BUSINESS LAW TODAY

Delaware Insider:

Singh v. Attenborough: Delaware Supreme Court Slams Door Shut on Aiding and Abetting Claims against Board Advisors

By Myron T. Steele and Christopher N. Kelly

Since March 2014, when Vice Chancellor Laster issued a post-trial decision in *In re Rural Metro Corp.* finding an investment bank liable for having aided and abetted the breaches of fiduciary duty committed by the board of directors of Rural/Metro Corporation in connection with the company's sale, financial and other board advisors (including outside counsel) have been squarely in the cross hairs of entrepreneurial plaintiffs' lawyers litigating corporate governance claims. Following the vice chancellor's later decision finding the bank liable for more than $75 million in damages, and the Supreme Court's affirmance of those decisions, plaintiffs' lawyers were emboldened to pursue aiding and abetting claims against what they perceived as potentially deep-pocketed (and non-exculpated) defendants.

In a five-page order issued on May 6, 2016, in *Singh v. Attenborough*, the Supreme Court effectively foreclosed aiding and abetting claims against board advisors.

Singh v. Attenborough was an appeal from Court of Chancery decisions issued in October 2015 in *In re Zale Corp. Stockholders Litigation* dismissing claims brought by common stockholders of Zale Corporation against Zale's board of directors, Signet Jewelers Limited, and the financial advisor to Zale's board relating to Signet's $690 million purchase of Zale. The plaintiffs had contended, among other things, that the Zale board breached its fiduciary duties by failing to sufficiently inquire into its financial advisor's potential conflicts, which allegedly included having received $2 million in fees from Signet in the prior two years and having recently made a pitch to Signet regarding a potential acquisition of Zale, and that the financial advisor aided and abetted that breach by failing to disclose its earlier relationships with Signet until after the merger agreement had been signed.

On defense motions, former Vice Chancellor Parsons dismissed the plaintiffs' claims against the Zale directors, finding that a Section 102(b)(7) exculpatory charter provision protected the directors and that the plaintiffs had failed to plead adequately a breach of the duty of loyalty. Initially, the vice chancellor declined to dismiss the aiding and abetting claim against the financial advisor, finding that the Zale board conceivably may have breached its duties under *Revlon v. MacAndrews & Forbes Holdings, Inc.* by allegedly not having engaged in a more probing inquiry of the advisor's conflicts, and that the advisor conceivably may have knowingly participated in the Zale board's breach of fiduciary duty by allegedly having made a conscious decision not to disclose the earlier Signet pitch to the Zale board until after the merger agreement had been signed. On reargument, following the Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC* holding that a fully informed, uncoerced vote of disinterested stockholders invokes the business judgment rule, Vice Chancellor Parsons dismissed the plaintiffs' aiding and abetting claim against the financial advisor, finding that the plaintiffs had not adequately alleged a predicate breach of fiduciary duty because there were not sufficient facts in the complaint making it reasonably conceivable that the Zale board had been grossly negligent in failing to become informed of the bank's putative conflicts when engaging it as financial advisor.

On appeal, the Supreme Court, sitting *en banc*, affirmed. The court did so "solely on the basis of [the vice chancellor's] decision on reargument . . . , finding that a fully informed, uncoerced vote of the disinterested stockholders invoked the business judgment rule standard of review." The court noted that the vice chancellor's consideration post-closing "whether the plaintiffs stated a claim for the breach of the duty of care after invoking the business judgment

rule was erroneous." The court explained that the gross negligence standard employed by the vice chancellor was not sufficiently deferential given the stockholder vote, stating, in pertinent part:

> When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result. That is because the vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful.

The court also distanced itself from the vice chancellor's original decision in its handling of the aiding and abetting claim against the financial advisor, expressing skepticism that "the late disclosure of a business pitch that was then considered by the board, determined to be immaterial, and fully disclosed in the proxy" was sufficient for a court to reasonably infer scienter. The court explained that aiding and abetting requires "the second highest state of scienter—knowledge—in the model penal code," and that "[n]othing in this record comes close to approaching the sort of behavior at issue in [*Rural Metro*]."

The Supreme Court's ruling in *Singh v. Attenborough* establishes that the invocation of the business judgment rule following the fully informed, uncoerced approval of a merger by disinterested stockholders generally will necessitate dismissal of all claims relating to the merger—including aiding and abetting claims against board advisors. Though, in theory, a plaintiff still may attempt to attack as wasteful a merger that has been approved by a stockholder vote, practically speaking, it will be impossible to plead or prove that "no person of ordinary sound business judgment" could consider the challenged merger to be fair when it has been approved by a majority of disinterested and presumably rational stockholders. Because of the almost case-dispositive deference a court now must give to a transaction approved by a fully informed stockholder vote, it is important that the proxy statement disclose all material information, including information about any conflicts held by board advisors. Even if belated, so long as an advisor discloses its conflicts in time for the company to include them in the proxy, the board (and the advisor) can obtain the benefit of the business judgment rule following a fully informed stockholder vote and secure early dismissal of any stockholder claims relating to the transaction.

What is more—and importantly for post-closing cases where potential disclosure issues may have rendered the stockholder vote less than fully informed—the Supreme Court's ruling appears to have raised the burden for a plaintiff to establish scienter on the part of an alleged aider and abettor. By specifying that aiding and abetting liability only will be imposed upon a showing of "the second highest state of scienter—knowledge—in the model penal code," the court appears to have clarified language in its decision last year in *RBC Capital Markets, LLC v. Jervis*, wherein it appeared to suggest that "reckless indifference" would suffice. Because the Model Penal Code distinguishes "knowingly" from "recklessly," with the latter being a less culpable mental state, the Supreme Court now has made clear that reckless conduct will not render a board advisor susceptible to aiding and abetting liability. Further, by judging the financial advisor's alleged conduct in *Zale* against the conduct at issue in *Rural Metro* and finding that the former did not come close to raising a reasonable inference of scienter, the Supreme Court strongly indicated that aiding and abetting liability will be limited to extreme situations involving "fraud on the board."

In sum, by adopting the essentially case-dispositive waste standard for transactions approved by a fully informed, uncoerced stockholder vote, and by clarifying that only knowing conduct (and only knowing, disloyal conduct at that) can subject a board advisor to potential aiding and abetting liability, the Supreme Court in *Singh v. Attenborough* established defendant-friendly standards that should lead to early dismissal of aiding and abetting claims.

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