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TOUGH LAW FOR INVESTMENT BANKS IN DELAWARE COURTS

By Alan Parker, LLM Candidate 2016 | October 30, 2015

Investment banks are having a rough time litigating in Delaware Courts, and the horizon does not look any clearer. As the presence of investment banks in major merger deals in US becomes almost mandatory, it is easy to observe an ever-growing number of disputes related to alleged conflicts of interests between the investment banks and the multiple parties involved in such transactions. These disputes are mostly resolved in Delaware courts, which are the main venues for merger disputes, as most of the publicly-traded companies are incorporated in such state.

One of the latest lawsuits discussing this kind of conflict of interests is *In Re Zale Corporation Stockholders Litigation*. As explained in this comprehensive article published by Prof. Steven Solomon, in this case Merrill Lynch ("ML") was retained by the Board of Directors of Zale Corporation ("Zale") to advise it on the latter's buyout by Signet Jewelers Limited ("Signet") in a $1.4 billion transaction. However, before being retained by Zale, ML pitched to advise Signet on the very same deal, and the former only disclosed that it had previously pitched Signet after the closing of the transaction. Zale accepted a price per share of $21.00, which represented a 41% premium, exactly within the price range suggested by ML's pitch to Signet.

Based on these and other facts, the second largest shareholder of Zale, TIG Advisors ("TIG"), claimed that (i) the deal was underpriced; (ii) ML was conflicted; (iii) Zale's management projections were not properly disclosed, and; (iv) the largest shareholder of Zale, Golden Gate Capital ("GGC"), was very pushy to perform the deal. On October 1, 2015, a Delaware judge allowed the lawsuit to move forward.

Although at a first glance one could argue for the existence of a conflict of interest in this case, a detailed analysis may convince you otherwise. An investment bank, by its nature, will always be pitching clients and observing the market for potential transactions, and thus exercising a relevant role for the country's economy. Whether in connection to the pricing of the deal or the relations with Zale's Board and GGC, nothing in this case suggests that ML acted in violation of such duties. In addition, both Zale's shareholders and its Board approved and respectively ratified the deal, and there is Delaware case law establishing that similar conflicts may be dismissed when shareholders are aware of the "potential" conflict and, nevertheless, vote in favor of the transaction.

Therefore, although Delaware courts are historically favorable to Board of Directors as opposed to shareholders and investment banks, an adverse ruling against ML in this case may set a dangerous precedent for the investment banking activities, and even materially impact the US merger market in general.