Liability for Fairness Opinions Under Delaware Law

Cameron Cushman*

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I. INTRODUCTION

Fairness opinions are statements or reports issued by investment banks stating at what price a specific corporate transaction is fair, from a financial perspective, to a
particular party. These transactions are typically transactions that involve control of the corporation. In Smith v. Van Gorkom, the Delaware Supreme Court found a board of directors personally liable for an unfavorable merger—approved without an outside valuation—because they failed to fulfill their duty of care to make an informed business decision. Since then, fairness opinions have become commonplace in corporate control transactions.

As fairness opinions have become more common, the liability that an investment bank may incur as a result of issuing an opinion has become an issue of great importance. Courts differ on the extent to which an investment bank may face liability to shareholders of a company when that bank issues a fairness opinion to that company’s board of directors, and scholars disagree on the most appropriate solution. Delaware—the state where more than half of the country’s major corporations are incorporated and whose state corporate law has been described as “a de facto national corporate law”—has little authority on the subject.

This Note attempts to predict whether and to what extent Delaware courts will find investment banks liable to third-parties for negligently issued fairness opinions, and it argues which approach would be most beneficial. Part II examines the extent to which courts outside Delaware have found investment banks liable to third-party shareholders for fairness opinions. Part III examines Delaware authority, analyzes what that authority could mean, and provides the likely outcomes to some common fact patterns under Delaware law. Part IV recommends that Delaware allow shareholders to bring negligent misrepresentation claims against investment banks for negligently issued fairness opinions, that Delaware should use the “reasonably foreseeable” approach to negligent misrepresentation for these claims, and that Delaware should follow New York courts by adopting the Schneider v. Lazard Freres Co. holding.

2. See id. (citing the use of fairness opinions in cases involving negotiated mergers, freeze-out mergers, hostile tender offers, friendly tender offers, self-tenders, leveraged buyouts, negotiated share repurchases, and negotiated sales of treasury stock).
4. Id. at 893.
5. Bebchuk & Kahan, supra note 1, at 27.
7. See infra Part II (discussing different ways courts have found investment banks liable to third-party shareholders for fairness opinions).
8. See, e.g., Elson, supra note 6, at 1002–03 (arguing that investment bank liability for fairness opinions should be eliminated); Robert J. Giuffra, Jr., Investment Bankers’ Fairness Opinions in Corporate Control Transactions, 96 YALE L.J. 119, 135–36 (1986) (arguing that investment banks should be liable to shareholders for negligence or breach of contract in issuing fairness opinions).
10. Id. at 786 (quoting Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 AM. J. COMP. L. 329, 350 (2001)).
11. See infra Part III.A (explaining that Delaware courts have addressed the issue of when investment banks may be liable to shareholders when issuing fairness opinions in relatively few cases).
II. BACKGROUND

There are multiple theories under which an investment bank may be held liable to third-party shareholders for a fairness opinion issued to a board of directors. The most common is the tort of negligent misrepresentation. One court has also imposed liability under the law of agency. Shareholders sometimes bring claims against investment banks on the theory that the banks breached a fiduciary duty owed to the shareholders. However, these claims have not been successful, so this Note does not address them.

A. Negligent Misrepresentation

Negligent misrepresentation is “[a] careless or inadvertent false statement in circumstances where care should have been taken.” To succeed in a negligent misrepresentation claim, plaintiffs must show that the defendant owed them a duty. When applying negligent misrepresentation to professionals whose business involved issuing statements for the guidance of others (such as investment bankers or accountants), courts traditionally only found a duty to claimants with whom the professional was in privity. Recently, however, courts have liberalized this privity requirement. A line of cases decided by the New York Court of Appeals illustrates the development of this liberalization: Ultramares Corp. v. Touche, Credit Alliance Corp. v. Arthur Andersen.
& Co., and Wells v. Shearson Lehman/American Exp., Inc.

In Ultramares Corp. v. Touche, the New York Court of Appeals dismissed a negligence claim against a firm of public accountants because the plaintiffs were not in contractual privity with the accounting firm. In January 1924, Fred Stern & Co. hired Touche, Niven & Co., an accounting firm, to prepare a balance sheet showing the state of Fred Stern’s business. The accounting firm knew that Fred Stern would present this balance sheet to lenders in order to procure loans. While conducting the audit, the accounting firm failed to verify accounts and investigate suspicious information that a “careful and skilled auditor would have desired to investigate.” In March 1924, relying on the certified balance sheet, Ultramares Corporation—the plaintiff—agreed to loan Fred Stern a substantial amount of money. In January 1925, Fred Stern declared bankruptcy.

