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Warnings Persist for Corporate Directors Evaluating LBO and Other Multi-Step Transactions

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I. Executive Summary.

As the year 2020 was coming to a close, District Judge Rakoff issued a decision in *In re Nine W. LBO Sec. Litig.*, No. 20 MD. 2941 (JSR), 2020 WL 7090277 (S.D.N.Y. Dec. 4, 2020) ("*Nine West*") that sent some shockwaves through the M&A community with respect to the future of corporate governance in the context of director duties relating to the sale of a plainly solvent company.

As the second quarter of 2021 comes to a close, the implications and potential for far-reaching consequences of Judge Rakoff's decision continues to draw fascinating intellectual debate amongst legal and financial advisors and corporate professionals alike, as reasonable minds differ as to whether Judge Rakoff's decision also marked a new beginning—as with much else in 2020—for directors in their execution of applicable state-mandated duties. Indeed, the *New York Times* recently published an article **[1]** discussing Judge Rakoff's decision and querying whether the private equity party that Wall Street has been embracing for years might be coming to an end as "[w]hat had for decades been considered a virtue—selling a company for a market-clearing price to the benefit of existing shareholders—might have become a vice."

While Judge Rakoff's decision was in the context of a motion to dismiss (which requires a court to draw all reasonable inferences in the plaintiff's favor) and the claims at issue against the JG Directors (as hereinafter defined) were subsequently settled among the parties, it nonetheless may have moved the needle as to the potential risk directors may face and the considerations they should be factoring when transacting to sell companies. **[2]** And—again, as with many things in 2020—industry professionals are questioning whether this development has saddled directors with new and moving boundaries and constituents, and in so doing added (perhaps materially) to their risk for no greater reward. While hindsight offers 20/20 perspective, are directors now charged with having a lens into the future, even—perhaps especially—over matters that fall under the purview of the acquiror's own subsequent post-transaction directors?

Prior to *Nine West*, it has been axiomatic that, when selling a solvent company, the directors are tasked with obtaining the highest price for the selling shareholders. What happens to the business in new hands has not been the concern of selling shareholders, and all the more so when sophisticated lenders are financing the acquisition and sophisticated investors are contributing new equity to the transaction.

But now: if something goes awry or differently than as may have been hoped at the time of the transaction, as is often the unfortunate case in corporate transactions, are former directors now effectively charged with being guarantors of the

company's future success under new directorship— lest they face liability? Is the state of the law now that if a corporate transaction goes south, the legal blame can be placed on the doorstep of the selling directors, as opposed to (or perhaps in addition to) the actions of the subsequent directors in the post-transaction period?

Said differently, once a solvent company changes ownership, why would the selling directors not be able to put the transaction, and future success or failure of the company, completely in their rear-view mirror absent fraud in connection with the sale?

Where the line—the new line—may ultimately get drawn in terms of the where, when, and to whom a director owes its duties remains to be seen, but, for now, *Nine West's* implications for director liability have many on high alert as to whether existing practices amongst directors requires reformation.

II. Factual Background.

On April 8, 2014, The Jones Group, Inc. ("*JG*"), a Pennsylvania corporation and at the time a publicly-traded footwear and apparel company (and the owner of a collection of brands including Nine West and Anne Klein), finalized its entry into a leveraged buyout transaction (the "*2014 Transaction*") with private equity sponsor Sycamore Group ("*Sycamore*"). **[3]** Although JG's financial performance was flat-to-down in the years leading up to the 2014 Transaction, two of its brands—the Stuart Weitzman and Kurt Geiger brands, which JG had acquired between 2010 and 2012 (together, the "*Carve-Out Businesses*")—had increased in value and were "substantially exceeding" projections. **[4]**

Previously, in July 2012, JG's board of directors (the "*JG Directors*") began evaluating a sale of the company and retained Citigroup Global Markets ("*Citigroup*") to act as its investment banker in connection therewith. **[5]** At the time, Citigroup advised the JG Board that the entire JG enterprise (including the Carve-Out Businesses) could support a maximum debt-to-EBITDA ratio of 5.1x. **[6]**

