May 23, 2016

Delaware Supreme Court Clarifies Standards in Corporate Takeovers

On May 6, 2016, the Delaware Supreme Court upheld a merger between Zale Corporation ("Zales") and Signet Jewelers Limited ("Signet") when it affirmed a lower court's dismissal of a shareholder class action that sought to enjoin the merger, thereby allowing the merger to go forward.[1] In so ruling, the court gave some comfort to boards of directors and their financial advisors by clarifying the limits of liability when a corporate sale is approved by an informed majority of disinterested shareholders. In that situation, when a corporate change in control has been approved by a majority of informed, disinterested shareholders, Delaware courts will almost always dismiss claims seeking to avert the transaction.

Zales and Signet first entertained the possibility of a strategic acquisition in 2006. However, the idea went nowhere until October 2013, when the companies began to discuss the possibility more seriously. The board of Zales reviewed a number of strategic plans and consulted with Merrill Lynch along the way. Merrill Lynch presented Zales with various financial projections, and Zales' board ultimately voted in favor of the deal in February 2014, after Signet raised its offer to a price of $21 per share.

When the deal was announced, certain Zales shareholders voiced disagreement. Among the objections voiced, shareholders argued that members of the board were self-interested and that the agreed price was too low; they also argued that Merrill Lynch had misled Zales' board because it had advised Zales regarding the acquisition without disclosing previous, related work Merrill Lynch had done on behalf of Signet. When a class of shareholders filed suit, the plaintiffs alleged that Zales' board breached its fiduciary duty to the company when they accepted Signet's $21-per-share offer in 2014. They also accused Merrill Lynch of aiding and abetting that breach because Merrill Lynch did not timely disclose its potential conflict.[2]

Using the *Revlon* standard of enhanced scrutiny, the Chancery Court analyzed both sets of claims and dismissed the allegations against the board members, but denied Merrill Lynch's motion to dismiss. However, the very next day, the Delaware Supreme Court issued a separate opinion clarifying that the business judgment rule applies when an informed majority of disinterested shareholders approve a merger, not the *Revlon* standard applied by the Chancery Court. Merrill Lynch sought a reargument regarding the claim against it, and the Chancery Court granted the request. After reargument, the Chancery Court dismissed the claim against Merrill Lynch. The Chancery Court held that, applying the business judgment rule, gross negligence must be found in order to support a breach of the duty of care. And because the Chancery Court found no conceivable gross negligence by Zales' board of directors, no breach of care by Zales' directors could exist. Merrill Lynch thus could not have aided and abetted the directors' breach because no predicate breach existed.

Upon review, the Delaware Supreme Court affirmed the Chancery Court's dismissal of the shareholders' suit and, in so doing, clarified the potential ambiguity in the two Zales opinions regarding the appropriate standard of review involving mergers approved by informed, unbiased stockholders: "When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."

However, despite affirming the Chancery Court's opinion, the Delaware Supreme Court walked back the Chancery Court's analysis of the aiding and abetting claims against Merrill Lynch. While the claim against Merrill Lynch was ultimately dismissed, the Delaware Supreme Court indicated that there could exist a situation in which a financial advisor is liable for aiding and abetting a fiduciary duty breach, even if, as was the case with Zales, a board of directors is nevertheless protected from liability under corporate bylaws. As the Delaware Supreme Court wrote, "an advisor whose bad-faith actions cause its board clients to breach their situational fiduciary duties is liable for aiding and abetting." Even though individual directors might be shielded from liability, financial advisors can still face litigation when faced with their "own knowing disloyalty."

The Delaware Supreme Court's opinion therefore clarifies and reemphasizes the standard of review applicable in a corporate takeover context when a majority of informed, unbiased shareholders vote to approve the transaction. The court also clarified to an extent the possible scope of liability for financial advisors who engage in bad faith conduct when advising corporate clients regarding possible takeovers. This guidance will enable boards of directors and their advisors to better protect against obstructionist litigation by running thorough sales processes and seeking the informed approval of shareholders.

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[1] *Singh v. Attenborough*, No. 645 (Del. May 6, 2016).

[2] The plaintiffs asserted a third claim, alleging that Signet too had aided and abetted the board's breach of its fiduciary duty, but that claim was summarily dismissed without much discussion.