Ultramares brought a claim against Touche, Niven & Co. for negligently conducting its audit of Fred Stern’s. The court stated that Touche did perform the audit negligently. However, the court went on to hold that Ultramares could not maintain a tort action against Touche because Touche did not owe Ultramares any duty to conduct the audit with care. The court reasoned that, because the duty of an accountant to use “care and caution proper to their calling” arose from contract, Ultramares was not in privity of contract with Touche.

Later, in Credit Alliance Corp. v. Arthur Andersen & Co., the New York Court of Appeals reaffirmed Ultramares, but elaborated on its proper application. Instead of requiring that parties be in strict contractual privity, the Credit Alliance court set forth a three-part test to determine whether the relationship between a professional and a third-party constituted “near privity,” in which case the third-party could bring a negligent misrepresentation suit against the professional even though there was not actual privity. The court held that in order for there to be near privity: (1) the professional must have known that its representation would be used for a particular purpose; (2) a known party or parties intended to rely on that representation; and (3) there was some conduct by the

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23. Id. at 444–48.
24. Id. at 442.
25. Id.
26. Id. at 433–44.
27. Ultramares, 174 N.E. at 443.
28. Id.
29. Id.
30. Id. at 443–44.
31. Id. at 444–48.
32. Ultramares, 174 N.E. at 444.
33. Id. at 444–48.
35. Id. at 119.
36. Id. at 118.
professional “linking them to that party or parties, which evidences the [professional’s] understanding of that party or parties’ reliance.”

Although Credit Alliance concerned a claim against accountants, in Wells v. Shearson Lehman/American Exp., Inc., the New York Court of Appeals extended the application of its “near privity” test to investment bankers. In Wells, the board of directors of Metromedia created a committee, comprised of four of its members, to evaluate the fairness of a proposed buyout to the corporation’s shareholders. That committee hired two investment banks—Shearson Lehman and Bear Stearns—to issue fairness opinions on the buyout. Both banks issued opinions that were included in proxy materials sent to shareholders. Based on these proxy materials, the shareholders voted to approve the buyout. After the fact, it turned out that both opinions significantly undervalued the company.

A shareholder of the corporation brought a claim against the banks, asserting that they failed to use due care in issuing the fairness opinions. The New York Supreme Court, Appellate Division, held that the plaintiff could maintain a claim against the investment banks. The court explained that because the committee, and not the board itself, hired the investment banks and the committee’s purpose was to determine the fairness of the buyout to the stockholders, the banks were actually retained to advise the shareholders. Citing Credit Alliance, the Wells court found this bond sufficient to create liability to the shareholders.

With this line of cases, New York pioneered the application of negligent misrepresentation to investment bankers without contractual privity. However, the requirements to bring a claim of negligent misrepresentation still vary from jurisdiction to jurisdiction. There are currently three approaches to professional negligent misrepresentation: the strict-privity approach, the actually foreseen approach, and the reasonably foreseeable approach.

1. **Strict-Privity Approach**

The “strict privity” approach limits liability for professional negligent misrepresentation to those in privity with the professional. It does so based on the

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37. Id.
39. Id. at 1.
40. Id.
41. Id.
42. Id.
43. Wells, 514 N.Y.S.2d at 1–2.
44. Id. at 2.
45. Id. at 2–3.
46. Id.
47. Id. at 3.
49. See infra, Part II.A.1–3 (discussing the three basic approaches to applying negligent misrepresentation to professionals).
50. Martin, supra note 12, at 150–51.
51. Id. at 152.
The approach was originally derived from *Ultramares*, discussed above. *Ultramares* attempted to limit the liability of professionals, noting that otherwise professionals could be subject to near unlimited liability. The *Credit Alliance* method of allowing claims by third parties in cases where the relationship between the professional and the third-party approaches “near privity” is a variation of this approach.

2. Actually Foreseen Approach

The Second Restatement of Torts adopts the “actually foreseen” approach to professional liability to third-parties for negligence. This is also the view adopted by a majority of jurisdictions. This approach allows claims only when the professional actually knew that the third-party claimant was going to rely on their misrepresentation, so it avoids the unlimited liability feared in *Ultramares* without overly restricting third-party claims. In the context of fairness opinions, this standard would often be met because—although they often include language that the opinion is only for the use of the board of directors—investment banks are well aware that fairness opinions are usually included in proxy materials used to solicit shareholder approval.

