United States District Court

EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

ARNAUD VAN DER GRACHT DE ROMMERSWAEL, Derivatively on Behalf of RENT-A-CENTER, INC. Plaintiff	§	
V.	§	
MARK E. SPEESE, J.V. LENTELL, JEFFERY M. JACKSON, STEVEN L. PEPPER, MICHAEL J. GADE, LEONARD H. ROBERTS, RISHI GARG, ROBERT D. DAVIS, GUY J. CONSTANT, PAULA STERN, JPMORGAN CHASE BANK, N.A, and THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A. Defendants	§	**No. 4:17CV227** **Judge Mazzant/Judge Craven**
and	§	
RENT-A-CENTER, INC., a Delaware Corporation Nominal Defendant	§	

ORDER ADOPTING REPORT AND
RECOMMENDATION OF THE UNITED STATES MAGISTRATE JUDGE

Came on for consideration the report of the United States Magistrate Judge in this action, this matter having been referred to the United States Magistrate Judge pursuant to 28 U.S.C. § 636. On August 11, 2017, the Magistrate Judge issued a Report and Recommendation, recommending Defendants Motion to Dismiss Plaintiff's Second Amended Complaint (Doc. No. 29) be denied, with the part of the motion seeking dismissal of Plaintiff's POS claims for failure to demonstrate demand futility being denied without prejudice. Defendants filed objections to the Report and Recommendation, and Plaintiff filed a response to the objections. The Court conducts a *de novo*

review of the Magistrate Judge's findings and conclusions.

BACKGROUND

This is a direct and shareholder derivative action brought by Arnaud van der Gracht de Rommerswael ("Plaintiff") on behalf of nominal defendant Rent-A-Center, Inc. ("RAC" or the "Company") against Mark E. Speese, J.V. Lentell, Jeffery M. Jackson, Steven L Pepper, Michael J. Gade, Leonard H. Roberts, Rishi Garg, Robert D. Davis, Guy J. Constant, and Paula Stern ("Individual Defendants") for breach of fiduciary duty, waste of corporate assets, unjust enrichment, and declaratory judgment. The Individual Defendants are current and former officers and directors of RAC who allegedly "presided over the Company while its stock price has been decimated and its leadership forced to resign." Docket Entry # 30 at pg. 1. Individual Defendants, together with RAC, are referred to as "RAC Defendants."

The original complaint was filed on April 3, 2017. RAC Defendants filed a motion to dismiss on April 25. Rather than respond to the motion to dismiss his original complaint, Plaintiff amended his complaint twice, once on May 9 and again on May 19 (with leave of court) to address actions taken by RAC's Board of Directors following the filing of the initial complaint. The live complaint is Plaintiff's Verified Second Amended Stockholder Direct and Derivative Complaint for Breach of Fiduciary Duty, Waste of Corporate Assets, Unjust Enrichment, Aiding and Abetting, and Declaratory Judgment (the "SAC"). (Doc. No. 26).

The Court provides the following facts, as outlined in the Report and Recommendation. RAC is one of the largest rent-to-own operations in America. SAC, ¶ 1. RAC is managed by a board of directors (the "Board"). At the time Plaintiff filed suit, Defendants Pepper, Gade, Garg, Jackson, Lentell, Roberts, and Speese were members of the Board (the "Directors"). *Id*., ¶ 141. Defendant

Stern previously served as a member of the Board. *Id.*, ¶ 33. The Directors, along with Stern, are referred to collectively as the "Director Defendants." Defendants Davis and Constant are former executive officers of the Company, and together with the Director Defendants, are referred to as "Individual Defendants." Individual Defendants, together with RAC, are referred to as "RAC Defendants" or just "Defendants."

The SAC asserts seven causes of action, including five derivative counts and two direct counts.[1] The four derivative counts remaining include claims of breach of fiduciary duty, unjust enrichment, and waste of corporate assets against the Individual Defendants. The two direct causes of action are for declaratory judgment concerning the alleged illegal "Proxy Put" provisions and the alleged entrenching actions by the Board.

The allegations in Plaintiff's SAC relate to the following issues: (1) alleged acts for the purposes of entrenching Board members, including the Board's adoption of Proxy Put provisions in certain of the Company's financing agreements; (2) the Company's financial and management performance, particularly for the implementation of a new point-of-sale ("POS") system; (3) statements made and approved by the Individual Defendants regarding the Company's financial and management performance and the POS system; and (4) alleged corporate waste related to severance compensation paid to two former RAC executives. Specifically, the SAC alleges as follows.

