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Guzman v. Johnson, 137 Nev. Adv. Op. 13 (Mar. 25, 2021)

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BUSINESS JUDGMENT RULE: NRS 78.138(7) PRECLUDES *FOSTER V. ARATA*

Summary

This is an appeal on a dismissal of a shareholder complaint against individual directors of a corporation and its controlling stockholder for failure to state a claim as a result of not rebutting the business judgment rule. The question considered is whether NRS 78.138(7) supplants the “inherent fairness” standard adopted in *Foster v. Arata*.² The standard set in *Foster* requires a mere allegation that a director was an interested party in the transaction in order to rebut the business judgment rule as a matter of law and shift the burden to the director to prove the inherent fairness of the transaction. In contrast, NRS 78.138(7) requires that the party rebut the business judgment rule and demonstrate that the alleged breach involved intentional misconduct, fraud, or a knowing violation of the law.³ The Court restated its ruling in *Chur v. Eighth Judicial District Court*, that NRS 78.138(7) supplies “the *sole avenue* to hold directors and officers individually liable for damages arising from official conduct,”⁴ and further clarified that *Chur* and NRS 78.138 control on the present issue, abrogating *Foster* and *Shoen*⁵ to the extent that they conflict with the statute and *Chur*. In the instant case, the Court ruled that Guzman failed to rebut the business judgment rule and allege particularized facts demonstrating the requisite breach of fiduciary duty, affirming the district court’s dismissal of the complaint.

¹ Kelsey DeLozier.

² *Foster v. Arata*, 325 P.2d 759 (1958).

³ NEV. REV. STAT. § 78.138(7) (2020).

⁴ *Chur v. Eighth Judicial Dist. Court*, 458 P.3d 336, 340 (2020).

⁵ *Shoen v. SAC Holding Corp.*, 173 P.3d, 1171 (2006).

Background

In August of 2016, RLJ Entertainment, Inc. (RLJE) and respondent Digital entertainment Holdings, LLC (a subsidiary of respondent AMC Networks, Inc.) entered into an investment agreement in which AMC, through Digital, loaned RLJ \$65 million in return for the option of owning at least 50.1% of RLJ's outstanding common stock. The agreement also contained a "No Shop Provision" which prohibited RLJ from considering any other acquisition proposal and gave AMC the right to designate two directors to RLJ's board and, upon exercise of the warrants in full, the right to designate a majority of RLJE's board. Nearly two years later in February 2018, AMC sent RLJ a letter offering to purchase the aforementioned stock for \$4.25 per share, stated that it would not sell its stake in RLJ or be a part of any other process, and urged the board to form an independent special committee to review the proposal. RLJ then formed a special committee consisting of two of its directors, respondent Andor M. Laszlo and respondent Scott Royster (The Special Committee). The Special Committee asked RLJ's board for the authority to consider and solicit offers from third parties, which was denied after AMC expressed disfavor towards the request. Over the next 50 days, the Special Committee negotiated the merger, eventually settling with AMC on the price of \$6.25 per share for the outstanding common stock.

As of October 3, 2018, AMC owned about 51.9 percent of the outstanding stock and stated that it would vote all of its shares in favor of the merger. The merger proxy statement was mailed to stockholders approximately two days later and contained a contribution agreement between AMC and respondent Robert L. Johnson (chair of RLJ's board of directors). It also stated that the Special committee and its financial advisor deemed that the merger was fair and in the best interest of RLJ's stockholders. The merger was approved on October 31, 2018.

A day before the shareholder vote that approved the merger, Guzman filed a class action lawsuit against RLJ directors, AMC, and AMC's subsidiaries, alleging a breach of fiduciary duty. The directors and AMC moved to dismiss the complaint under NRCP 12(b)(5), arguing that Guzman failed to rebut the business judgment rule in NRS 78.138, but Guzman countered that she had done so under the standard set by *Foster* by arguing that the fiduciaries in the case were interested parties to the transaction and that the burden was, therefore, on the directors to show that they acted in good faith when negotiating and approving the merger. When asked to provide allegations to support the claim that the Special Committee was not disinterested in the transaction, Guzman responded saying, "they were at risk of being ousted and that's not a good footing," but admitted to the district court that she had no specific allegations implicating the Special Committee. The district court concluded that she failed to state adequate facts and the business judgment rule applied, dismissing the action against all directors and AMC with leave to amend.