3. Reasonably Foreseeable Approach

The “reasonably foreseeable” approach is the least restrictive of the three standards of negligent misrepresentation by a professional. It allows anyone that a reasonable person would have foreseen relying on a fairness opinion to bring a claim, even if the banker did not actually realize that person would rely on the opinion. Courts applying this standard of liability essentially reject the *Ultramares* privity requirement and apply

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52. See, e.g., *Ultramares* v. Touche, 174 N.E. 441, 444–48 (N.Y. 1931) (finding no duty between an accountant and a third party that relied on that accountant’s audit because there was no contractual privity between the two, and declining to continue the “assault upon the citadel of privity” by loosening privity requirements).
54. *Ultramares*, 174 N.E. at 444 (stating that if liability for negligence existed without a privity requirement, accountants would be exposed to liability “in an indeterminate amount for an indeterminate time to an indeterminate class”).
55. *Id.* at 978–79.
56. See *Restatement (Second) of Torts § 552(1)–(2)(a) (1977)* (limiting the liability of a person for information issued in the course of his “business, profession, or employment . . . for the guidance of others in their business transactions” to “the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it”).
57. *Id.* at 156.
58. Id. at 156–57.
59. *See*, e.g., *Collins* v. Morgan Stanley Dean Witter, 224 F.3d 496, 497 (5th Cir. 2000) (“The Agreement provided that Morgan Stanley had ‘duties solely to Allwaste.’”).
60. *See*, e.g., *Wells* v. *Shearson Lehman/American Express*, Inc., 514 N.Y.S.2d 1, 3 (N.Y. App. Div. 1987) (assuming investment banks were aware their fairness opinions were used to help shareholders make a decision on a stock offer “as they must have been”), rev’d on other grounds, 526 N.E.2d 8 (N.Y. 1988).
61. *Id.* at 156.
62. *Elson*, supra note 6, at 980.
63. *Id.* at 155.
standard tort principles.  

B. Agency

Recently, instead of applying tort law and privity requirements to shareholder claims against investment banks, a New York court allowed liability under an agency theory. In Schneider v. Lazard Freres & Co., a company formed a special committee comprised of disinterested directors to run an auction for the stock of the company. The committee hired an investment bank to advise it in conducting the auction. The investment bank recommended that the special committee accept one bid, even though another qualifying bid was substantially more valuable. Stockholders of the corporation brought a claim against the bank, alleging that they suffered damages as a result of its negligently advising the special committee.

The court noted that the parties presented their arguments regarding “whether the bankers owed the shareholders a duty of care” in terms of whether their relationship was “‘approaching privity’ within the meaning of Credit Alliance Corp. v. Arthur Andersen & Co.” It described this characterization as “distracting” and did not perform any privity analysis. Instead, the court addressed whether the relationship between the shareholders and the investment bank “was one governed by the law of agency or the law of corporations.” The court found that, because the sale of control of a corporation is not normal corporate business and the shareholders, not the corporation, would directly realize any losses resulting from the transaction, the special committee did not stand in the normal corporate law based director–shareholder relationship with the shareholders. As a result, the court held that the special committee was an agent of the shareholders, so the investment bank was essentially dealing directly with the shareholders, giving rise to privity.

Understanding the different ways courts find investment banks liable for negligent misrepresentation to third-parties is important because it shows the different paths Delaware could choose to take on the issue. Wells is cited throughout existing Delaware authority on the issue, and the line of New York cases leading up to Wells are important to understand that decision’s meaning. With this background laid, we can begin to analyze the Delaware authority on third-party claims of negligent misrepresentation against investment banks.

64.  Id.; Elson, supra note 6, at 980.
66.  Id. at 572.
67.  Id.
68.  Id.
69.  Id.
70.  Schneider, 552 N.Y.S.2d at 574 (citing Credit Alliance Corp. v. Arthur Anderson & Co., 483 N.E.2d 110 (N.Y. 1985)).
71.  Id. at 574–75.
72.  Id. at 575.
73.  Id.
74.  Id.
II. Analysis

A. Delaware Authority

Considering the frequency with which plaintiffs bring claims involving corporations in Delaware, the state has surprisingly little authority regarding whether investment banks may be liable to shareholders when issuing fairness opinions. Delaware courts have addressed the issue in only one published opinion and two unpublished opinions. Delaware courts have, however, addressed the tort of negligent misrepresentation in the context of other professionals.

1. Weinberger v. UOP, Inc.

In Weinberger v. UOP, Inc., the Delaware Court of Chancery issued the only published Delaware opinion addressing investment bank liability to a corporation’s shareholders for a fairness opinion. However, the Weinberger court’s analysis provides very little direction as to whether tort liability exists. This is because in Weinberger the shareholders’ claim against the investment bank—and as a result, the court’s analysis—focused on a conspiracy charge, not negligent misrepresentation. The shareholders did allege that the investment bank breached a fiduciary duty owed to them. However, the court described this claim as “lumped together” with the breach of fiduciary duty claims against the majority shareholder and the corporation itself and disposed of the issue in a single sentence:

In addition, although Lehman Brothers has been lumped together with Signal and UOP in plaintiff’s allegations of breach of fiduciary duty, plaintiff has offered no authority to indicate that an investment banking firm rendering a fairness opinion as to the terms of a merger owes the same fiduciary duty to the minority shareholders as does the majority shareholder who initiated the merger as a direct result of being retained by the management of the controlled subsidiary.

