IN THE CIRCUIT COURT FOR MONTGOMERY COUNTY, MARYLAND

Walter Penchuk, Individually and On Behalf of All Others Similarly Situated,	)	
Plaintiff,	)	Case No. 449557V
v.	)	
Kevin E. Grant, *et al.*	)	
Defendants.	)	

MEMORANDUM OPINION AND ORDER

This purported class action arises out of a "mixed consideration" stock-and-cash merger between CYS Investments, Inc. ("CYS") and Two Harbors Corporation ("Two Harbors"), both publicly-traded Maryland corporations. The merger is now complete, having been approved by 57% of CYS's common stock owners in a July 27, 2018 vote. Here, Plaintiff Walter Penchuk, an owner of CYS common stock, claims that the eight members of CYS's board of directors breached their fiduciary duties by recommending the merger, with the result that CYS's common stockholders received inadequate consideration for their shares. Plaintiff also seeks a declaration that CYS's October 23, 2017 bylaw amendment regarding venue selection is unenforceable.

On October 30, 2018, this matter was before the Court for hearing on Defendants' Motion to Dismiss (DE 16). Having considered the Motion, together with Plaintiff's Opposition (DE 25), Defendants' Reply (DE 28), all of the supporting memoranda and exhibits, and the arguments of counsel, the Court will DENY the Motion to the extent that Defendants seek dismissal or transfer for improper venue and GRANT the Motion to the extent that Defendants seek dismissal for failure to state a claim. The Court's reasons are set forth below.

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

The following facts (as well as those set forth below in "Plaintiff's Allegations") are as alleged in Plaintiff's Second Amended Complaint, and as stated in the June 25, 2018 Joint Proxy Statement/Prospectus and the July 17, 2018 Form 8Ks from CYS and Two Harbors. *See* Exhibits 1, 6, and 8 (respectively) to Defendants' Motion.[1]

CYS invests in residential mortgage pass-through certificates for which the principal and interest payments are guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal National Mortgage Association ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"), collectively "Agency RMBS." Sec. Am. Comp. at ¶ 41. Two Harbors Corporation ("Two Harbors"), also a publicly-traded Maryland corporation, focuses on investing in, financing, and managing Agency RMBS and other financial assets. Two Harbors operates as a Real Estate Investment Trust ("REIT") and is externally managed. *Id.* at ¶ 43.

On June 14, 2018, after the proposed merger was announced to the press but before it closed, Plaintiff filed the instant class action against CYS and the eight members of CYS's Board of Directors. On June 25, 2018, CYS and Two Harbors filed a Definitive Joint Proxy Statement/Prospectus ("Joint Proxy"). The case then leap-frogged along, such that on July 13, 2018, Plaintiff filed an Amended Complaint, wherein he dropped CYS as a Defendant. On or

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[1] In his Second Amended Complaint, Plaintiff cites the Joint Proxy/Prospectus seven times. Sec. Am. Comp. at ¶¶ 42, 56, 58, 67 – 70 and refers to Defendants' "supplemental disclosures" of July 18, 2018 once. Sec. Am. Comp. at ¶14. Accordingly, and the assumption that Plaintiff meant the July *17,* 2018 Form 8Ks (no other exhibits are provided), the Joint Proxy/Prospectus and the July 17, 2018 Form 8Ks provided by CYS and Two Harbors are incorporated by reference in the Second Amended Complaint within the meaning of Rule 2-303(d). *See also Winshall v. Viacom Intern., Inc.* 76 A.3d 808, 818 (2013)("'A plaintiff may not reference certain documents outside the complaint and at the same time prevent the court from considering those documents' actual terms.'"(citing cases)).

about July 17, 2018, CYS supplemented the Proxy with two Form 8-Ks filed with the U.S. Securities and Exchange Commission. While denying that the Proxy was deficient, CYS represented that it was making the additional disclosures " . . . to avoid further expense and the nuisance created by the Lawsuits,[2] and in particular the request for preliminary injunctive relief. . ." *Id.* at ¶14 and Exhibits 6 and 8 to Defendant's Motion to Dismiss at 2 (both).