In April 2013, JG and Sycamore began negotiating the terms of a merger agreement (the "*Merger Agreement*", and the transaction contemplated thereunder, the "*Merger*") pursuant to which Sycamore would purchase JG for $15 per share, constituting an implied enterprise valuation of $2.15 billion for the company. **[7]**

The Merger Agreement was comprised of the following five "integrated" component transactions, which the parties understood would "occur substantially concurrently":

1. JG would merge with an affiliate of Sycamore; the surviving corporation would be renamed Nine West Holdings, Inc. ("*Nine West*" or the "*Company*");
2. Sycamore would contribute at least $385 million in new equity financing to Nine West;
3. Nine West would increase its total debt from $1.0 billion to $1.2 billion (the "*Additional Debt Transaction*");
4. JG shareholders would be cashed out at $15 per share (representing a total value of approximately $1.2 billion); and
5. post-closing, the Carve-Out Businesses would be sold to another Sycamore affiliate for "substantially less than fair market value" (the "*Carve-Out Transaction*"). **[8]**

Prior to the closing of the 2014 Transaction, Sycamore made two material changes to the deal terms reflected in the Merger Agreement. First, Sycamore reduced its equity contribution from $395 million to $120 million. Second, Sycamore increased the total amount of new debt being assumed by Nine West from $1.2 billion to $1.55 billion. As a result of these pre-closing adjustments, Nine West's pro forma debt-to-EBITDA ratio climbed to a range between 6.6x and 7.8x. **[9]**

In anticipation of the Carve-Out Transaction, Sycamore retained Duff & Phelps ("*D&P*") to issue a solvency opinion as to the Nine West enterprise that would remain following the Carve-Out Transaction (the remaining collection of Nine West brands and businesses, "*RemainCo*"). **[10]** Sycamore created "unreasonable and unjustified" financial projections for RemainCo and instructed D&P to use such projections for their solvency analysis. As a result, D&P concluded that RemainCo had a valuation of $1.58 billion; accordingly, D&P opined that RemainCo was solvent because its valuation ($1.58 billion) exceeded the $1.55 billion of debt being assumed by RemainCo in connection with the 2014 Transaction. **[11]**

The JG Directors unanimously approved the Merger Agreement on December 19, 2013. [12] Significantly, the suite of board approvals issued by the JG Directors in connection with their overall approval of the Merger Agreement purported ***to exclude*** the Additional Debt Transaction and the Carve-Out Transaction. [13]

The Merger closed on April 8, 2014, at which point the JG Directors were replaced with two Sycamore principals, who became the sole directors of Nine West (the "*Sycamore Directors*"). [14] Shortly thereafter, the Sycamore Directors caused the consummation of the Additional Debt Transaction and the Carve-Out Transaction. Pursuant to the Carve-Out Transaction, the Carve-Out Businesses were sold to a newly-formed Sycamore affiliate for $641 million. [15]

Four years later, in April 2018, Nine West filed for chapter 11 bankruptcy. [16] As part of Nine West's chapter 11 plan approved by the bankruptcy court in February 2019, the Nine West Litigation Trust (the "*Litigation Trust*") was established to pursue claims and causes of action arising out of the 2014 Transaction for the benefit of unsecured creditors. [17] Thereafter, the litigation trustee (the "*Trustee*") appointed to oversee the Litigation Trust brought an action asserting various claims against the JG Directors and certain of JG's officers arising out of the 2014 Transaction, including, *inter alia*, claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty. [18]

The JG Directors moved to dismiss the Trustee's claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty. [19] The JG Directors moved to dismiss the breach of fiduciary duty claims on two grounds: (i) first, their approval of the 2014 Transaction was protected by the business judgment rule (the "*BJR*"); and (ii) second, even if the court concluded that the BJR did not apply to their approval of the 2014 Transaction, the JG Directors were nonetheless protected from liability by certain exculpatory provisions contained in JG's corporate bylaws. [20]

