic valuation analyses performed were fully disclosed in proxy statements and ratified by an informed stockholder vote.

In Count three, the Plaintiffs alleged violations by the defendants of their duties of loyalty. With respect to the directors' duty of loyalty, the Plaintiffs claimed among other things that there were conflicts between the Special Committee and some of the directors, that the Special Committee failed to negotiate properly on price or allocations of merger proceeds among the various classes of stock and that the fee paid to one of the financial advisors to the Special Committee was excessive. The Court again disagreed with the Plaintiffs, noting the ample disclosures made by the directors in proxy statements as to the dialogues between the directors and the Special Committee regarding the allocations, and highlighting that all of the facts supporting the allegations made by the Plaintiffs had been ratified by an informed stockholder vote.

Finally, the Court held that the directors' alleged breach of the duty of disclosure similarly failed. The Plaintiffs claimed that neither the purchase of Prime shares from one shareholder prior to the merger, nor the fact that the purchase price paid in that transaction exceeded the value allocated to shares of that same class after the merger, had been disclosed. The Plaintiffs further claimed that the role of one of the directors in the allocation negotiations went undisclosed. The Court dismissed the allegations of this count, holding that it was not improper for a shareholder to have received a higher price for his or her shares in an independent transaction prior to the merger. The Court further held that the Plaintiffs' complaint lacked sufficient facts to demonstrate that the directors knew about or had control over the sale of shares prior to the merger, or that the director allegedly involved in the allocation determination had a role other than as fully disclosed in the proxy statements. Finally, because all of the underlying counts of the Plaintiffs' complaint failed, the Court also dismissed the aiding and abetting claim against Lightstone.

This case is a good example of a Maryland court applying the business judgment rule in the context of a merger.