On or about July 31, 2018, at the recommendation of CYS's directors and the affirmative vote of 57% of CYS's unaffiliated common stockholders, CYS merged into Two Harbors Corporation, such that CYS became the wholly-owned subsidiary of Two Harbors. Each outstanding share of CYS common stock was converted into the right to receive 0.4680 shares of Two Harbors and cash of $0.0965, equating to an implied value of $7.35 per CYS share. *Id.* at ¶¶ 4 and 71.

On August 27, 2018, after the merger closed, Defendants filed the instant Motion to Dismiss. On October 5, 2018, Plaintiff filed a Second Amended Complaint, wherein he dropped one breach-of-fiduciary duty count and narrowed the other by limiting the alleged disclosure deficiencies to two: (1) that Defendants refused to disclose pro forma projections; and (2) that Defendants refused to disclose distributable cash flow projections, both of which projections " . . . were necessary for CYS's stockholders to cast fully informed votes on the Merger." *Id.* at ¶ 14. On October 5, 2018, Plaintiff also filed an Opposition to the pending Motion. On October 23, 2018, Defendants replied to Plaintiff's Opposition.

Defendants now wish the Court to treat their Motion to Dismiss as being directed to Plaintiff's Second Amended Complaint, even though the Motion was filed first. With their

[2] According to the Form 8-Ks, the instant case was one of six filed in various state and federal courts following the announcement of the merger.

Motion, Defendants contend that dismissal (or transfer) is warranted because the Circuit Court for Montgomery County is not one of the two exclusive venues that CYS designated in its October 23, 2017 bylaw amendment. In addition, Defendants argue that Plaintiff's allegations are insufficient as a matter of law because a majority of CYS's stockholders ratified the merger; because Defendants' decisions in assessing the fairness of the merger were protected by the business judgment rule.[3]

PLAINTIFF'S ALLEGATIONS

Prior to the merger, CYS's board consisted of Defendants Kevin E. Grant, who also served as CYS's CEO, Tanya S. Beder, Karen Hammond, Stephen P. Jonas, Raymond A. Redlingshafer, Jr., Dale A. Reiss, James A. Stern, and David A. Tyson. On February 13, 2018, the full board formed a Special Committee comprised of Stern as its chairman, Beder, and Hammond. Its purpose was to review, evaluate, and negotiate the terms and provisions of any transaction involving change of control of CYS, determine whether any such transaction was fair to, and in the best interests of, CYS stockholders, and make a recommendation to the full board to approve or disapprove any proposed transaction. Sec. Am. Comp. at ¶ 53.

From February, 2018 through April, 2018, the Special Committee held at least 15 telephonic meetings to discuss the sales process and proposals from interested parties. The other board members were not present. After receiving some indications of interest in February, 2018, the Special Committee requested that interested bidders submit revised indications of

[3] Defendants also contend that they are protected from suit by an exculpation clause in CYS's bylaws. The Court need not address this argument now because Plaintiff makes no allegation regarding the applicability (or not) of the exculpation clause. See *Frederick, et al. v. Corcoran, et al.*, Circuit Court for Montgomery County, Maryland Case No. 370685V, slip op. at 31 (Md. Cir. Ct. Aug 14, 2013).

interest by March 16, 2018. To this end, the Special Committee received five bids, including one from Two Harbors. After granting access to CYS's virtual data room to one bidder, and declining same to another who would not agree to CYS's "timeline and approach" rules for such access, the Special Committee narrowed their consideration to the Two Harbors bid and one from another company. On April 12, 2018, Two Harbors delivered a proposed merger agreement to the Special Committee, together with a proposal for an exclusivity period of at least a week prior to the anticipated signing date of April 24, 2018. *Id.* at ¶¶ 55-59.