As to the Trustee's claims for aiding and abetting breaches of fiduciary duty, the JG Directors similarly moved to dismiss such claims on two grounds. [21] First, the JG Directors argued that any actions taken by the Sycamore Directors before they became the sole directors of Nine West could not form the basis of an aiding and abetting claim vis-à-vis the JG Directors, because the fiduciary duties owed by the Sycamore Directors to Nine West did not attach until they assumed their roles as Nine West's new directors. Second, the JG Directors argued that the Trustee had failed to adequately plead that the JG Directors "knowingly participated" in the breaches of fiduciary duty committed by the Sycamore Directors. [22]

III. The S.D.N.Y.'s December 4, 2020 Ruling.

On December 4, 2020, District Judge Rakoff issued a decision denying the JG Directors' motion to dismiss with respect to the Trustee's claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty. [23]

A. Claims for Breaches of Fiduciary Duty by JG Directors.

The court ruled that the JG Directors "cannot take cover behind the business judgment rule" as applied under Pennsylvania law. [24] In reaching this conclusion, the court first observed that "a breach of fiduciary duty renders the business judgment rule inapplicable." [25]

The court noted that, pursuant to the applicable Pennsylvania statute, the BJR would apply to the approval of the 2014 Transaction by the JG directors "unless it is proven by clear and convincing evidence that the . . . directors did not assent to such act in good faith ***after reasonable investigation***." [26]

Accordingly, in order to overcome application of the BJR, the Trustee had to allege that the JG Directors did not approve the 2014 Transaction "in good faith after reasonable investigation." [27]

Ultimately, the court found that by failing to consider the Additional Debt Transaction and Carve-Out Transaction, the JG Directors did not conduct a "reasonable investigation" into the merits of the 2014 Transaction, as was required under applicable Pennsylvania law. [28] As a result, the court ruled that the BJR did not apply to the JG Directors' approval of the 2014 Transaction. [29] In this respect, the court agreed with the Trustee's argument that application of the BJR "presupposes that directors made a business judgment", and accordingly "does not protect directors with respect to matters they expressly do not consider." [30]

Notably, it was in this context that the court appeared to observe that the JG Directors had a duty to investigate whether the Additional Debt and Carve-Out Transactions—components of the overall 2014 Transaction that the JG Directors had

excluded, as noted above, from their overall approval process— "would render the Company insolvent." **[31]**

In addition, the court rejected the JG Directors' argument that they could not be liable for breaches of fiduciary duty committed in connection with the Additional Debt and Carve-Out Transactions, because these transactions were effectuated post-closing, ***after*** the Sycamore Directors had replaced them on the board of Nine West. **[32]**

On this issue, the court observed that multi-step transactions (such as the five component parts of the 2014 Transaction) can be treated as one integrated transaction where a plaintiff pleads (i) that the transaction "reasonably collapse[s] into a single integrated plan" and (ii) that the defendant had "foreseeability of the alleged harm" that would result. **[33]** The court concluded that the harm caused to Nine West as a result of the Additional Debt and Carve-Out Transactions was reasonably foreseeable from the point-of-view of the JG Directors, and accordingly the court elected to treat the 2014 Transaction as one single, integrated transaction.

B. Exculpatory Provisions in JG's corporate Bylaws Did Not Protect the JG Directors from their own "Reckless" Acts.

The JG Directors argued that even if the court were to determine that the BJR did not apply to their approval of the 2014 Transaction, they were nonetheless shielded from liability by an exculpatory provision contained in JG's corporate bylaws. **[34]** As background, JG's bylaws contained an exculpatory provision that—consistent with Pennsylvania corporate law—limited the JG Directors' liability to instances of "self-dealing, willful misconduct, or recklessness." **[35]** Accordingly, in order to find the JG Directors liable for breach of fiduciary duty, the court had to find that the Trustee's complaint sufficient alleged either recklessness or self-dealing. **[36]**

Ultimately, the court concluded that the JG Directors' approval of the 2014 Transaction—while at the same time purported to disclaim any oversight responsibility over the Additional Debt and Carve-Out Transactions—was "reckless" under Pennsylvania law. **[37]** The approval of the 2014 Transaction was "reckless", in the court's view, because the Trustee sufficiently alleged that the JG Directors "knew, or had reason to know, of facts that created a degree of risk that the 2014 Transaction would harm the Company, and that they deliberately acted or failed to act in disregard of that risk." **[38]**