Although defendants have tried to construe this statement broadly, the Weinberger court did not reject the claim or even analyze whether the claim had any merit. Rather, the court simply stated that the plaintiff presented no persuasive authority supporting the

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79. Weinberger, 426 A.2d at 1333.
80. Id. at 1347–48.
81. Id. at 1348.
82. Id.
83. See, e.g., In re Shoe-Town, 1990 WL 13475, at *6 (noting defendants’ claim that Delaware courts have uniformly held that a corporate financial advisor issuing a fairness opinion does not owe a fiduciary to minority stockholders).
84. Weinberger, 426 A.2d at 1348.
claim of liability. It is not surprising that the plaintiff was unable to offer authority to support the proposition; the court decided this case in 1981, before any of the cases that modern courts look to in addressing the issue of investment bank liability were decided. Furthermore, because the plaintiff only claimed a breach of fiduciary duty and Wells had not yet extended the application of the tort of negligent misrepresentation to this context this case provides no insight on the extent to which negligent misrepresentation would apply in a similar factual situation under Delaware law.

2. In re Shoe-Town, Inc. Stockholders Litig.

In re Shoe-Town, Inc. Stockholders Litig. was decided in an unreported opinion by the Delaware Court of Chancery. In Shoe-Town, shareholders challenged a two-step “going private” transaction led by Shoe-Town’s management. Shoe-Town’s board of directors hired Shearson Lehman, an investment bank, to advise them on the transaction. The board also created a special committee comprised of the directors of Shoe-Town who were not involved in the takeover. The purpose of the committee was to ensure that the transaction was “fair and equitable.” Shearson Lehman issued a fairness opinion stating that the tender offer price of $9.75 per share was fair. Over 90% of the publicly held outstanding shares were tendered and the buyout was consummated successfully. Shareholders who did not tender their shares brought suit, claiming, amongst other things, that Shearson Lehman breached a fiduciary duty owed to them. The In re Shoe-Town court held that, under these circumstances, Shearson Lehman owed no fiduciary duty to the shareholders.

Like the court in Weinberger, the Shoe-Town court was concerned with a breach of fiduciary duty claim, not a negligent misrepresentation claim. However, unlike Weinberger, the Shoe-Town court had other authority to consider in making its decision—the Wells decision. Although the Shoe-Town decision is unreported, because

85. Id.
87. Weinberger, 426 A.2d at 1348.
90. Id. at *1. The transaction involved a tender offer for all publicly held outstanding shares conditioned upon the tender of a majority of those shares and a conversion into cash at the tender offer price of any untendered shares, if the tender offer was successful. Id. at *3.
91. Id. at *1–2.
92. Id. at *2.
93. This special committee is substantially similar to the one created in Wells. 514 N.Y.S.2d at 2.
95. Id.
96. Id.
97. Id. at *7.
98. Id. at *6.
the court considered the cases cited by the plaintiffs as contrary authority and analyzed why the claim did not apply to the facts of the case at issue, *Shoe-Town* is a much more current rejection of a fiduciary duty where an investment bank is hired by management to issue a fairness opinion and shareholders rely on that opinion under Delaware law.

Interestingly, the *Shoe-Town* court examined and factually distinguished the *Wells* case in addressing whether a financial advisor owes a fiduciary duty to shareholders.100 The court also limited its holding to situations where the bank was hired by management, not by a special committee, as occurred in *Wells*.101 This suggests that in a case factually similar to *Wells*, Delaware courts may find that an investment bank owes a fiduciary duty to shareholders. At the very least, this holding demonstrates that Delaware courts may consider *Wells* to be persuasive authority.

The distinction between Delaware courts allowing a fiduciary duty claim under *Wells* or simply accepting *Wells* as persuasive authority is deceptively important because *Wells* does not actually stand for the proposition that an investment bank owes a fiduciary duty to shareholders.102 Rather, *Wells* addresses a negligent misrepresentation claim.103 The *Wells* court focused on the special committee and privity not to determine whether there was a fiduciary duty, but to see whether the facts of that case satisfied the *Credit Alliance* “near privity” test for negligent representation claims without actual privity.104 Whether Delaware courts facing this issue in the future will give more weight to the *Wells* decision or the *Shoe-Town* analysis of the *Wells* decision could greatly influence the way the issue is decided.