Between April 12 and 25, 2018, telephonic meetings continued, at times between the Special Committee, the full board, and between representatives of Two Harbors and CYS. Thus, CYS' full board discussed projections prepared by CYS's management, and authorized the Special Committee to negotiate with Two Harbors about an exclusivity period. Two Harbors notified CYS that it wanted the transaction to be structured as taxable to CYS's stockholders, not non-taxable. On April 16, 2018, the Special Committee met telephonically with its counsel to discuss open issues in Two Harbors' draft merger agreement, including the tax treatment. The Special Committee offered a one-week exclusivity period if Two Harbors would appoint three CYS directors to its board. Two days later, the Special Committee agreed to two Two Harbors board seats for Special Committee members Stern and Hammond.[4] On April 25, 2018, the Special Committee agreed to structure the merger as taxable to CYS stockholders, and CYS' full board approved it. A definitive merger agreement was signed that day. *Id.* at ¶¶ 12, 60-65.

Under the Merger Agreement, Two Harbors would acquire CYS, and CYS stockholders would exchange their shares of common stock for newly-issued shares of Two Harbors common

[4] Two Harbors' Board of Directors would expand by two, and CYS directors Stern and Hammond would join it as independent directors. Sec. Am. Comp. at ¶¶ 45 and 65.

stock as well as aggregate cash consideration of $15,000,000. The number of Two Harbors shares to be issued would be based on an exchange ratio to be determined by dividing 96.75% of CYS's adjusted book value per share by 94.20% of Two Harbors' adjusted book value per share. The actual exchange ratio for the merger would be publicly announced at least five business days before the stockholder vote on the merger.[5]

With regard to other bidders, the Merger Agreement included a "no solicitation" provision that required CYS and the Defendants to cease any discussions or negotiations with others for superior proposals and not solicit or facilitate alternative proposals. The Merger Agreement also granted Two Harbors "matching rights," such that Two Harbors would have unfettered access to non-public information about any competing proposals CYS might receive from others and the right to amend Two Harbors' offer in the event CYS received a superior offer. CYS also agreed to pay Two Harbors a "termination fee" of $43.2 million in the event CYS elected to pursue a superior proposal. *Id.* at ¶¶ 48-50.

On June 25, 2018, Defendants disseminated the Joint Proxy to CYS stockowners to solicit them to vote in favor of the merger. According to Plaintiff, even after supplemental disclosures to the SEC, Defendants "refused to disclose two significant pieces of information that were necessary for [stock]holders to cast fully informed votes on the Merger: (i) the pro forma projections; and (ii) the distributable cash flow projections." *Id.* at ¶ 14. As to the latter, Plaintiff alleged that ". . . the Proxy failed to disclose the cash flow projections for either CYS or

[5] Plaintiff alleges that in the Merger Agreement, CYS stockowners were told that the implied value of the merger consideration they would receive was $7.79 of combined cash and stock per share of CYS common stock. *Id.* at ¶ 44. Plaintiff then alleges that in the press release about the merger, CYS and Two Harbors provided the $7.79 combined stock-and-cash consideration per share figure as an illustrative example based on March 31, 2018 adjusted book value per share. The press release makes clear that actual exchange ratio would be publicly announced five days before the vote. *Id.* at ¶ 45.

Two Harbors. These crucial financial metrics were specifically relied upon by both companies' financial advisors and must be disclosed." *Id.* at ¶ 68. As to the former, Plaintiff alleged that " . . . the Proxy wholly fails to disclose the Pro Forma Projections, despite the fact that they existed and were provided to and relied upon by both companies' financial advisors when rendering their respective fairness opinions." *Id.* at ¶ 69. The result, Plaintiff claims, is that CYS stockholders " . . . were not fully informed when they voted on the Merger." *Id.* at ¶ 71.[6]

On July 27, 2018, CYS held a special meeting of stockholders in Boston, Massachusetts. Of the 155,439,713 outstanding shares of common stock entitled to vote on the Merger, 89,265,178 voted in favor, or 57% of CYS's unaffiliated common shares. *Id.* at ¶ 71. When the merger closed on July 31, 2018, the actual exchange ratio was 0.4680 plus cash consideration of $0.0965 per share, equating to an implied value of $7.35 per CYS share of common stock. *Id.* at ¶ 44.