In particular, the court noted the existence of certain "red flags" that should have put the JG Directors on notice that the Additional Debt and Carve-Out Transactions would ultimately render the company insolvent. **[39]** The first "red flag", according to the court, was the fact that the 2014 Transaction saddled RemainCo—which according to the court was worth no more than $1.4 billion—with $1.55 billion of debt. **[40]**

The second "red flag", in the court's view, was the fact that the $1.55 billion debt burden placed upon RemainCo as a result of Sycamore's pre-closing adjustments to the 2014 Transaction increased Nine West's pro forma debt-to-EBITDA ratio to between 6.6x and 7.8x. **[41]** This range—even at the low end of 6.6x—greatly exceeded the 5.1x debt-to EBITDA ratio that Citigroup had previously advised the Board was the maximum sustainable debt level for the company. **[42]**

Because the JG Directors "failed to make a reasonable investigation (or any investigation, for that matter) into the Additional Debt and Carve-Out Transactions even in the face of red flags suggesting the 2014 Transaction would render the Company insolvent," the court found that the JG Directors had behaved in a "reckless" manner such that they were not entitled to the protections of either the BJR or the exculpatory provision contained in JG's bylaws. **[43]**

The court summarized its conclusion as follows:

"In spite of these red flags, the Board did not make any inquiry into RemainCo's solvency; to the contrary, the Board expressly disclaimed any view of the Additional Debt and Carve-Out Transactions. This, the Court holds, was reckless." **[44]**

C. Claims Against JG Directors for Aiding and Abetting Breaches of Fiduciary Duty Committed by the Sycamore Directors.

The court similarly denied the JG Directors' motion to dismiss the Trustee's claims for aiding and abetting the fiduciary duty breaches committed by the Sycamore Directors. **[45]**

The court upheld the aiding-and-abetting claims for two principal reasons. First, the Court rejected the JG Directors' argument that they could not be liable for aiding and abetting the fiduciary duty breaches committed by the Sycamore Directors before the Sycamore Directors took control of the Nine West board. **[46]** The court described as "senseless" any purported requirement that "the aider and abettor's assistance must occur while the fiduciary duty exists." **[47]**

Second, the court dismissed the JG Directors' argument that they did not "knowingly participate" in the fiduciary duty breaches committed by the Sycamore Directors. **[48]** To the contrary, the court found that the Trustee had sufficiently pleaded that the JG Directors "had actual or constructive knowledge that [the Sycamore Directors] would carry out the contemplated [Additional Debt and Carve-Out Transactions] and that such actions would leave the Company insolvent." **[49]** Consequently, by approving the 2014 Transaction with the knowledge that, post-closing, the Sycamore Directors would execute the Additional Debt and Carve-Out Transactions—which would render the Company insolvent—the Trustee had adequately alleged a claim against the JG Directors for aiding and abetting the Sycamore Directors' breach of fiduciary duty. **[50]**

IV. Analysis / Implications of Nine West Decision.

A. Does *Nine West* impose conflicting fiduciary duties upon corporate directors?

In several instances throughout its decision, the *Nine West* court appeared to suggest that the JG Directors may have breached their fiduciary duties owed to the Company by failing to reasonably investigate whether the 2014 Transaction as a whole would be likely to render the Company insolvent, notwithstanding that at the time of the 2014 Transaction the JG Directors may have maximized value for the shareholders. *See, e.g.*, *Nine West*, 2020 WL 7090277 at *11 (finding that the JG Directors' failure to investigate whether the Additional Debt and Carve-Out Transactions would "render the Company insolvent" precluded application of the BJR); *id.* at *13 (finding that JG Directors had behaved "recklessly" by ignoring certain "red flags" that "should have put the [JG Directors] on notice that the Additional Debt and Carve-Out Transactions would leave the Company insolvent."); *id.* at *13 (explaining that these "red flags", combined with the knowledge that the 2014 Transaction would impose $1.55 billion of debt on an enterprise worth no more than $1.4 billion, "should have alerted the [JG Directors] that they needed to investigate RemainCo's solvency[.]"); *id.* at *13 (describing as "reckless" the decision of the JG Directors to "not make any inquiry into RemainCo's solvency"; also describing as "reckless" the JG Directors' attempts to "disclaim[] any view of the Additional Debt and Carve-Out Transactions.").