Discussion

Standard of Review

The Court reviews de novo, the order granting a NRCP 12(b)(5) motion to dismiss. Under *Buzz Stew, LLC v. City of N. Las Vegas*, this decision is rigorously reviewed on appeal with facts alleged in the complaint presumed true and all inferences drawn in the complainant's favor.⁶ Dismissal of a complaint is only appropriate if it appears beyond a doubt that the plaintiff could not prove any set of facts, which, if true, would entitle them to relief; however, because Guzman alleged fraud in her claim, she must satisfy the heightened pleading requirement of NRCP 9(b), which requires that allegations of fraud must be pleaded with particularity.⁷ The Court also reviews

⁶ *Buzz Stew, LLC v. City of N. Las Vegas*, 181 P.3d 670, 672 (2008).

⁷ *See In re Amerco Derivative Litig.*, 252 P.3d 681, 700 (2011); *See also Nev. R. Civ. P. 9(b)*

legal conclusions de novo and does not look beyond a statute's language if the plain meaning is clear on its face.⁸

The Inherent Fairness Standard is Precluded by NRS 78.138

The Court first discussed whether Guzman met the requirements of NRS 78.138(7), finding that the inherent fairness standard as found in *Foster* is precluded by NRS 78.138, because the plain language of NRS 78.138(7) requires the plaintiff to both rebut the business judgment rule's presumption of good faith and show a breach of fiduciary duty involving intentional misconduct, fraud, or a knowing violation of the law. This, the Court says, follows the recent *Chur* decision which held that NRS 78.138(7) "provides the sole avenue to hold directors and officers individually liable for damages arising from official conduct."⁹ If the inherent fairness standard were used, it would contravene express provisions in NRS 78.138(7) and so the Court abrogates *Foster* and *Shoen*¹⁰ to the extent that they conflict with NRS 78.138(7) and *Chur*. Guzman's contention of a rebuttal of the business judgment rule through a mere allegation is, therefore, rejected and the Court proceeds to analyze whether Guzman's pleaded facts would fulfill the requirements set by NRS 78.138(7).

Guzman's claims for breach of fiduciary duty against the individual directors fail under NRS 78.138(7)

A claim for breach of fiduciary duty has three elements: (1) existence of a fiduciary duty, (2) breach of the duty, and (3) damages as a result of the breach.¹¹ The Court here found that because most of the directors were not on the Special Committee and, therefore, did not negotiate

⁸ *Zohar v. Zbiegien*, 334 P.3d 402, 405 (2014).

⁹ *Chur*, 458 P.3d at 340.

¹⁰ *Shoen v. SAC Holding Corp.*, 173 P.3d 1171 (2006).

¹¹ *See Guilfoyle v. Old Monmouth Stock Transfer Co.*, 335 P. 3d 190, 198 (2014); 121 AM. JUR. TRIALS 129 *Fiduciary Fraud* §2020.

or approve of the merger, Guzman failed to allege facts showing that those directors' interests affected the transaction and that they engaged in any intentional misconduct, fraud, or knowing violation of the law in regard to the merger.

Furthermore, Guzman alleged that Laszlo and Royster, the directors on the Special Committee, acted to protect themselves from being ousted from RLJ's board, improperly advised RLJ's long-term revenue projections downward, and chose not to include a "majority of the minority" provision in the merger. She also claimed that Royster's principal income stemmed from RLJ, that both directors had too few shares to be incentivized to negotiate to a higher price, that they were enriched more by serving on the Special Committee than they would have been by negotiating a higher sale price, and that both lacked the power to negotiate the sale. The Court found these claims to fall short of the standard required under NRCP 9(b) and NRS 78.138(7) in light of the fact that Laszlo and Royster had agreed to be removed from the board of directors as part of the merger agreement and had negotiated for a higher sales price. Most importantly, the Court held that Guzman's allegations didn't support her claim that the two were motivated by self-interest to sell the stock, particularly due to her admission that she based her interested-fiduciary argument solely on speculation that Laszlo and Royster were at risk of being ousted from the board.