In general, Plaintiff alleges that the consideration for the merger was inadequate in light of CYS's strong historical performance and potential for significant future growth. *Id.* at ¶ 6, and that the implied value of the per-share consideration was considerably below CYS's 52-week trading high. *Id.* at ¶ 9. Plaintiff also alleged Defendants breached their fiduciary duties to CYS stockholders by delegating control cover the merger negotiations to a conflicted Special Committee, conflicted because two of its members sought to maintain seats on Two Harbors' board after the merger; by structuring the merger as a taxable transaction to CYS's common stockholders; by agreeing to onerous "deal protection" provisions in the merger agreement; by

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[6] CYS and Two Harbors disclosed their respective projected dividends per common share and projected Core Earnings Per Common Share. See Joint Proxy at 111-16; CYS Form 8_k at 6-7. Defendants point out that because CYS's and Two Harbor's financial advisors employed a dividend discount model, rather than a discounted cash flow analysis, the figures used were the only material figures. See Proxy at 92, 100, 109-110.

enacting a bylaw amendment that purports to limit venue; and by authorizing the filing of a materially incomplete Proxy Statement with the United States Securities and Exchange Commission. *Id.* at ¶¶ 10-15; 66.

The result, Plaintiff claims, for himself and the other members of the putative class, is that they did not receive adequate compensation for their shares. Based on these allegations, Plaintiff seek damages, rescission of the merger, and a variety of injunctive and declaratory relief, including that CYS' October 23, 2017 bylaw amendment is unenforceable.

VENUE

Defendants contend that venue in this court is improper because on October 23, 2017, CYS amended its bylaws to state that ". . . the Circuit Court for Baltimore City, Maryland, or, if that Court does not have jurisdiction, the United States District Court for the District of Maryland, Baltimore Division, shall be the sole and exclusive forum . . . " for claims of the kind asserted here. Defendants are incorrect.

Under Maryland law, a damages action against non-resident Defendants may be brought in any county in Maryland. Md. Cts. & Jud. Proc. § 6-202(11). Here, Plaintiff seeks damages (and other relief) against all Defendants; all are non-residents as they allegedly live in Waltham, Massachusetts. Sec. Am. Comp. at ¶¶ 30 and 77. Defendants have offered no evidence to suggest that Defendants actually reside in Maryland.

With regard to impact of CYS's bylaw amendment, a Maryland corporation may enact various bylaws as long as they are not inconsistent with Maryland law. Specifically, a Maryland corporation's "bylaws may contain any provision not inconsistent with law or the charter of the corporation for the regulation and management of the affairs of the corporation." See Md. Code

Ann., Corps. & Ass'ns § 2-110(a).[7] Moreover, since October 1, 2017, and as to "internal corporate claims," Maryland has allowed some limit on the *jurisdiction* for suit. Specifically, Section 2-113 of the MGCL provides

> (a) The charter or bylaws of a corporation with capital stock may not impose liability on a stockholder who is a party to an internal corporate claim for the attorney's fees or expenses of the corporation or any other party in connection with an internal corporate claim.
>
> (b)(1) Except as provided in paragraph (2) of this subsection, the charter or bylaws of a corporation may require, consistent with applicable jurisdictional requirements, that any internal corporate claim be brought only in courts sitting in one or more specified jurisdictions.
>
> (2)(i) This paragraph does not apply to a provision contained in the charter or bylaws of a corporation on October 1, 2017, unless and until the provision is altered or repealed by an amendment to the charter or bylaws of the corporation, as applicable.
>
> (ii) The charter or bylaws of a corporation may not prohibit bringing an internal corporate claim in the courts of this State or a federal court sitting in this State.

MGCL § 2-113.

But jurisdiction is not venue, and on plain reading, Section 2-113 does not address venue. Nowhere in the statute does the word "venue" appear.[8] Of course, Maryland has three venue

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[7] Hereinafter, Title 2 of the Corporations and Associations Article will be referred to as the Maryland General Corporation Law ("MGCL").