However, what has sparked debate in the corporate and legal community alike on this suggestion is how to reconcile the proposition that the *Nine West* directors may have breached their duties, with the well-developed body of caselaw from Delaware (the hotspot state for incorporations) supporting the proposition that, absent exceptional (or certain insolvent) circumstances, corporate directors do ***not*** owe fiduciary duties to creditors. **[51]**

Under Delaware law, it is well-settled that corporate directors "owe their fiduciary obligations to the corporation and its shareholders." **[52]** It is equally well-accepted that directors are free to pursue "value maximizing strategies" for the benefit of the corporation as well as its residual stakeholders—who, typically, are the shareholders of the corporation. **[53]**

Creditors of the corporation, on the other hand, "are afforded protection through contractual agreements" and general commercial law. **[54]** For this reason, Delaware courts have rejected the proposition that creditors are owed fiduciary duties (whether direct or derivative) when a corporation enters the so-called "zone of insolvency". **[55]** Nor does Delaware law recognize a cause of action based upon "deepening insolvency". **[56]** Under Delaware law, "[t]he only transition point that affects fiduciary duty analysis is insolvency itself." **[57]**

In other words, creditors of an insolvent corporation are owed fiduciary duties by the corporation's directors only insofar as such creditors "take the place of the shareholders as the residual beneficiaries of any increase in value" of the corporation. **[58]** And while it is true that Delaware law recognizes the right of creditors of an ***insolvent*** corporation to assert a derivative claim on behalf of the insolvent corporation **[59]**, the important caveat is that this right is ***derivative*** only. **[60]** Significantly, the Delaware Supreme Court has opined that regardless of whether a corporation is solvent, insolvent, or somewhere in between, the directors of the corporation remain "free to pursue value maximizing strategies". **[61]**

All of this begs the question: how can *Nine West's* admonition that directors have a fiduciary responsibility to reasonably investigate whether a transaction bearing their approval may result in the corporation's eventual insolvency be squared with the well-settled body of caselaw which holds that directors owe scant (if any) duties to a corporation's creditors?

B. Does *Nine West* create liability risk for former directors based upon subsequent actions taken by new, replacement directors?

The *Nine West* court determined that the JG Directors might be liable for aiding and abetting the breaches of fiduciary duty committed by the Sycamore Directors when, *post-closing,* the Sycamore Directors executed upon the Additional Debt and Carve-Out Transactions. **[62]** Critical to this ruling was the court's determination that the JG Directors had "actual or constructive knowledge" not only that the Sycamore Directors would effectuate these transactions, but also that these transactions, when executed, "would leave the Company insolvent." *Id.* at *14.

Commentators have questioned whether the imposition of liability upon former directors for actions taken by subsequent directors will have a "chilling effect" on the LBO industry. **[63]** Indeed, as a general matter, corporate directors may only be held liable for acts taken during their tenure on the corporation's board of directors.

One apparent exception to this general rule, however, is where a multi-step transaction "reasonably collapses into a single integrated plan." **[64]** In such circumstances, a court will treat a multi-step transaction as "one integrated transaction." **[65]** The practical import of this "collapsing" doctrine is that corporate directors can be held liable for breaches of fiduciary duty "even if the director defendants did not formally approve every component of the contested transaction" **[66]**, provided that the harm caused to the corporation was reasonably foreseeable to the former directors at the time they approved the integrated transaction. **[67]**

Therefore, implicit in the *Nine West* decision was the court's finding that Nine West's insolvency and eventual chapter 11 filing—which occurred ***four years*** after the JG Directors approved the 2014 Transaction—was (or should have been) reasonably foreseeable to the JG Directors at the time they approved the 2014 Transaction, since components of such transaction ultimately led to the company's collapse, notwithstanding that the JG Directors did not have any role in approval or effectuation of those specific components.

