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Mergers and Acquisitions

Attorneys Provide Key Takeaways of High Court Affirming RBC's Liability

A recent Delaware Supreme Court decision affirming that Royal Bank of Canada aided and abetted Rural/Metro Corp. directors' breaches of fiduciary duty in connection with a $438 million buyout is a red flag to investment bankers, attorneys said.

Practitioners agreed that the decision serves as a warning to firms advising boards on deals that they may be held liable when they stand on both sides of a transaction.

However, the ruling also clarifies that the aiding and abetting standard is high and that financial advisers won't be liable for failing to prevent every breach of duty, they said.

Aiding and Abetting Upheld. The state high court's decision stemmed from a shareholder lawsuit alleging that the company's board breached its fiduciary duties by approving a 2011 merger with a Warburg Pincus LLC affiliate.

In March 2011, the Delaware Chancery Court concluded that Rural/Metro's board breached its fiduciary duties and that RBC aided and abetted those breaches by misleading directors about the company's true value in order to get the deal completed quickly (12 CARE 293, 3/14/14)(41 CARE, 10/17/14). Subsequently, the chancery court ordered RBC to pay $75.8 million in damages—constituting 83 percent of the total damages suffered by the class of shareholders.

On appeal, the Delaware Supreme Court Nov. 30 upheld the lower court's rulings (78 CARE, 12/1/15).

Knowledge, Participation. Former Delaware Supreme Court Justice Henry duPont Ridgely, who now is senior counsel with DLA Piper, and John L. Reed, the partner in charge of DLA Piper's Delaware litigation practice, told Bloomberg BNA in a joint e-mail that a financial adviser can be held liable for aiding and abetting if it ''knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating an informational vacuum.''

Jayne Juvan, a New York-based partner at Roetzel & Andress LPA, also noted in an e-mail that the Supreme Court's decision serves as a warning to financial advisers to manage conflict situations prudently and take their disclosure requirements seriously.

Juvan, who co-chairs the American Bar Association's Task Force on Director Misconduct, observed that the damages awarded in the case were not insignificant. ''Financial advisors that have large damage awards similar to those in this case may suffer harm to their reputation given that these cases typically are widely covered by the media,'' she warned.

Not 'Gatekeepers.' However, the state high court declined to adopt the lower court's description of financial advisers' role in mergers and acquisition deals as ''gatekeepers,'' observed Albert Manwaring IV, a Wilmington, Del.-based partner at Morris James LLP. In addition, the court stressed that its ruling was narrow, he said.

Accordingly, while the court has sent a strong message to bankers playing both sides of the deal, it also ''assuages the concerns of bankers'' who act in good faith and are transparent about disclosing conflicts of interest, Manwaring said in an interview.

One key takeaway from the decision is that Delaware courts will not view financial advisers as ''policemen for the board'' when advising on transactions and they will not be required to seek out and prevent the board from violating its fiduciary duty of care, he said.

Ridgely and Reed similarly observed that the financial adviser's role is primarily contractual, and it doesn't have an obligation to prevent all breaches of duty. ''But a financial advisor cannot act contrary to the interests of the board and mislead the board in a way that causes the board to breach its duty of care,'' they said in their e-mail.

The DLA Piper attorneys also noted that RBC's liability was based upon unique and unusual facts that were not challenged on appeal. ''Other recent cases will be decided upon their own facts under the principal legal holdings explained in RBC,'' they said. ''Aiding and abetting liability remains among the most difficult claims to prove and the Supreme Court reiterated that point in the RBC Opinion.''

Impact from Ruling. Going forward, Ridgely and Reed said there may be broader indemnification provisions in adviser engagement letters, with possible choice of law and forum provisions selecting a jurisdiction other than Delaware to try to prevent a Delaware court from striking the provision as void against public policy.

''We may also see efforts to narrowly define the scope of services and perhaps disavow knowledge of what the directors are or are not doing, which could have the perverse effect of reducing information flow,'' they said.

Manwaring suggested that sellers, boards and advisers have engagement letters that spell out an ongoing obligation to keep boards apprised of conflicts of interest that impact their analyses.

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''Counsel to boards, special committees and investment bankers guiding corporate sales processes must emphasize the requirement for complete and ongoing banker disclosures of conflicts of interest to the seller's board,'' a client memorandum authored by Manwaring said. ''This obligation should be memorialized in the banker's engagement letter to the seller.''

By Michael Greene

To contact the reporter on this story: Michael Greene in Washington at mgreene@bna.com

To contact the editor responsible for this story: Yin Wilczek at ywilczek@bna.com

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