[8] Apparently, limitation of *venue* was not the rationale given by those who proposed Section 2-113. According to its legislative history, Section 2-113 was House Bill 744. Sponsored by Delegates Kramer and West, the bill was taken up by the House Economic Matters Committee. It was proposed to these delegates by the Maryland State Bar Association's ("MSBA") Section of Business Law, Committee on Corporation Law as part of a 2017 "MGCL Miscellaneous Provisions" bill intended to keep the MGCL current with nationwide trends. In written testimony explaining the need for Section 2-113(b) – (d), Chairman Carlson of the MSBA Committee said

> The new §2-113(b) – (d) expressly permits and provides rules for an existing, growing, and widely accepted practice of charters and bylaws imposing an "exclusive forum" requirement dictating where any lawsuits against a Maryland corporation must be brought. Patterned after a law enacted in 2015 in Delaware (and recognizing that

statutes in its Courts and Judicial Proceedings Article. *See* Md. Cts. & Jud. Proc. §§ 6-201 through 6-203. All three contain the word "venue." If Maryland's Legislature had intended that corporations be allowed to limit venue in their bylaws or charters, it would likely have put the word "venue" in the statute permitting same. Defendants' reliance on dictionary definitions and incidental appearances of the word "jurisdiction" in miscellaneous (but unrelated) Maryland opinions does not overcome this conclusion.

Equally unavailing is Defendants' citation to *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) and *Rihani v. Team Express Distrib., LLC*, 711 F. Supp. 2d 557, 559 (D. Md. 2010). Defendants cite these cases for the proposition that " . . . at common law, forum-selection bylaws are 'enforced just like any other forum selection clause.'" See Defendants' Motion at 8. But neither case says this. In *Boilermakers*, the forum selection bylaw at issue was authorized by the Delaware's General Corporation Law, not Delaware common law. *Id.* at 941. In *Rihani*, the venue-selection clause at issue appeared in an employment contract, not a bylaw. *Id.* at 561. Neither case says that a Maryland corporation may adopt bylaws that are plainly inconsistent with Maryland's statutory venue laws.

> companies like predictability and convenience in litigation), a Maryland corporation could require a disgruntled stockholder to sue in a particular court or courts, so long as a Maryland court is on the list. ***A corporation could require that all suits be filed in Maryland or, e.g., a NYC-based mutual fund, which is a Maryland corporation, might require that a lawsuit be brought only in either New York or Maryland. A Maryland corporation could not exclude Maryland courts from any such list.*** (See Bill File, HB 744).

Bill File, H.B. 744, Chapter 674 Maryland 2017 Session Laws, available from Maryland Legislative Services Library (emphasis added).

Ultimately, a defendant wishing to challenge venue under Rule 2-322(a)(2) has the burden of proof and " . . . must do more than merely raise 'a bare allegation that venue is improper, unsupported by affidavit or evidence.'" *Pacific Mortgage v. Horn*, 100 Md. App. 311, 322-23 (1994) (omitting citation). Here, Defendants have failed to demonstrate that CYS's October 23, 2017 bylaw amendment was effective to limit the venue choices ordinarily available to Plaintiff. Accordingly, venue here is proper.

THE SUFFICIENCY OF PLAINTIFF'S ALLEGATIONS

With a challenge to the sufficiency of plaintiff's complaint under Rule 2-322(b)(2), the court treats as true all well-pled allegations, and reviews them, together with all reasonable inferences from them, in a light most favorable to the plaintiff. Review is limited to the operative complaint, statements incorporated therein by reference, and any written instrument that is an exhibit to the complaint. Rule 2-303(d). Ultimately, "[t]he facts set forth in the complaint must be 'pleaded with sufficient specificity; bald assertions and conclusory statements by the pleader will not suffice.'" *Sutton v. FedFirst Financial Corp.*, 226 Md. App. 46, 74 (2015) (omitting citations).

STOCKHOLDER RATIFICATION AND THE BUSINESS JUDGMENT RULE

Under Maryland law, a director that acts "(1) [i]n good faith; (2) [i]n a manner [that he or she] reasonably believes to be in the best interests of the corporation; and (3) [w]ith the care that an ordinarily prudent person in a like position would use under similar circumstances[]" is immune from liability in "any action based on an act of the director." A director's acts are "presumed to be in accordance with [the above standards]." MGCL §§ 2-405.1(c), (e), and (g); Md. Cts. & Jud. Proc. § 5-417(b).