What Judge Rakoff's decision further makes clear is that a director cannot determine to make no investigation and consciously disregard the propriety of a particular component of a transaction on the basis that it had no duty to do so, but then seek cover behind the business judgment rule for protection.

However, the question must be asked: is it fair or reasonable to hold a corporation's *former* directors liable for the corporation's *subsequent* insolvency when their legally-required goal at the time of the transaction was maximization of value for shareholders, particularly where (i) such insolvency occurs nearly four years after the *former* directors stepped down from their official duties and (ii) the transactions that proximately caused the corporation's insolvency were actually approved by a suite of *successor, replacement* directors (not to mention, financed by sophisticated lenders and new investors) and only effectuated after the former directors ceded their directorships?

In a similar vein, central to Judge Rakoff's finding that the JG Directors had behaved in a "reckless" manner was the fact that the $1.55 billion debt burden placed upon RemainCo as a result of the 2014 Transaction exceeded the 5.1x debt-to EBITDA ratio that Citigroup had previously recommended as the company's maximum sustainable debt level. **[68]** However, the determination of any company's maximum sustainable debt load is ultimately a question that must be answered by its board of directors—not a third-party investment banker or financial advisor. In view of this, is it appropriate to characterize as "reckless" the actions taken by a board of directors any time such actions go beyond the metes and bounds recommended by the company's investment banker?

Do selling directors now need to be the guarantors of a company's proper capitalization (whatever that means) during the post-sale period? Can buyer representations and warranties, and investment banking opinions as to the company's post-closing solvency serve to minimize the seller's risk in this regard? And does a fairness opinion addressing the price to be received by the seller now have to look into a crystal ball in an attempt to forecast whether, under new stewardship, the company will or may become insolvent?

C. Practical Takeaways and Recommendations.

Corporate directors, deal professionals and their advisors should keep the aforementioned considerations top of mind as they navigate the post-*Nine West* landscape. Above all else, process is key. Corporate boards evaluating seminal transactions must engage in a deliberative, thoughtful process that involves legal counsel and experienced financial advisors every step of the way. Furthermore, in complex, multi-step transactions, directors and other interested parties must meaningfully consider each individual component of the larger transaction. Both before and after *Nine West*, the business judgement rule may not provide protection from liability where directors attempt to disclaim any oversight responsibility over discrete steps in an integrated transaction.

Despite the recent settlement of the claims asserted against the JG Directors in *Nine West*, Judge Rakoff's decision alone may have changed the playing field. While the potential far-reaching repercussions of *Nine West* remain to be seen, one thing appears certain at this juncture: directors transacting to sell companies should leave no stone left unturned—even as to potential future events that may occur under the corporation's new stewardship. In this respect, corporate directors can (and should) arm themselves with the full complement of legal and other tools available at their disposal. Corporate directors who fail to take these and other precautions may find themselves months—or even years—down the road in the unenviable position of having to defend themselves against after-the-fact attacks from plaintiffs now armed with the benefit of hindsight.

Endnotes

1 *See* "The Private Equity Party Might Be Ending. It's About Time," *The New York Times*, Feb. 28, 2021, available at: **https://www.nytimes.com/2021/02/28/opinion/private-equity-reckoning.html**.
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2 On June 10, 2021, the Trustee (as hereinafter defined), certain other settling plaintiffs (together with the Trustee, the "*Settling Plaintiffs*"), the JG Directors (as hereinafter defined), and certain other settling defendants (together with the JG Directors, the "*Settling Defendants*") filed in the U.S. District Court for the Southern District of New York that certain *Stipulation and [Proposed] Order Dismissing Settling Defendants With Prejudice* [Docket No. 437] (the "*Stipulation of Dismissal*"), which provides that the Settling Plaintiffs have reached a settlement with the Settling Defendants covering all of the claims and actions between the parties. Upon the Court's approval of such Stipulation of Dismissal, the parties have requested that all of the claims and associated actions covered thereby be dismissed with prejudice.
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3 *See In re Nine W. LBO Sec. Litig.*, No. 20 MD. 2941 (JSR), 2020 WL 7090277, *1 (S.D.N.Y. Dec. 4, 2020) ("*Nine West*"). JG was a Pennsylvania corporation. *Id.* at *10 n. 20.
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4 *Id.* at *1. JG had purchased the Stuart Weitzman and Kurt Geiger brands just a few years earlier for total consideration of $800 million. *Id.* at *3.
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5 *Id.* at *1.
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6 *Id.* at *1.
(go back)

