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11th Circ. Weighs In On Duty To Disclose Merger Talks

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Corporate merger negotiations are typically conducted under a veil of secrecy, with public disclosure withheld until the end when a definitive agreement has been signed. The fear is that premature disclosure of preliminary merger talks will negatively impact the deal. For example, early disclosure might encourage speculative investment in the target company's stock, driving up the price and diminishing shareholders' perception of the offered premium, or even cause potential bidders to be reluctant to make an offer in the first place.

In light of these problematic scenarios, courts widely recognize that typically, there is no duty to disclose merger negotiations prior to the execution of a definitive merger agreement. See, e.g., Thesling v. Bioenvision Inc., 374 F. App'x 141, 143 (2d Cir. 2010) (there is "no express duty [that] requires the disclosure of merger negotiations, as opposed to a definitive merger agreement"); Williams v. Dresser Industries Inc., 120 F.3d 1163, 1174 (11th Cir. 1997) ("In the context of sales of stock while negotiations for merger or acquisitions were pending, courts have found no duty to disclose the negotiations").

The Eleventh Circuit recently considered this issue and found that a duty to disclose can, in fact, exist with respect to merger discussions. In Finnerty v. Stiefel Laboratories Inc., 756 F.3d 1310 (11th Cir. 2014), a former employee (Finnerty) of a privately held pharmaceutical company (Stiefel) received notice that he was entitled to a distribution of vested benefits from Stiefel's employee stock bonus program. Finnerty also received a "put" option on the stock he received, which allowed him to direct Stiefel to repurchase the stock at fair market value.

Finnerty requested his distribution and sold his shares back to Stiefel in February 2009. Unbeknownst to him, Stiefel was at that time in the early stages of negotiating the sale of the company to a larger pharmaceutical company. After receiving bids from two suitors, Stiefel consummated a sale transaction with GlaxoSmithKline in April 2009, two months after Finnerty exercised his "put" and received fair market value for his stock. The value received by Stiefel shareholders in the GSK transaction was more than four times per share what Finnerty had received two months earlier. He brought suit for securities fraud, alleging that Stiefel had a duty to disclose its merger negotiations and had failed to do so.

At trial, the jury returned a verdict in favor of Finnerty, awarding him $1.5 million in compensatory damages. The district court denied Stiefel's motion for a judgment as a matter of law, and the Eleventh Circuit affirmed, finding that Stiefel had a duty to update Finnerty prior to the share repurchase.

The Eleventh Circuit's decision was significantly influenced by statements made by Stiefel management over the years regarding the "great pride" the company took in its privately held status. In particular, two years before the GSK merger, Stiefel's CEO wrote an email to employees announcing a new minority investor and assuring recipients that Stiefel would "continue to be a privately held company operating under my direction."

Then, shortly before the GSK merger was consummated, Stiefel management allegedly told employees that the company was "'160 years in the [Stiefel] family' and that there were no plans 'to change that.'" Based on these assurances, the Eleventh Circuit found that Stiefel "had a duty to disclose facts that were necessary to make its 'will continue to be privately held' statements not misleading."

Because of its recent vintage, it is not yet clear the extent to which Finnerty has altered the merger landscape. One thing, however, is certain: Finnerty has not created a general duty to disclose at the outset of merger negotiations. In fact, the decision expressly refrained from answering whether and when Stiefel had a duty to articulate its intentions to the public at large. 756 F.3d at 1319 ("we do not decide whether [Stiefel] had an immediate duty to update the public" regarding the merger discussions). Rather, the decision explains that Stiefel could have satisfied its "duty to update" by communicating, at least to Finnerty, that "a sale of the company was under consideration." Id.

In its motion for a rehearing en banc, Stiefel challenged the notion that Finnerty could be narrowly applied, arguing that it would be functionally impossible to make a highly confidential disclosure to one employee without disclosing to all. Thus, Stiefel contended that the panel's decision effectively requires immediate and unrestricted disclosure of a company's preliminary consideration of merger options.

Finally, Stiefel posited that, post-Finnerty, companies will be faced with a dilemma of choosing between complying with new disclosure obligations or meeting fiduciary duties related to maximizing corporate value for its shareholders. The Eleventh Circuit, however, denied rehearing en banc, and the Finnerty decision remains good law in that circuit.

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