*Stuchen v. Duty Free International, Inc.* was decided in an unreported opinion by the Delaware Superior Court.105 This case arose out of the merging of United Exports Trading Association (UETA) and Overseas Trading Corporation (OTC) with Duty Free...

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101. See id. (holding that a bank owes no fiduciary duty to the shareholders where the bank was “hired by management to work for and answer to management”).
102. See *Wells*, 514 N.Y.S.2d 1 (failing to discuss a fiduciary duty).
103. *Id.* at *2*. Mrs. Wells claimed either that defendants “fail[ed] to use due care” or that they “intentionally issued erroneous opinions with the motive . . . [to] bring them[sel]ves substantial monetary gain.” *Id.*
104. *Id.* The *Credit Alliance* test allows a negligent misrepresentation suit against a professional without actual privity if (1) the professional knew that his representation would be “used for a particular purpose,” (2) “a known party or parties [were] intended to rely” on that representation, and (3) there was “some conduct” by the professional “linking them to that party or parties, which evidences the [professional’s] understanding of that party or parties’ reliance.” *Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 118 (N.Y. 1985) (specifically testing accountants’ liability). The *Wells* court assumed that the investment banks involved “were aware (as they must have been) that their opinion would be used to help shareholders decide on the fairness of Metromedia’s stock offer.” *Wells*, 514 N.Y.S.2d at 2. The court stated that this assumption, coupled with the relationship evidenced by the special committee, satisfied the *Credit Alliance* test. *Id.* The assumption that the investment banks were aware that the purpose of the fairness opinion was to influence the shareholders is the *Wells* court’s way of addressing prongs (1) and (2) of the *Credit Alliance* test, and the relationship evidenced by the special committee is used to satisfy prong (3). See *id.* (supporting but not clearly stating the court’s application of the test step-by-step).
International, Inc. (DFI). UETA and OTC, though separate corporations, shared many of the same shareholders. The two corporations decided to investigate the sale of their combined businesses and hired Goldman, Sachs & Co. (Goldman) to assist them in that endeavor. They located a potential buyer: DFI. UETA and OTC asked Goldman to represent their interests in the transaction, including a request that Goldman issue a fairness opinion regarding the sale. On March 16, 1992, the parties entered into a merger agreement, which provided that Delaware law would apply to any disputes regarding the merger.

The deal closed on April 24, 1992. On that same day, Goldman issued the fairness opinion requested by the UETA and OTC boards stating that the deal was fair. This fairness opinion indicated that it was provided “solely for the information and assistance” of UETA’s board of directors. Goldman’s representations in this fairness opinion turned out to be incorrect, and the shareholders of UETA and OTC lost substantial amounts of money. The shareholders brought a claim against Goldman, asserting in part that Goldman owed a duty of care to the shareholders of UETA and OTC. Finding no duty of care, the court dismissed the claim.

The Stuchen court’s primary reason for not finding a duty was that the reasoning and holding of Shoe-Town were “equally applicable” to this case. This gives added support to the Shoe-Town holding, as well as to the possibility that Delaware courts will follow the Shoe-Town decision even though it relies on a misunderstanding of Wells. The shareholders in Stuchen also offered several cases to support their proposition that the Shoe-Town plaintiffs did not. However, the court distinguished all of the cases on the grounds that each involved something “on which it was expected shareholders would rely in making decisions affecting their interest in the corporation in which they owned stock.”

Linked with the Stuchen court’s acceptance of the Shoe-Town holding, this emphasis on a lack of reliance could support Delaware courts finding a broad fiduciary duty that investment banks owe to shareholders any time an investment bank issues a fairness opinion knowing that shareholders are going to rely on that opinion in making a decision.

106. Id. at *1.
107. Id. (stating that the ownership of OTC “included a significant number of UETA’s shareholders”).
108. Id.
109. Id.
111. Id. at *2.
112. Id. at *3.
113. Id.
114. Id.
116. Id. at *10.
117. Id. at *12.
118. Id. at *11.
119. See supra note 104 (discussing the actual meaning of the Wells holding).
Stuchen also differs from Weinberger and Shoe-Town in that the plaintiffs claimed that the investment bank owed them a duty of care, rather than expressly alleging a fiduciary duty. As a result, this case could be interpreted as addressing either a negligent misrepresentation claim or a fiduciary duty claim. However, in distinguishing this case from Dowling, the Stuchen court noted that while the Dowling court found that there was a duty, it did so based on a claim of negligent misrepresentation. This distinction, coupled with the court’s focus on the Shoe-Town court’s reasoning, indicates that the Stuchen court probably was not thinking in terms of negligent misrepresentation.

