



In re Nine West: A New World for Post-Closing Breach of Fiduciary Duty Liability?

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Authors:

[Mike Brewster](#)

At the end of 2020, the United States District Court for the Southern District of New York in *In re Nine West LBO Securities Litigation*, Case No. 20-2941 denied motion dismiss claims for breach of fiduciary duty and, in so doing, validated that the claims set forth a cause of action under Pennsylvania law. While the court's decision was at a very preliminary stage, it *could* mean a narrowing of protections under the business-judgment rule for directors who fail to account for expected post-closing sales. Here's why.

The relevant background to all of this starts with a merger agreement between The Jones Group, Inc. ("Jones Group") and Nine West Holdings, Inc. ("Nine West"). This agreement contemplated a multistage transaction whereby an affiliate of Sycamore Partners Management, L.P. ("Sycamore") would merge with Jones Group (a publicly traded company), and the surviving company (Jones Group) would be renamed "Nine West Holdings, Inc." Sycamore and another firm were to contribute \$395 million in equity and assume \$1.2 billion of additional debt. As the deal progressed, these terms changed. Instead of \$395 million, Sycamore and the other firm contributed only \$120 million in equity. Instead of assuming \$1.2 billion in debt, they assumed \$1.55 billion. Jones Group shareholders were cashed out at \$15 per share, for a total of approximately \$1.2 billion. As part of the transaction, some of Jones Group's profitable brands were carved out and sold to affiliates of Sycamore ("the carve-out businesses") as a separate transaction from the merger.

Four years after the close of the transaction, Nine West filed for bankruptcy. The bankruptcy trustee then sued the former directors of the Jones Group on behalf of the unsecured creditors, claiming they breached their fiduciary duty as directors by excluding from consideration the debt, spin-offs of the profitable brands, and the solvency of the surviving entity. The trustee pointed to a number of red flags the directors should have heeded:

- The projected adjusted debt to EBITDA multiple was higher than the multiple that Jones Group’s advisers had reported that the company could sustain.
- The post-merger estimated value of valuation of the company after the sale of the profitable businesses was less than the amount of Nine West’s total post-transaction debt.
- Unreasonable and unjustified EBITDA projections were used to obtain a solvency opinion in connection with the sale of the carve-out businesses.

The directors responded with a motion to dismiss. The directors argued that they could not be liable for actions that occurred after they were in control of the company. Recall that the former directors served on the board for Jones Group – not Nine West.

Sitting in diversity jurisdiction, the court not only applied federal procedure law, but also substantive Pennsylvania law. The court accepted as true every well-pled factual allegation in the complaint as is required in ruling on motions to dismiss. That is, assuming every fact is true, does this complaint set forth a cause of action? Applying Pennsylvania substantive law, the court said “yes.”

A focus of the directors’ motion to dismiss was the multistage nature of the transaction—that the directors were not part of every stage and therefore could not be held liable. Applying the proverbial substance over form, the court recognized the reality that all the steps happened at the same time—that it was essentially one integrated transaction. Thus, the directors could not isolate themselves and ignore later steps taken on their watch under the business judgment rule’s protection.

Is this ruling a harbinger of tectonic changes for directors and the business judgment rule? It’s unclear at this point. This ruling is preliminary—it only decided that the complaint does say enough that the directors *could* be liable. Courts, in general, are hesitant to dismiss a case at this stage unless the complaint fails to set forth a cause of action. It is, therefore, not horribly surprising that this court overruled the directors’ motion to dismiss. Moreover, at the motion to dismiss stage, the only facts that are considered are those alleged in the complaint. The directors have not had a chance to tell

their side of the story, which they will certainly do. Stay tuned.

Though not a crystal ball, this decision in *In re Nine West* still bears many fruits.

The board should consider the post-closing solvency of the company and should take steps to document this. At the very least, a board cannot ignore solvency-affecting information, and the board would do well to ensure that its vigilance in this regard is documented.

Boards cannot find protection in the insulating spaces of a multistage deal when, in reality, it's one integrated transaction.

A board ignores significant deal changes at its peril. Instead, these should be met with subsequent meetings and thoughtful, documented consideration of what these changes are and whether other changes must be made to deal with them.

Red flags regarding post-merger insolvency will likely not be resolved by shortcuts. While time is often of the essence, the use of inflated solvency reports to obtain the opinions required is a recipe for litigation.

For more information, contact [Mike Brewster](#) or any member of Frost Brown Todd's [Private Equity](#) industry team.

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