To overcome this presumption, known as the "business judgment rule," a plaintiff who challenges the validity of a board's actions must produce evidence sufficient to rebut the presumption. See *Wittman v. Crooke*, 120 Md. App. 369, 376 (1993). Thus, "'[i]f the corporate director's conduct is authorized, a showing must be made of fraud, self-dealing or unconscionable conduct to justify judicial review.'" *Id.* (omitting citation); *see also In re Nationwide Health Props, Inc.*, No. 24-C-11-001476, 2011 WL 10603183, at *13 (Md. Cir. Ct. May 27, 2011) (a plaintiff must plead specific facts alleging that directors "acted (1) fraudulently, (2) in self-interest, or (3) with gross negligence." (omitting citation)).

Even if a stockholder has a valid claim for breach of fiduciary duty arising from a proposed merger, Maryland has long recognized that such claims are extinguished when a majority of informed, disinterested stockholders nonetheless votes to ratify the proposed merger. *Wittman v. Crooke*, 120 Md. App. 369, 377 (1998) ("It is well-established that 'a [corporate] board of directors is not 'liable to [that corporation's] stockholders for acts ratified by them.'") (quoting *Coffman v. Maryland Publ'g Co.*, 167 Md. 275, 288 (1934)); *see also In re Apollo Residential Mortg., Inc. S'holder Litig.*, No. 24-C-16-002610, slip op. at 15 (Md. Cir. Ct. Aug. 14, 2017) (noting that "ratification by informed disinterested stockholders extinguishes claim for breach of duty of loyalty.")

Why this is so was recently explained by the Delaware Supreme Court in *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (2015). In *Corwin*, another post-closing damages suit, plaintiffs challenged a stock-for-stock merger between KKR & Co., LLP and KKR Financial Holdings LLC.[9] After concluding that KKR did not exercise the kind of control that would

[9] Noting that the case involved a merger between a limited partnership and a limited liability company, both of whose ownership interests were publicly traded, the court treated it as if it were a merger between two corporations governed by the Delaware General Corporation Law

invite scrutiny under the entire fairness standard, the Delaware Supreme Court held that " . . . the business judgment rule is invoked as the appropriate standard of review for a post-closing damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of disinterested stockholders." *Id.* at 305-06. Of course, " . . . the doctrine applies only to fully informed, uncoerced stockholder votes, and if troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked." *Id.* at 312.

In reaching this conclusion, the Delaware Supreme Court explained

> . . . when a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves. There are sound reasons for this policy. When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them. The reason for that is tied to the core rationale of the business judgment rule, which is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders). In circumstances, therefore, where the stockholders have had the voluntary choice to accept or reject a transaction, the business judgment rule standard of review is the presumptively correct one and best facilitates wealth creation through the corporate form.

Id. at 312-14. In *Corwin*, because " . . . all of the objective facts regarding the board's interests, KKR's interests, and the negotiation process, were fully disclosed," the business judgment rule protected the board's decisions. *Id.*

Here, Plaintiff contends that because he has identified two disclosure deficiencies in the Joint Proxy, his claim is sufficient notwithstanding the stockholders' approval of the merger.

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and related case law. The Court did so because that was the approach adopted by the parties themselves and the lower court. *Corwin*, 125 A.3d at 306, n.3.

Specifically, Plaintiff points to two Delaware Chancery Court opinions[10] and the word "full" in *Wittman* to argue that in order to invoke a ratification defense on a motion to dismiss, Defendants must demonstrate that the proxy statement made "full" (as opposed to "partial") disclosure to the shareholders. *See* Plaintiff's Opposition at 26. Plaintiff also argues that " . . . in order to bypass Defendants['] ratification argument at the motion to dismiss stage, it is important to note that Plaintiff need not establish that the information omitted from the Proxy was material as a matter of law; rather, at the pleading stage, Defendants must establish that the omitted information was immaterial as a matter of law." *See* Plaintiff's Opposition at 27. Plaintiff is incorrect.