4. Negligent Misrepresentation Under Delaware Law

Courts first applied the tort of negligent misrepresentation to investment bankers negligently issuing fairness opinions to the detriment of third-party stockholders in Wells. However, as discussed above, the Shoe-Town court’s misapplication of the Wells opinion and subsequent decisions relying on that application make it unclear how the tort applies under Delaware law. Complicating things further, Delaware follows the Restatement’s “actually foreseen reliance” approach to privity in negligent misrepresentation claims against professionals, a significantly broader standard than the “actual privity” or “near privity” requirement used under New York law and applied in Wells.

If Delaware courts decide to follow Wells and allow negligent misrepresentation claims against investment bankers, they could do so by adopting the New York approach verbatim, or they could follow the reasoning of Wells but apply the Delaware standard of negligent misrepresentation. If they chose the former, this liability would still be limited to the narrow situation espoused in Wells, where an investment bank in some way had a close enough link to the shareholders of a company to give rise to privity or near privity. If they chose the latter, liability could attach every time a fairness opinion was disclosed to shareholders in order to influence their decision. The fact that the reliance had to be “actually foreseen” would not provide much of a barrier because investment banks are almost always aware that their opinions will be included in disclosures (such as proxy statements) designed to influence shareholders.
B. Application of Delaware Authority in Different Factual Circumstances

In light of the complicated Delaware treatment of this issue, it is helpful to consider the possible application of this authority to a few fact patterns common in these types of shareholder claims.

1. Scenario One: Management Hired Investment Bank, Shareholders Did Not Act in Reliance on Fairness Opinion

The outcome, under Delaware law, is clearest when the management of the corporation hired the investment bank to advise them, and the shareholders did not act in reliance on the opinion issued by the investment bank. Both Shoe-Town and Stuchen expressly held that no fiduciary duty attached in this situation. Because there is no special relationship between the investment bank and the shareholders, there cannot be liability under the New York version of the “negligent misrepresentation by a professional” test. Finally, because there was no reliance by the shareholders, there cannot be liability under the “actually foreseen reliance” standard of negligent misrepresentation by a professional.

2. Scenario Two: Management Hired Investment Bank, Shareholders Did Act in Reliance on Fairness Opinion

Predicting what Delaware courts might do becomes more difficult in a situation in which the shareholders relied on the fairness opinion. The Shoe-Town and Stuchen holdings imply that, where the investment bank was hired by management in order to assist management, the bank owes no fiduciary duty to shareholders. However, neither Shoe-Town nor Stuchen involved a situation where the shareholders relied on the opinion; the Stuchen shareholders did not see the fairness opinion before making their decision, and although the fairness opinion in Shoe-Town was disclosed to shareholders in order to influence their decision, the shareholders who brought the claim were the ones who decided not to tender their shares. Furthermore, the Stuchen court distinguished almost all other authority cited by noting that those cases all involved situations where

129. See supra Parts III.A.2–3 for a discussion of Shoe-Town and Stuchen.

130. See supra Part III.A.4 for a discussion of this test as set out in Wells.

131. See id. (discussing Delaware’s previous application of the “actually foreseen reliance” test to negligent misrepresentation claims).


133. See Stuchen, 1996 WL 33167249, at *3 (concluding the parties to the transaction entered into a shareholder agreement and were legally bound to go through with the deal before the investment bank issued the fairness opinion and therefore, that the shareholders could not claim that they had relied on that opinion in entering the agreement).

134. The plaintiffs in Shoe-Town claimed that the price they received for their shares was unfair, but did not do so based on new information learned after the merger. See generally In re Shoe-Town, 1990 WL 13475 (explaining that plaintiffs must have thought the price was unfair in the offer and that shareholders would presumably not tender if the offer price was unfair, and thus the plaintiffs were reasonably among the shareholders who did not tender).
shareholders would be expected to rely on the actions of the investment bank.\textsuperscript{135}

The outcome of this fact pattern under a negligent misrepresentation theory would depend on whether Delaware adopted the New York method of determining negligent misrepresentation or used the Restatement’s “actually foreseen” approach. Under the New York approach, the shareholders would not be in privity or “near privity,” and thus would not be able to maintain a claim. Under the Restatement method, however, if the bank actually knew that the person to whom it issued the fairness opinion would use that opinion to influence shareholders, liability could attach.

3. Scenario Three: Special Committee Hired Investment Bank

If the investment bank was hired by a special committee created by the board of directors to determine the fairness of a particular transaction to the shareholders of the corporation, the investment bank would most likely be liable to those shareholders. The holdings in Shoe-Town and Stuchen both rely on distinguishing Wells on the grounds that in Wells, the special committee hired the investment bank specifically to determine whether the transaction was fair to the company’s shareholders.\textsuperscript{136} A Delaware court following the reasoning behind those cases would likely find that the investment bank owed a fiduciary duty to the shareholders.

