

Investment Banker to a Seller's Board Owes No Fiduciary Duties to the Seller's Shareholders, Seventh Circuit Rules

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Joyce v. Morgan Stanley & Co.

The U.S. Court of Appeals for the Seventh Circuit recently held that Morgan Stanley & Co., Inc. ("Morgan Stanley") did not owe any contractual or extra-contractual duty to the shareholders of 21st Century Telecom Group, Inc. ("21st Century" and its shareholders, the "Shareholders"). *Joyce v. Morgan Stanley & Co.*, No. 07-1992 (7th Cir. Aug. 19, 2008). The Seventh Circuit's holding relied in large part on specific language contained in Morgan Stanley's engagement letter and fairness opinion specifically disclaiming any such duties. The case revisits the precept that the fiduciary duties to stockholders rests with boards of directors and not with hired third-party advisors.

Background

21st Century and RCN Corporation ("RCN") entered into a merger agreement on December 12, 1999, under which RCN was to acquire 21st Century. Between the signing of the merger agreement and the effective date of the merger, the value of the RCN stock plummeted and the Shareholders received nearly worthless stock.

The Shareholders alleged that, even though Morgan Stanley was acting as the financial advisor to 21st Century, Morgan Stanley should have given advice to the Shareholders about how to minimize their exposure to a potential loss in value of the RCN stock. Morgan Stanley moved to dismiss the complaint based on the Shareholders' (1) alleged lack of standing, (2) failure to state a claim and (3) failure to sue within the statutory limitations period. The district court granted the motion to dismiss, and the Seventh Circuit affirmed the dismissal for failure to state a claim and failure to sue within the statutory limitations period.

Seventh Circuit Decision

In affirming the lower court's decision, the Seventh Circuit found that the Shareholders' relationship with Morgan Stanley did not possess the "special circumstances" necessary to give rise to an extra-contractual fiduciary duty. One such special circumstance is that the dominant party must "accept the trust of the other party before a court can find a fiduciary relationship." The engagement letter between Morgan Stanley and 21st Century made it clear that Morgan Stanley did not accept any such responsibility. Therefore, the court concluded, no such fiduciary duty toward the Shareholders ever arose. Specifically, the engagement letter stated that Morgan Stanley was working only for 21st Century. The Seventh Circuit cited the following language from the engagement letter: "Morgan Stanley will act under this letter agreement as an independent contractor *with duties solely to 21st Century.*" (Emphasis as added by the Seventh Circuit.)

In addition, Morgan Stanley's fairness opinion to the board of directors of 21st Century specifically disclaimed any duty to the Shareholders. The Seventh Circuit cited the following language from the fairness opinion: "It is understood that *this letter is for the information of the Board of Directors of the Company... Morgan Stanley expresses no opinion as to the relative valuations of each of the voting and non-voting 21st Century Common Stock.* In addition, *this opinion does not in any manner address the prices at which the RCN Common Stock will trade following announcement or consummation of the proposed Merger, and Morgan Stanley expresses no opinion or recommendation as to how the holders of the 21st Century Common Stock should vote at the shareholders' meetings held in connection with the Merger.*" (Emphasis as added by the Seventh Circuit.)

Based on the foregoing and the language contained in the engagement letter, the Seventh Circuit determined that "Morgan Stanley never owed any contractual nor extra-contractual duty to the Shareholders."

Impact of *Joyce*

Joyce serves as a welcome reminder that boards of directors, not hired third-party advisors, have fiduciary duties to their stockholders. Boards must carefully discharge these duties and can rely on the expertise of experts but cannot relinquish or transfer these important responsibilities to others. The provisions relied upon by the Seventh Circuit are generally found in standard investment banking engagement letters and fairness opinions. Investment banking firms may wish to carefully review such forms to confirm that similar language is included.

For the full text of this decision, see: [*Joyce v. Morgan Stanley*](#).