

Alleged Standstill Breaches Result in \$45 Million Settlement in Cornerstone Take Private Deal



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The Delaware Chancery Court recently approved a \$45 million settlement in connection with a take-private transaction involving the acquisition of Cornerstone Building Brands (Cornerstone) by its then-controlling stockholder, Clayton Dubilier & Rice (CD&R). The settlement ended a class action litigation commenced by former minority stockholders of Cornerstone that alleged breach of fiduciary duty and breach of contract claims against CD&R.

Prior to its acquisition of Cornerstone, CD&R already owned approximately 49% of Cornerstone's shares and controlled a majority of its board seats. CD&R was also subject to a stockholders agreement containing, according to the complaint, seven standstill restrictions until it no longer held at least 10% of the voting power of Cornerstone for six consecutive months. Two provisions were particularly significant. First, Section 3.3(a)(i) prohibited CD&R from "directly or indirectly... in any way acquir[ing], offer[ing] or propos[ing] to acquire... in any manner... Beneficial Ownership of any securities of [Cornerstone]." Second, Section 3.3(a)(ii) did not allow CD&R to make "any statement or proposal to the [Cornerstone] Board or any of [Cornerstone's] representatives or stockholders regarding" an acquisition, unless doing so would not reasonably be expected to require public disclosure.

According to the May 2022 proxy statement filed in connection with the transaction, CD&R expressed interest in acquiring the remaining outstanding shares of Cornerstone at a board meeting on September 21, 2021. The complaint alleged that these discussions occurred while the stockholders agreement was still in effect, triggering a series of events, including the formation of a Special Committee to evaluate the proposal and the appointment of Centerview as financial advisor to Cornerstone. According to the complaint, despite the ongoing discussions, the Special Committee did not consider waiving the standstill provisions until February 11, 2022, nearly five months after initial discussions began, at which time the Cornerstone Board approved the waiver. Two days later, CD&R made a formal offer to acquire all remaining shares of Cornerstone for \$24.65 per share. CD&R filed a Schedule 13D amendment the following day disclosing the offer.

On May 2, 2022, the Securities and Exchange Commission sent a comment letter requesting clarification as to why CD&R had not amended its Schedule 13D filings until February 2022, despite transaction-related discussions occurring as early as 2019 when CD&R first communicated a potential interest in a transaction to a Cornerstone director. CD&R responded, arguing all disclosure obligations were met. In a follow-up letter, the SEC stated it would be taking no further action. However, the SEC stated that CD&R had experienced a material change that should have triggered an amendment, and that CD&R's interest in a potential take-private transaction had existed since at least 2019. This SEC correspondence was not disclosed publicly until one month after the transaction closed.

Plaintiffs' counsel described the SEC's communications as nearly a "smoking gun" for pleading purposes, arguing that this omission rendered the proxy statement false or materially incomplete.

In the complaint, Cornerstone's minority stockholders claimed that the proxy statement mischaracterized the standstill restrictions and failed to disclose CD&R's violations of both contractual obligations and securities laws describing the SEC's communications as "pretty close to a pleading stage smoking gun", arguing that the omission of relevant facts and history rendered the proxy statement false or materially incomplete. The minority stockholders also argued that because the standstill provisions were ignored, sale discussions resulted in an undervalued purchase price. Vice Chancellor Laster also noted that CD&R and Cornerstone appeared to "stage" portions of the negotiation process and "curate" the record to obscure potential breaches and avoid documentation that could be damaging.

As a result of the settlement, the Chancery Court did not render an opinion on the case. However, the Cornerstone case underscores the importance of compliance with both contractual standstill restrictions and securities disclosure requirements. The Chancery Court's approval of a \$45 million settlement serves as a reminder that attempts to obscure or bypass governance obligations can lead to significant financial and legal consequences. A Delaware vice chancellor criticized early efforts by Cornerstone and CD&R to obscure the nature of the negotiations as "farcical" and highlighted what he described as deliberate attempts to get around the standstill agreement, factors that likely have influenced CD&R's decision to settle.