7 *Id.* at *2.
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8 *Id.* at *2. The Merger Agreement contained a "fiduciary out" clause which allowed the JG Directors to withdraw their recommendation in favor of the 2014 Transaction if they thereafter determined that such a withdrawal would be consistent with their fiduciary duties. *Id.* at *2. The Merger Agreement also contained certain provisions that required the company to assist Sycamore in effectuating the Additional Debt Transaction and the Carve-Out Transaction. *Id.* at *2.

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[9] *Id.* at *2.
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[10] *Id.* at *2.
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[11] *Id.* at *2.
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[12] *Id.* at *2.
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[13] *Id.* at *2.
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[14] *Id.* at *3.
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[15] *Id.* at *3.
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[16] *Id.* at *4.
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[17] *Id.* at *4.
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[18] *Id.* at *1.
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[19] *Id.* at *5.
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[20] *Id.* at *10.
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[21] *Id.* at *14.
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[22] *Id.* at *14.
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[23] *Id.* at *21. The court did, however, grant the dismissal of these same claims with respect to certain of JG's officers. As noted in the *Executive Summary* section, *supra*, on June 10, 2021, the parties filed with the Court a Stipulation of Dismissal which, once approved by the Court, will effect a settlement of all of the claims and actions asserted by the Trustee and the other Settling Plaintiffs against the Settling Defendants party thereto.
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[24] *Id.* at *12.
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[25] *Id.* at *10.

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[26] *Id.* at *10. It is important to note that the "reasonable investigation" requirement discussed by the court in *Nine West* is a statutory requirement under Pennsylvania law that applies only in the context of mergers and acquisitions. *See id.* at *10. Under Pennsylvania law, a corporate director's failure to make a reasonable investigation is sufficient to overcome application of the deferential business judgment rule. *Id.* at *12.
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[27] *Id.* at *10.
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[28] *Id.* at *11.
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[29] *Id.* at *11.
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[30] *Id.* at *11.
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[31] *Id.* at *11.
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[32] *Id.* at *12.
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[33] *Id.* at *12. On this point, the court cited to *In re Hechinger Investment Co. of Delaware*, 274 B.R. 71, 90-91 (D. Del. 2002), where the district court, confronted with a two-step LBO transaction, rejected the director defendants' argument that "they merely approved the merger step of the LBO, and not the pledging of the post-LBO debtor's assets." *See id.*
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[34] *Id.* at *10.
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[35] *Id.* at 12.
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[36] *Id.* at 12. Notably, the Trustee did not allege that the JG Directors engaged in "willful misconduct". *See id.* at 12 n. 22.
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[37] *Id.* at *13.
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[38] *Id.* at *13.
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[39] *Id.* at *13.
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[40] *Id.* at *13. For this part of its analysis, the court began with the $2.2 billion valuation implied by the 2014 Transaction (i.e., the $15 per share paid to JG's selling shareholders), and then subtracted out $800 million on account of the Carve-Out Businesses (i.e., the Stuart Weitzman and Kurt Geiger brands) to arrive at an implied valuation of $1.4 billion for the remaining JG enterprise. *Id.* The court then compared this $1.4 billion implied valuation with the $1.55 billion of debt that was assumed by JG pursuant to the Additional Debt Transaction. *Id.*

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[41] *Id.* at *13.
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[42] *Id.* at *13.
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[43] *Id.* at *14.
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[44] *Id.* at *13.
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[45] *Id.* at *14.
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[46] *Id.* at *14.
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[47] *Id.* at *14.
(go back)

[48] *Id.* at *14.
(go back)

[49] *Id.* at *14.
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[50] *Id.* at *15.
(go back)