With regard to the breadth of information that must be disclosed to stockholders before a merger, Delaware applies a materiality standard. This is the " . . . the standard of materiality used under the federal securities laws. Information is material 'if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.'" *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884, 899 (2016) (citing *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985)). Plaintiff even recognizes as much in a footnote. *See* Plaintiff's Opposition at 26, n.18.

Maryland applies the same standard. Thus, Maryland " . . . does not require that directors disclose all available information merely because investors might find it helpful. Rather, it is well-established that an omitted fact is considered material only if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available. Material

[10] These are *In re Celera Corp. S'holder Litig.*, No. 6304-VCP, 2012 Del. Ch. LEXIS 66 (Del. Ch. March 23, 2012) and *N.J. Carpenters Pension Fund v. infoGROUP, Inc.*, No. 5334-VCN, 2013 Del. Ch. LEXIS 43 (Del. Ch. Feb. 13, 2013).

facts include those which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities, such as any fact which might significantly affect the value of the corporation's stock." *In re Nationwide Health Props, Inc.*, No. 24-C-11-001476, 2011 WL 10603183, at *18 (Md. Cir. Ct. May 27, 2011) (omitting citations). In *Wittman*, nothing suggests that a different standard was at play. Presumably, the proxy statement stockholders got was subject to the same federal materiality requirements as above.

While a defendant may test the sufficiency of materiality allegations with a preliminary dismissal motion, and therein argue the plaintiff's identified disclosure deficiencies are immaterial, the possibility of such a motion, and defendant's role as the movant on it, do not relieve plaintiff of his initial obligation to make sufficient allegations. Indeed, Maryland requires plaintiffs to explain how omitted material would have significantly altered the total mix of information made available. *Nationwide*, *supra,* at 17-18. It is not enough for a plaintiff to provide unsupported conclusions and speculations that alleged disclosure deficiencies are material. *Id.* at 16 (citing *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1173 (Del. 2000)).

Measured against these pleading requirements, Plaintiff's Second Amended Complaint is insufficient as a matter of law. With regard to Defendants' behavior before the merger, while Plaintiff may take issue with the decisions Defendants reached about formation of the Special Committee, the number of board seats they would occupy post-merger, the tax treatment of the merger to CYS's common stock holders, the deal protection provisions, and CYS's bylaw amendment, Plaintiff does not claim that these decisions went undisclosed to CYS stockholders

before the July 27, 2018 vote.[11] With regard to the two items (the distributable cash flow projections for CYS and Two Harbors and the Pro Forma projections for the combined company post-merger) that were absent from the Joint Proxy and the Form 8K's,[12] while Plaintiff alleges

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[11] Nor could Plaintiff reasonably make such a claim given the breadth of disclosures in the Joint Proxy.

With regard to the need for, and the function and composition of the Special Committee, Defendants disclosed that, " . . . due to the possibility of conflicts of interest with [CYS CEO] Mr. Grant, should he be requested to continue employment Company C or another acquirer of CYS, the independent members of the CYS Board formed a special committee (the "CYS Special Committee") comprised of James A. Stern (designated by the CYS Board at the February 13, 2018 meeting as the chairman of the CYS Special Committee), Karen Hammond, and Tanya S. Beder." See Joint Proxy at 68. And, with regard to Defendants Stern and Hammond's continuing on as independent directors of Two Harbors post-merger, and being compensated for their service as same, Defendants disclosed that, " . . . [u]pon closing, each of James A. Stern and Karen Hammond, independent directors from the CYS Board, will be appointed to the Two Harbors Board and will be entitled to compensation pursuant to Two Harbors' independent director compensation program." See Joint Proxy at 26.