A Delaware court applying the New York method of negligent misrepresentation to this fact pattern would find that the investment bank is liable for negligently preparing a fairness opinion because it is in “near privity” with the shareholders, as this is the fact pattern that gave rise to Wells, the case responsible for this theory of liability.\textsuperscript{137} If liability would attach under the New York method, a Delaware court applying the “actually foreseen” method would also find liability because knowledge that a party was intended to rely on a disclosure is one of the requirements for finding “near privity.”\textsuperscript{138}

4. The Schneider Situation

Delaware courts up to this point have offered no insight on whether they might follow the agency theory of liability set forth in Schneider. Schneider involved a special committee of disinterested directors formed to execute a sale of the company, a transaction in which any losses sustained would go to the shareholders directly, not the company.\textsuperscript{139} The Schneider court based its opinion on this exceptional set of facts, in which the committee was not acting as part of the corporation at all, but as the agent of the shareholders.\textsuperscript{140} Investment banks, and the lawyers who advise them, should be wary in situations like this until more authority is available.

\textsuperscript{135} See supra, notes 120–21 and accompanying text (discussing the Stuchen court’s treatment of the plaintiff’s asserted authority).

\textsuperscript{136} See supra Parts III.A.2–3 for a discussion of Shoe-Town and Stuchen.

\textsuperscript{137} See supra notes 38–43 and accompanying text (discussing Wells and the Wells court’s extension of negligent misrepresentation liability to third-parties).

\textsuperscript{138} See Credit Alliance Corp. v. Arthur Andersen & Co., 65 N.Y.2d 536, 551 (1985) (requiring that a known party or parties were intended to rely on a representation to find near privity).


\textsuperscript{140} Id. at 571.
IV. RECOMMENDATION

Delaware courts should officially move beyond Weinberger and recognize tort liability for investment banks to third-party shareholders for negligently rendered fairness opinions. Corporate boards pay investment banks substantial sums of money for these opinions in order to avoid liability for financial decisions themselves.\(^{141}\) If these banks have no duty to prepare the opinions with care, then corporate directors, in effect, are able to spend corporate money—money that should advance the interests of the shareholders—to delegate their duties owed to shareholders to parties that have no responsibility to those shareholders themselves. In such a climate, fairness opinions are damaging to stockholders’ rights instead of benefitting the interests of the stockholders and the corporation itself.

Delaware should not, however, require privity or near privity to maintain an action for negligent misrepresentation. The concern that tort liability would “expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class”\(^{142}\) is not present in investment banker negligent misrepresentation cases. Even when “near privity” is allowed, this standard is overly restrictive because the requirement that there be conduct linking the investment bank to the shareholders to evidence the bank’s “understanding of [the shareholders’] reliance” is only satisfied in narrow circumstances.\(^{143}\) Investment banks usually know that their fairness opinions, if negligently made, will injure shareholders even when they are not in a position of privity or near privity. In all cases concerning investment bank liability to company shareholders, a discernable class of potential plaintiffs can be found: there is a limited number of shareholders in the corporation.\(^{144}\) Therefore, there is no need to limit liability by requiring privity.

Delaware courts will need to limit liability to injured parties that the investment bank either actually foresaw or reasonably should have foreseen. Both approaches have pros and cons. For instance, subjective standards, such as “actually foreseen,” can be difficult to enforce. An investment bank, which is a corporation, is a fictional entity. A fictional entity cannot “actually foresee” anything, and it is unclear who would have to “actually foresee” a plaintiff’s reliance to impute that knowledge to the bank. Plaintiffs might also be unable to realistically prove what individual investment bank employees knew. On the other hand, the potential for increased liability leads to offsetting cost in negotiations. So investment banks would theoretically charge more for an opinion issued under a reasonably foreseen liability standard than they would under an actually foreseen standard to account for the possibility of liability to a person that they had not thought of.

In the context of liability to shareholders for fairness opinions, the distinction between the “actually foreseen” and the “reasonably foreseen” approaches may be of little importance. In almost all cases, it would be difficult for an investment bank to claim that it did not actually foresee the shareholders’ reliance on the opinion. Even though opinions typically contain language claiming that they are solely for the use of a board of

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141. See Smith v. Van Gorkom, 488 A.2d 858, 871–73 (Del. 1985) (stating that fairness opinions insulate corporate directors from liability for decisions based on inadequate information).
142. Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931).
144. Martin, supra note 12, at 159–60.
directors, investment banks know in what contexts these opinions will be shown to shareholders and that shareholders will rely on the opinions.

