Fashion Apparel Law Blog

Posted at 2:15 PM on December 16, 2010 by Sheppard Mullin

Companies can Limit Exposure to Shareholder Litigation in Going Private Transactions

Shareholder lawsuits are practically inevitable in any going private transaction in today's economic climate and under the current securities regulatory regime. Two major apparel companies, Gymboree and J. Crew, have recently gone private in very high profile transactions that have not unexpectedly spawned multiple shareholder lawsuits. In connection with the proposed sale of J. Crew to Texas Pacific Group and Leonard Green & Partners, J. Crew shareholders have filed suits against the company's management and directors alleging breaches of fiduciary duties. Shareholders similarly sued Gymboree after its sale to Bain Capital Partners, alleging breach of fiduciary duties. All companies attempting to go private can expect to be served with complaints challenging the process of negotiating an offer and the price of the offer itself within days of announcing a transaction. However, there are several actions that companies can take when contemplating these types of transactions in order to limit exposure to this sort of costly litigation.

The first is that any serious takeover offer should be reported to the board of directors immediately to allow the board to set up an independent committee. The independent committee can properly evaluate the offer and eliminate or diminish any appearance of impropriety, especially if there are one or more interested directors involved in the negotiation process.

Second, clients should be advised to think strategically about the timing of sale negotiations. Negotiating buyout prices right before releasing quarterly results can be damaging to any negotiation. If the results are worse than expected, a buyer will justifiably lower the offer. If, on the other hand, results are better than expected, shareholders will complain that the company did not demand a higher price.

Finally, companies should be very careful about screening for conflicts related to buyouts. If it even appears that any director would benefit as an insider from a deal, especially if he or she was personally involved in negotiating that deal, shareholders may cry foul.

The same holds true for selecting financial advisors. When advisors are also creditors of a target company, and therefore have a significant stake in the fortunes of that company, shareholders will look at any offer with skepticism. In the same vein, shareholders will allege impropriety when a financial advisor has done work for both sides of a contemplated transaction. When choosing financial advisors, both sides of a going private transaction ought to screen for these types of prior relationships, knowing that shareholders will seize on any perceived conflict to challenge a deal.

Taking these precautionary steps when contemplating this type of transaction may help to avoid or at least somewhat limit exposure to costly and meritless shareholder lawsuits.