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Director Fiduciary Duties May Extend Post-Closing in Multi-Stage Transactions

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A recent decision by the United States District Court for the Southern District of New York highlights directors' fiduciary duty to evaluate all aspects of multi-stage transactions, including those portions to be effectuated post-closing by successor directors.

In *In re Nine West LBO Securities Litigation*, the district court denied a motion to dismiss breach of fiduciary duty and aiding and abetting breach of fiduciary duty claims asserted against former directors of Jones Group, Inc. ("Jones Group") by the bankruptcy litigation trustee of Nine West Holdings, Inc. ("Nine West"), the successor of Jones Group. The trustee's claims were based on a 2014 multi-stage leveraged buyout of Jones Group by Sycamore Management, L.P. ("Sycamore"), which contemplated: (1) the merger of Jones Group with a Sycamore affiliate to form Nine West; (2) Sycamore's contribution of $395 million to Nine West; (3) an increase in Nine West's debt from $1 billion to $1.2 billion (the "Additional Debt"); (4) a distribution to Jones Group shareholders; and (5) the later sale of certain of Jones Group's most successful brands to another Sycamore affiliate for less than fair market value (the "Carve-Out").

The Jones Group board voted to approve the transaction but explicitly noted that their approval did not consider or extend to the Additional Debt or Carve-Out, both of which would occur post-closing and after the board disbanded. Shortly before closing, Sycamore altered the terms of the deal, lowering its contribution to $120 million and increasing the Additional Debt to $1.55 billion (which was likely to exceed sustainable post-transaction debt levels). After the transaction closed, Nine West sold the Carve-Out businesses to the Sycamore affiliate for substantially less than market value.

Less than four years later, Nine West filed for bankruptcy. The bankruptcy court confirmed a plan of reorganization assigning Nine West's claims arising from the Sycamore transaction to a litigation trust. Subsequently, the litigation trustee pursued claims against the Jones Group directors, asserting the directors had violated their fiduciary duties by approving the Sycamore transaction. In response, the directors sought to dismiss the claims, arguing they were shielded from liability, in part, by the business judgment rule. Generally, the business judgment rule insulates a disinterested director from liability for decisions made in good faith, on a reasonably informed basis, and where the director rationally believed that the decision in question was in the corporation's best interests.

In denying the directors' motion to dismiss, the court treated the multi-step leveraged buyout as one integrated transaction and held that the complaint adequately alleged that the directors had failed to appropriately investigate the totality of the transaction, particularly the Additional Debt and the Carve-Out. The court further held that the directors were not protected by the business judgment rule because the litigation trustee had alleged facts showing the directors had acted recklessly in disregarding these post-closing portions of the transaction and their effect on the solvency of the company. In reaching this decision, the court identified a number of indicators alleged in the complaint which should have put the directors on notice that the entire transaction was reasonably likely to lead to Nine West's insolvency, including: (1) that the Additional Debt would exceed the post-Carve-Out value of Nine West, and (2) that the Additional Debt would be greater than what the board was advised was sustainable. The court also found that the trustee had adequately pleaded that, in approving the transaction, the directors had aided and abetted breaches of fiduciary duty by the new Nine West board by assisting the new board in carrying out the Additional Debt or the Carve-Out portions of the transaction, leaving Nine West insolvent.

While the court's decision in *Nine West* only addressed whether the asserted claims survived a motion to dismiss, and these surviving claims are still being adjudicated, the decision still provides valuable insight. In particular, to satisfy their fiduciary duties, directors contemplating the approval of multi-stage transactions should analyze such transactions as single integrated transactions and should carefully memorialize their informed analysis of all aspects of the transaction, including those aspects to be executed post-closing by successor directors. In addition, the decision may provide court-appointed trustees and fiduciaries with additional reasons to scrutinize whether all aspects of previous corporate transactions were reasonably analyzed prior to approval.

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