With regard to the tax consequences of the merger to CYS common stockholders, Defendants disclosed that, "[a]ssuming that the Merger is completed as currently contemplated, CYS and Two Harbors expect that the receipt of (i) cash and Two Harbors Common Stock in exchange for CYS Common Stock, . . . by U.S. stockholders pursuant to the Merger will be a taxable transaction for U.S. federal income tax purposes. Generally, for U.S. federal income tax purposes, U.S. stockholders of CYS Common Stock will recognize gain or loss as a result of the Merger measured by the difference between, if any, between (i) the sum of the fair market value of the Two Harbors Common Stock received and the amount of any cash received, and (ii) the stockholder's adjusted tax basis in its CYS Common Stock." See Joint Proxy at 31. A broader explanation of these and other tax consequences was included in Joint Proxy at pages 151-176.

With regard to the "deal protection" provisions, these were described in the Merger Agreement and Plan of Merger that was included with the Joint Proxy as Annex A.

With regard to CYS's October 23, 2017 bylaw amendment attempting to limit venue, Defendants included a copy of CYS's Amended and Restated Bylaws as Annex B-2 to the Joint Proxy. Article XIV appeared at page B-2-13.

[12] CYS and Two Harbors disclosed their respective projected dividends per common share and projected Core Earnings Per Common Share. *See* Proxy at 111-116 and Form 8-K (ex 6) at 6-7.

that "nothing is more valuable to shareholders." Sec. Am. Comp. at ¶ 68,[13] Plaintiff has not alleged how the disclosure of these items would have "significantly altered" the "total mix" of information that was available to reasonable CYS stockholders prior to their deciding how to vote on July 27, 2018. Without this explanation, in other words, Plaintiff's allegations are merely conclusory, speculative statements about materiality.

Ultimately, Plaintiff has provided no real basis for claiming that the July 27, 2018 vote was ineffective to extinguish any breaches of fiduciary duty that may have occasioned it. Nor has he put forth any reason for judicial second-guessing about the economic merits of this now-

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[13] As to distributable cash flow projections, Plaintiff alleged that

> 68. First, the Proxy failed to disclose the cash flow projections for either CYS or Two Harbors. These crucial financial metrics were specifically relied upon by both companies' financial advisors and must be disclosed. Indeed, perhaps nothing is more valuable to shareholders when valuing the fairness of a proposed merger that the cash flows of the companies involved. This is true whether the deal is a cash, stock, or mixed consideration transaction. Here, the Board has asked CYS stockholders to approve the Merger, pursuant to which the Merger Consideration will be composed of stock in Two Harbors.

Sec. Am. Comp. at ¶68. As to Pro Forma projections, Plaintiff alleged that

> 69. Second, the Proxy wholly fails to disclose the Pro Forma Projections, despite the fact that that they that they [sic] existed and were provided to and relied upon by both companies' financial advisors when rendering their respective fairness opinions. See Proxy at 92-101, 107. Pro Forma projections forecast the future financials for the combined company. CYS stockholders were being asked to vote on the Merger, which, if completed, would result in former CYS common stockholders only owning in the aggregate ***approximately 30%*** of the post-close, combined business. Accordingly, the Pro Forma Projections spoke squarely to the decision placed before shareholders – whether a smaller stake in the combined company was more or less valuable than larger stake in the stand-alone company.

Sec. Am. Comp. at ¶69 (emphasis in original).

complete merger. Plaintiff has amended his complaint twice, the second time after having had the benefit of Defendants' Motion. A fourth try is not appropriate.

ORDER

For the foregoing reasons, it is this 15th day of November, 2018, by the Circuit Court for Montgomery County, Maryland hereby

ORDERED, that Defendants' Motion to Dismiss (DE 16) is hereby GRANTED IN PART and DENIED IN PART as set forth below; and it is further

ORDERED, that to the extent that it seeks dismissal or transfer for improper venue, Defendants' Motion is hereby DENIED; and it is further

ORDERED, that to the extent that it seeks dismissal for failure to state a claim, Defendants' Motion is hereby GRANTED; and it is further

ORDERED, that Count I of Plaintiff's Second Amended Complaint is hereby DISMISSED WITH PREJUDICE; and it is further

ORDERED, that on November 26, 2018 at 2:30 pm, counsel for the parties shall appear telephonically for a status conference to determine whether the Amended Scheduling Order remains appropriate for the adjudication of Count II.

Anne K. Albright
Judge
Circuit Court for Montgomery County, Maryland