[1] In one derivative count, Plaintiff alleged RAC's lenders—JPMorgan Chase Bank, N.A. ("JPMorgan") and The Bank of New York Mellon Trust Company, N.A. ("BNY Mellon")—were liable for aiding and abetting the Individual Defendants' breaches of fiduciary duty in connection with the Proxy Put provisions in the Company's debt agreements. On July 10, 2017, the undersigned dismissed Plaintiff's claims against JPMorgan and BNY Mellon without prejudice.

Proxy Put provisions in RAC's debt agreements

In August of 2015, Engaged Capital, LLC ("Engaged Capital"), an investor group with a significant stake in RAC, began engaging with RAC in an "attempt to determine how to improve the returns of the Company for the benefit of all stockholders." *Id.*, ¶ 9. On December 7, 2016, Engaged Capital sent RAC's Board a private letter, noting its concerns with the Company's governance and suggesting the Company "immediately explore all available strategic alternatives, including a potential sale of the Company." *Id.*, ¶¶ 9, 107.

Following discussions with the Board, on February 23, 2017, Engaged Capital sent a formal letter to RAC setting forth its initial five nominees for director positions for election to the Board at the 2017 Annual Meeting of Stockholders ("2017 Annual Meeting"). *Id.*, ¶¶ 9-10. Engaged Capital indicated it would withdraw two of the five nominees provided three of the Company's seven directors would be up for election at the 2017 Annual Meeting. *Id.*, ¶ 10. According to Plaintiff, the Board obstructed these efforts, almost immediately, by challenging the validity of Engaged Capital's nominations. *Id.*, ¶ 109.

Plaintiff alleges the steps Engaged Capital can take "are limited by the defensive measures put in place by the Board," particularly the "Proxy Put in place in its debt agreements." *Id.*, ¶ 85. The Company's financing includes a credit agreement negotiated with JPMorgan and an indenture agreement negotiated with BNY Mellon. *Id.,*¶ 86. According to Plaintiff, these agreements are significant because they contain provisions that are triggered under a "change of control," when a majority of the Board changes, referred to herein as the "Proxy Put" provisions. *Id.* A change of control can also occur under the Proxy Put provisions if new directors are not "continuing directors," as defined within these agreements. *Id.,* ¶ 87.

According to Plaintiff, if a change in control occurs, the Company faces serious harm. Specifically, a change in control would force the Company to purchase all of the outstanding notes at 101% of their original principal amount, plus accrued interest to the date of repurchase, and would allow JPMorgan to force the Company to pay the amount owed under the loan.[2] *Id.* RAC would not be able to pay these debts back, as it had only $95.4 million in cash and cash equivalents as of December 31, 2016. *Id.,* ¶ 90. According to Plaintiff, "this Proxy Put will hang over any election, impairing stockholders free exercise of their vote knowing that electing Engaged Capital's slate runs the risk of RAC having to immediately pay $750 million, without adequate means." *Id*., ¶ 11.

Plaintiff alleges the Proxy Put "is a defensive measure that interferes with the stockholder voting franchise without any compelling justification, and would embed structural power-related distinctions between groups of directors not found in the certificate of incorporation." *Id*., ¶ 92. Plaintiff alleges the Board members' agreement to the Proxy Put could only be done to entrench themselves "just in case such a situation as here arises," and the entrance into the Proxy Put was in breach of the Board's fiduciary duties. *Id*., ¶ 11. Plaintiff further alleges the adoption of the Proxy Put is inexcusable, asserting the members of the Board "were required to know that they were breaching their fiduciary duties in agreeing to the Proxy Put." *Id*., ¶ 93.

Despite warnings from Delaware courts starting in 2009 regarding the potentially "eviscerating" nature of the change of control penalties imposed by proxy put clauses, the senior notes were issued after these warnings, in November 2010 and March 2013, and the Board kept the Proxy Put in the credit agreement despite amendments in July 2011 and March 2014. *Id*., ¶¶ 93-94,

[2]At the time the complaint was filed, Rent-A-Center had $550 million worth of senior notes outstanding and a $186.7 million outstanding loan with JPMorgan. SAC, ¶ 86.

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