Published on *The National Law Review* https://natlawreview.com

Feeling Conflicted: Importance of Disclosing Potential Conflicts, Stockholder Vote and Business Judgment Rule

Article By:

Michael J. Maimone

Joseph C. Schoell

Shortly after the announcement of a merger (the Merger) between Zale Corporation (Zale) and Signet Jewelers Limited (Signet) on February 19, 2014, each of five plaintiffs (stockholders of Zale) filed a class action complaint to enjoin the Merger, which the Delaware Court of Chancery denied. Four months after consummation of the Merger, plaintiffs filed a consolidated second amended class action complaint seeking damages against the Zale directors for breaching their fiduciary duties of loyalty and care, and against Signet and Merrill Lynch, Pierce, Fenner & Smith (Merrill), financial advisor to Zale's board of directors, for aiding and abetting the breaches of fiduciary duties. In the complaint, plaintiffs alleged, among other things, that a presentation made by Merrill to Signet regarding the possible acquisition of Zale "created an unreasonable sale process" because the presentation (a) occurred prior to Merrill's engagement by Zale's board, and (b) was not disclosed to Zale's board until after the board approved Merger.

Soon thereafter, each group of defendants separately moved to dismiss the complaint based upon plaintiffs' failure to state a claim upon which relief could be granted. In its motion to dismiss, Merrill argued, among other things, that the presentation to Signet (a) was in the ordinary course of business, (b) created no conflict between Merrill and Zale's stockholders, (c) did not involve any of Zale's non-public information, and (d) was disclosed to Zale's board and stockholders before the Merger was consummated. Indeed, Merrill emphasized that, after disclosing the presentation to Zale's board and stockholders, the board did not rescind its approval of the Merger and Zale's stockholders approved the Merger, with 53.1% of the stockholders approving the Merger.

On October 1, 2015, the court granted the Zale directors' motion to dismiss and Signet's motion to dismiss, but denied Merrill's motion to dismiss, holding that plaintiffs adequately alleged that Merrill knowingly participated in (and, thus, aided and abetted) the Zale directors' breach of the duty of care.[1] In so holding, the court addressed whether the approval of the Merger by a majority of fully informed, disinterested stockholders had the effect of subjecting plaintiffs' claims to business judgment rule review (rather than an enhanced scrutiny review), which would insulate the Merger "from all attacks other than on the grounds of waste." In support of the motions to dismiss, each group of defendants relied upon *In re KKR Fin. Hldgs. S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014), *aff'd sub nom Corwin v. KKR Fin. Hldgs., LLC*, 125 A.3d 304 (Del. 2015), which defendants asserted

supports their argument that the business judgment rule standard of review applies to mergers "approved by a majority of the shares held by disinterested stockholders . . . in a vote that was fully informed." Plaintiffs responded that defendants' reliance upon *KKR* was in conflict with the decision of the Supreme Court in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), which plaintiffs asserted supports their argument that no cleansing effect should be given to a statutorily required stockholder vote (rather than a purely voluntary stockholder vote) and required continued use of enhanced scrutiny in reviewing the Merger.

At the time of the court's decision in *Zale*, the decision in *KKR* had been appealed, and a decision of the Delaware Supreme Court was pending. The court decided not to adopt defendants' application of the holding in *KKR* while the appeal was pending and held that, "[u]ntil the Supreme Court signals otherwise," the court should apply the decision in "*Gantler* as holding that an enhanced standard of review cannot be pared down to the business judgment rule as a result of a statutorily required stockholder vote, even one rendered by a fully informed, disinterested majority of stockholders." Based upon that application of *Gantler*, and because plaintiffs alleged facts in the Complaint that (a) Merrill failed to disclose the presentation to Signet to Zale's board prior to being engage by the board; (b) the Zale directors breached their duty of care by not taking further steps to discover or remedy any conflict that may have been created by the presentation to Signet; and (c) the breach of the duty of care (based upon the conduct of Merrill) conceivably damaged Zale's stockholders, the court concluded that, under an enhanced scrutiny review, plaintiffs "conceivably could prove their claim that Merrill . . . is liable for aiding and abetting a breach of the [Zale directors'] duty of care."

On October 2, 2015, the Delaware Supreme Court "signal[ed] otherwise" by affirming the decision in *KKR* and by holding that a fully informed vote of a majority of disinterested stockholders—either a statutorily-required vote or a purely voluntary vote—invokes business judgment rule review in cases in which enhanced scrutiny otherwise would apply.[2] On October 5, 2015, Merrill moved for reargument based upon the Supreme Court's decision in *KKR*, and on October 29, 2015, the court granted the motion for reargument and granted Merrill's motion to dismiss.[3] Specifically, based upon the Supreme Court's decision in *KKR*, the court held that it "misapprehended the law regarding the cleansing effect of a fully informed, statutorily required vote by a disinterested majority of stockholders in the circumstances of the *Zale* case." Indeed, the court emphasized that, based upon the language of the Supreme Court in *KKR*, if a court is reviewing the actions of directors during a merger process after the merger has been approved by a majority of disinterested stockholders in a fully informed vote, then the appropriate standard of review is the business judgment rule.

Moreover, the court noted that, under the business judgment rule standard of review, gross negligence is the appropriate standard in determining the existence of due care liability. Although plaintiffs adequately pled a breach of the duty of care under an enhanced scrutiny review, they failed to plead that the Zale directors acted with gross negligence by not taking further steps to discover or remedy any conflict that may have been created by Merrill's presentation to Signet. Plaintiffs, therefore, failed to plead a breach of the duty of care under a business judgment rule review and, absent such predicated fiduciary breach for Merrill to have aided and abetted, the court held that Merrill's motion to dismiss should be granted.

The granting of Merrill's motion to dismiss was appealed by plaintiffs. The appeal has been briefed and an argument currently has not been scheduled. Notwithstanding the pending appeal, the decisions in *Zale* offer directors and their advisors guidance with respect to addressing a conflict, a possible conflict, or facts that may perceived as a conflict. For example, to benefit from the protection afforded by the business judgment rule (which, as in *Zale*, may result in an action being dismissed), directors should be prepared to question potential advisors regarding conflicts, possible conflicts, and

facts that may be perceived as a conflict. The questions may include prior meetings with potential acquisition partners (like in *Zale*) or other relationships that ultimately may need to be disclosed to the stockholders during the approval process.

Likewise, whether or not the directors inquire, potential advisors should be prepared to disclose such information to directors. As reflected in the decisions in *Zale*, there is a significant benefit that may be realized by directors and their advisors by disclosing conflicts, possible conflicts, and facts that may be perceived as a conflict to stockholders if an action for damages is commenced against the directors and their advisors after consummation of a transaction.

---

[1] *See In re Zale Corp. S'holders Litig.*, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015).

[2] *See Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304 (Del. 2015).

[3] *See In re Zale Corp. S'holders Litig*., 2015 WL 65514128 (Del. Ch. Oct. 29, 2015).

National Law Review, Volume VI, Number 90

Source URL:https://natlawreview.com/article/feeling-conflicted-importance-disclosing-potential-conflicts-stockholder-vote-and