In order to avoid the difficulty of enforcing a subjective standard, Delaware courts should allow negligent misrepresentation claims by anyone whom an investment bank should have reasonably expected to rely on a fairness opinion. Investment banks would no longer be able to disclaim liability by stating that an opinion is solely for the use of the board of directors even though they know shareholders will rely on the opinion. If investment banks want to contain their liability, they could specify in agreements that the person to whom they are issuing the fairness opinion may not disclose the opinion publicly. Then, it would be reasonable for the investment bank to assume that only the board would rely on the opinion. This would protect the bank from liability to shareholders. In circumstances where the board purchases a fairness opinion to solicit shareholder approval of a transaction, such as a leveraged buyout, the board will not agree to this language. As a result, the bank will not be able to disclaim liability by saying that the opinion is solely for the board of directors. Although this may raise the price of fairness opinions in this kind of transaction, it will also raise their value because shareholders will be able to safely rely on an opinion knowing that if it was negligently prepared, they can hold the bank responsible.

Delaware courts should also follow the reasoning of the New York Supreme Court, Appellate Division in Schneider. It is well settled that if a party is in privity with an agent, that party is also in privity with the principal. The controversial question presented in Schneider is whether a special committee can become an agent. The Schneider rationale is relevant under any theory of negligent misrepresentation because it can replace reliance by the principal with reliance by the agent—in this case, reliance by the shareholders with reliance by the board. In a fact pattern as specific as that in Schneider, this kind of liability is important to protect the shareholders’ interests because other protections, such as derivative claims, will no longer be available once the company has dissolved. If Delaware courts follow Wells and require privity or “near privity” to bring a negligent misrepresentation claim, Schneider is of further relevance because it can establish privity. In this capacity, Schneider can be used to soften the restrictive

145. Collins v. Morgan Stanley Dean Witter, 224 F.3d 496, 497 (5th Cir. 2000) (“The Agreement provided that Morgan Stanley had ‘duties solely to Allwaste’ and that any advice or opinions provided by Morgan Stanley could not be disclosed or referred to publicly without Morgan Stanley’s consent.”).

146. See Schneider v. Lazard Freres & Co., 552 N.Y.S.2d 571, 576 (N.Y. App. Div. 1990) (“We do not think it a startling proposition that a principal is in privity with his agent’s agent, or with anyone else his agent deals with on his behalf.”).

147. The Schneider court’s decision has given rise to much criticism. See, e.g., Ted J. Fiflis, Responsibility of Investment Bankers to Shareholders, 70 WASH. U. L. Q. 497, 506–13 (1992) (describing Schneider as poor precedent); Dale A. Oesterle, Fairness Opinions as Magic Pieces of Paper, 70 WASH. U. L.Q. 541, 553 n.28 (1992) (describing Schneider's rationale as “bizarre” and “fanciful”). This criticism mostly rests on assertions that, under corporate law, directors are not agents of the shareholders. However, properly understood, Schneider only addresses fact situations in which actors—although members of a board of directors in other contexts—are behaving as agents and not as corporate directors. It is circular to disclaim this agency under corporate law.

148. A derivative action is “[a] suit by a beneficiary of a fiduciary to enforce a right belonging to the fiduciary; esp., a suit asserted by a shareholder on the corporation’s behalf against a third party . . . because of the corporation’s failure to take some action against the third party.” BLACK’S LAW DICTIONARY 203 (3d pocket ed. 1996). In Schneider, the transaction at issue “contemplated [the company]’s demise.” Schneider, 552 N.Y.S.2d at 577. As a result, shareholders could not bring a suit on behalf of the corporation after-the-fact.
V. CONCLUSION

Delaware case law regarding third-party shareholder claims against investment banks when those banks issue fairness opinions to a corporation is scarce. Delaware cases addressing these issues, though not clear, support the idea that third-party shareholders can bring negligent misrepresentation suits against investment banks. However, to do so they will likely need to be in privity or “near privity” with the bank—most commonly seen when a special committee of the board, rather than the board itself, hires the bank—or they will need to show that the bank actually knew that they would rely on the fairness opinion. Delaware courts have also suggested that, in some circumstances, investment banks will owe a fiduciary duty to third-party shareholders—a largely novel approach.

In future opinions, Delaware courts should expressly allow third-party shareholders to bring negligent misrepresentation claims against investment banks and should reject privity requirements, allowing claims as long as the investment bank reasonably should have foreseen the shareholder’s reliance on the fairness opinion. This would best protect shareholders, while allowing investment banks to control the level of risk they assume when issuing opinions. Delaware courts should also allow agency principles to establish reliance in transactions that contemplate dissolution or transfer of control of the company. By expressly adopting the appropriate standards, Delaware courts can incentivize non-negligent behavior by investment banks issuing fairness opinions and allow parties to bargain for the allocation of liability, making fairness opinions fair.