[51] As noted herein, Pennsylvania law governed the duties applicable in the *Nine West* litigation. However, for purposes hereof, we have focused our analysis on Delaware corporate law, given the high percentage of corporations incorporated in the State of Delaware and the well-developed body of caselaw published by the Delaware courts on the issue of directorial fiduciary duties.
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[52] *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 99 (Del. 2007) ("*Gheewalla*") (explaining that "directors owe their fiduciary obligations to the corporation and its shareholders.").
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[53] *See Trenwick America Litigation Trust v. Ernst & Young*, 906 A.2d 168, 175 (Del. Ch. 2006) ("*Trenwick*").
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[54] *Gheewalla*, 930 A.2d at 99.
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[55] *See Gheewalla*, 930 A.2d at 101 (opining that the duties of corporate directors—and the beneficiaries of such duties—do not change as a corporation enters the "zone of insolvency"; further explaining that "no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency"); *Quadrant Structured Products Co., Ltd. v. Vertin*, 115 A.3d 535, 546 (Del. Ch. 2015) ("*Quadrant*").
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[56] *See Trenwick*, 906 A.2d at 205 (Del. Ch. 2006) (holding that the board's discretion in pursuing failed efforts to maximize corporate value was protected by the business judgment rule and rejecting independent cause of action for deepening insolvency); *Fehribach v. Ernst & Young LLP*, 493 F.3d 905, 908-09 (7th Cir. 2007) (applying and citing *Trenwick* for the proposition that the deepening insolvency theory "makes no sense").
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[57] *See Quadrant*, 115 A.3d at 546.
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[58] *See Gheewalla*, 930 A.2d at 101 (When a corporation is insolvent, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value. Consequently, the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties.").
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[59] *See Quadrant*, 115 A.3d at 551. Once a corporation becomes insolvent, Delaware law recognizes the right of creditors to assert a derivative claim on behalf of the insolvent corporation for breaches of fiduciary duty by the corporate directors. *See Quadrant*, 115 A.3d at 546. This is because, as a corporation crosses over into insolvency (and the corporation's debts exceed the fair value of its assets), "its creditors take the place of the shareholders as residual beneficiaries of any increase in its value." *See Gheewalla*, 930 A.2d at 101.
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[60] *See Gheewalla*, 930 A.2d at 103 ("Accordingly, we hold that individual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors.").
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[61] *See Trenwick*, 906 A.2d at 175 (stating that "[e]ven when the firm is insolvent, directors are free to pursue value maximizing strategies, while recognizing that the firm's creditors have become its residual claimants and the advancement of their best interests has become the firm's principal objective.").
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[62] *Id.* at *14.
(go back)

[63] *See, e.g.*, Sujeet Indap, Dealmakers warn of chilling effect on buyouts from US court ruling, Financial Times (Dec. 15, 2020), *available at* https://www.ft.com/content/01affe9d-89a7-4c0e-8a15-d6d544d4ce04.
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[64] *Id.* at *12; *In re Hechinger Investment Co. of Delaware*, 274 B.R. 71, 90-91 (D. Del. 2002).
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[65] *Id.* at *12; *In re Hechinger Investment Co. of Delaware*, 274 B.R. 71, 90-91 (D. Del. 2002) (rejecting directors' argument that, in the context of LBO transaction, directors "merely approved the merger step of the LBO, and not the pledging of the post-LBO debtor's assets", because the asset-pledge step of the transaction was technically approved by the corporation's subsequent board of directors); *see also United States v. Tabor Court Realty*, 803 F.2d 1288, 1302 (3d Cir. 1986) (construing Pennsylvania law for the general proposition that, in certain circumstances, courts may treat multi-step LBO transactions as "one integrated transaction").
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[66] *Id.* at *12.
(go back)

[67] *See Hechinger Investment Co.*, 274 B.R. at 91 (discussing the "foreseeability of the alleged harm" to the corporation as the determining factor in whether former directors may be liable for breaches of fiduciary duty that occur after such directors no longer occupy seats on the corporation's board of directors).
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[68] *Id.* at *13.
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