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Delaware Supreme Court Upholds Dismissal of Aiding and Abetting Claim against Financial Advisor Where Merger is Approved by Fully Informed, Disinterested Stockholder Vote

In *Singh* v. *Attenborough*, the Delaware Supreme Court upheld the dismissal of breach of fiduciary duty claims against directors of a target corporation and aiding and abetting claims against the target's financial advisor in connection with a merger that was approved by a fully informed, uncoerced vote of the corporation's disinterested stockholders and to which entire fairness review does not apply (*e.g.*, a merger without a controlling stockholder). In doing so, the Supreme Court clarified that, absent waste, the business judgment rule is invoked in these circumstances and that breach of fiduciary duty claims typically should be dismissed. The Supreme Court also emphasized the high standard required to plead scienter in order to allege an aiding and abetting claim against a financial advisor.

Background

In *In re Zale Corporation Stockholders Litigation*, the Delaware Court of Chancery considered, *inter alia*, stockholder plaintiffs' claims that the directors of a target corporation breached their fiduciary duties in connection with a sale process and that the target's financial advisor aided and abetted that breach by failing to disclose in a timely manner that it had previously sought to represent the acquirer in an acquisition of the target. The potential conflict was not disclosed to the board until the merger agreement was signed and the advisor had rendered a fairness opinion. After disclosure, the board deemed the conflict immaterial and disclosed it in the proxy to the target's stockholders who ultimately approved the merger. In evaluating whether the plaintiffs had adequately alleged that the directors had breached their fiduciary duties, the court applied the *Revlon* enhanced scrutiny standard of review despite the stockholder vote, which defendants argued should have invoked the business judgment rule. The court held that it was reasonably conceivable that the directors had breached their duties under *Revlon* in connection with their handling of the financial advisor's potential conflict, but that plaintiffs had only alleged facts sufficient to support a claim that the breach was of the duty of care, which was exculpated under the target's charter. The court also held that it was reasonably conceivable that the financial advisor "knowingly participated" in the directors' exculpated breaches of their duty of care because it allegedly delayed disclosure of the potential conflict to the board until after the merger agreement was signed. Accordingly, the court dismissed the claims against the directors, but denied the financial advisor's motion to dismiss ("*Zale I*").

Shortly after the court issued the *Zale I* opinion, the Delaware Supreme Court, in *Corwin* v. *KKR Financial Holdings LLC,* held that the fully informed, uncoerced vote of the disinterested stockholders of a target corporation invokes the business judgment standard of review in cases where *Revlon* otherwise would apply. After the financial advisor moved for reargument, the Court of Chancery, issued a new opinion ("*Zale II*") holding under *Corwin* that the stockholder vote invoked the business judgment rule standard of review and that *Revlon* did not apply. The court also considered whether the cleansing effect of the stockholder vote required plaintiffs to (1) state a claim for waste to rebut the business judgment presumption or (2) whether the plaintiffs could rebut the business judgment presumption as to the directors' duty of care by showing that it was reasonably conceivable that the director's actions were grossly negligent. The court held that once the stockholder vote shifted the standard of review to business judgment, the standard for finding a breach of the duty of care under the business judgment rule was gross negligence. The court determined that plaintiffs had not sufficiently pled facts to support a finding that the directors were grossly negligent. Because there was no predicate breach of fiduciary duty, the aiding and abetting claim against the financial advisor was dismissed. For more, click here.

Analysis

On appeal, the Delaware Supreme Court affirmed *Zale II*'s ruling that a fully informed, uncoerced vote of the disinterested stockholders invoked the business judgment rule standard of review and that the case should be dismissed. In doing so, the Supreme Court clarified the following points regarding the *Zale I* and *Zale II* opinions:

- *Absent waste, where a merger has been approved by a fully informed, uncoerced vote of the disinterested stockholders of the target corporation, dismissal should be the result* – The Supreme Court explained that "[a]bsent a stockholder vote and absent an exculpatory charter provision, the damages liability standard for an independent director or other disinterested fiduciary for breach of the duty of care is gross negligence," even in a change-of-control transaction. The Supreme Court further explained that "[w]hen the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result" because "stockholders would be unlikely to approve a transaction that is wasteful."

- *The scienter requirement of an aiding and abetting claim is defendant friendly, and allegations that a financial advisor belatedly disclosed a prior pitch to an acquirer, which the board determines to be immaterial and fully discloses in the proxy, are likely insufficient* – The Supreme Court expressly distanced itself from the holding in *Zale I* sustaining claims against the financial advisor. The Supreme Court was "skeptical that the supposed instance of knowing wrongdoing—the late disclosure of a business pitch that was then considered by the board, determined to be immaterial, and fully disclosed in the proxy—produced a rational basis to infer scienter." The Supreme Court explained that "Delaware has provided advisors with a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter and awards advisors an effective immunity from due-care liability." Only "an advisor whose bad-faith actions cause its board clients to breach their situational fiduciary duties . . . is liable for aiding and abetting." In this case, the court concluded that "nothing in [the] record [came] close to approaching [that] sort of behavior."

The Supreme Court's ruling is significant because it reiterates that Delaware courts will continue to dismiss cases challenging mergers approved by a fully informed, uncoerced vote of disinterested stockholders even where a plaintiff has alleged misconduct by a financial advisor, and suggests that, in the absence of persuasive allegations of egregious misconduct by a financial advisor, Delaware courts will not find scienter sufficient to support an aiding and abetting claim against a financial advisor.

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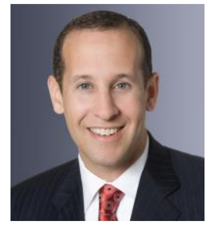

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