The district court properly dismissed Guzman's claim against AMC

The Court analyzed the claims against AMC under the structure set by *Cohen v. Mirage Resorts, Inc.*, which provides that a dissenting shareholder who wishes to attack the validity of a merger or seek monetary damages based on improper actions during the merger must allege wrongful conduct that goes to the approval of the merger.¹² They may also, under *Cohen*, challenge

¹² *Cohen v. Mirage Resorts, Inc.*, 62 P.3d 720, 728 (2003).

the merger process where it was procedurally deficient or approved on materially incorrect information; it can further be alleged by a minority shareholder that a merger was accomplished through the wrongdoing of majority shareholders and the minority shareholder can attempt to hold the individuals liable for monetary damages under theories of breach of fiduciary duty or loyalty.¹³ The Court found that Guzman failed to allege particularized facts to demonstrate a lack of fair dealing or fair price, which it says are the primary methods in which a fraud-based challenge is made against the validity of a merger. The Court also found that AMC's behavior surrounding its status as a majority shareholder, statements on offers from other buyers, and ownership of RLJ's debt were contractual rights arising from the investment agreement, approved a great deal prior to the proposed merger, and that Guzman further failed to show how these rights were used to force a merger, or how AMC improperly influenced the decision to the minority shareholders' detriment. Guzman's claims regarding the agreement with Johnson were also found to fall short of alleging particularized facts demonstrating that AMC acted fraudulently or unlawfully.

Conclusion

The Court found that a shareholder seeking damages against individual directors and officers must follow NRS 78.138(7) and abrogates *Foster* and *Shoen* to the extent that they conflict with the statute and *Chur*. The Court also affirmed the district court's dismissal of Guzman's claims.

Concurrence in part and Dissent in part

Justice Pickering wrote an opinion concurring in part and dissenting in part. In her opinion, she states that she would affirm the dismissal of Guzman's claims against all individual directors

¹³ *Id.* at 727.

(except Johnson), but would only do so on the grounds of the failure of the complaint to include allegations sufficient to overcome exculpatory provisions in NRS 78.138 (7). In regard to Johnson, Justice Pickering argued that the NRS 78.138(7) analysis would not be the analysis applied to the controlling shareholder, AMC, or Robert Johnson. She said that while NRS 78.138(7) addresses the business judgment rule as applied to a corporation acting through its directors, absolving them of liability for damages for breaches of fiduciary duty not involving intentional misconduct, fraud, or a knowing violation of the law, it says nothing about the duties that a majority shareholder owes the minority shareholders. *Foster*, Justice Pickering says, still states the rule correctly, as NRS 78.138 only supersedes the rule in regard to directors. She also cites *Cohen*, which states that while a lack of fair price may involve claims similar to those regarding the timing or structure of a merger and claims that a price per share was undervalued, it can also include negligent conduct.¹⁴ Justice Pickering ended by concluding that the district court erred in dismissing Guzman's claims regarding AMC and Johnson, stating that while she agrees that a transaction such as this one could be structured to receive business judgment rather than entire- or inherent-fairness review, the merger proposal included none of the features justifying such deference besides the creation of a special committee, whose decisions were allegedly influenced adversely to the minority shareholders. Under an entire- or inherent-fairness standard, therefore, Guzman's claims against AMC and Johnson are sufficient to states claims upon which relief could be granted. Justice Pickering concurs on the dismissal based on NRS 78.138(7) of the RLJ directors, but otherwise dissents.

¹⁴ *Id.* at 727–28.