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Takeaways from the Delaware Supreme Court's *RBG* decision

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While confirming the narrow contours of aiding and abetting liability, in upholding a $75 million judgment against the target's financial advisor, the Delaware Supreme Court's opinion in *RBC Capital Markets, LLC v. Joanna Jervis*, 2015 WL 7721882 (Del. November 30, 2015) further debunks the myth that Delaware is a defendant friendly jurisdiction in which plaintiffs will struggle even when they bring meritorious cases. Indeed, the court's dissection of various conflicts of interest and flaws in the sales process makes the opinion a cautionary tale that should be carefully reviewed by all participants in mergers and acquisitions transactions.

The case arose out of the sale of Rural Metro Corporation, a leading national provider of ambulance and private fire protection services, to an affiliate of Warburg Pincus LLC. Although the complaint named as defendants Rural's board of directors as well as the two financial advisors retained to advise the board's special committee, the case went to trial only against RBC as both the individual defendants and the secondary financial advisor settled before trial for $6.6 million and $5 million respectively. That posture gave rise to some interesting trial tactics by plaintiffs who (no doubt being mindful of possible contribution and apportionment claims that could arise post-verdict) elected not to contend that any of the individual defendants breached their duty of loyalty, while nevertheless pointing out various "personal circumstances that inclined them towards a near-term sale." *RBC*, 2015 WL at 4. Plaintiffs' "divide and conquer" strategy proved adept and no doubt led at least in part to appellant's urging that its arguments "do not require this Court to review findings of fact," an invitation the Supreme Court declined to accept.

In declining the appellant's invitation to avoid a review of the factual record, the court agreed with the Court of Chancery's conclusion that the board's conduct failed *Revlon* scrutiny" *Id.* at 26, which requires courts "to examine whether a board's overall course of action was reasonable under the circumstances as a good faith attempt to secure the highest value reasonably attainable." *Id.* at 23.

The court began its analysis by confirming that the evidence supported the chancery court's finding that two of the three members of the special committee as well as the CEO had "unique reasons to favor a near-term transaction." The special committee chair who lead the negotiations managed a hedge fund with a significant investment in the company. That fact would normally support a finding that the director's interest was aligned with shareholder interests in maximizing sale value. However, in this instance, the chancery court found and the Delaware Supreme Court confirmed that the fund's investment strategy was in conflict with the long-term growth strategy favored by the company's newly hired CEO, which would have required significant investment by

the company. Another committee member was faced with being forced to give up his board seat the following year to avoid violating an ISS policy against "over-boarded directors." Consequently, a sale would allow him not only to satisfy the ISS policy and avoid a negative ISS recommendation with respect to his other board positions, but also allow him to realize the value of his unvested equity interest in Rural that would have otherwise been lost upon his resignation from the board, absent a change of control. The court then discussed the sudden change in position of the CEO who, as a board member, was not originally inclined to a sale until he had the opportunity to implement what the chancery court found to be a growth strategy that was "reasonable and achievable." The chancery court found that change in position only came after the CEO had received a poor performance review from the special committee chair, who believed the CEO was being negative towards potential acquirers, and the CEO's realization that the buying pool was comprised almost entirely of private equity firms who would likely retain the CEO if he was supportive of a sale.

The court then turned to the overstepping by the committee of the authority delegated to it by the board, which the court found was attributable at least in part to a failure by the board to exercise due care in overseeing the committee's actions. The court noted that the board originally formed a special committee not for the purpose of selling Rural but rather to evaluate RBC's suggestion that the company acquire its primary competitor, American Medical Response Inc. (AMR), a subsidiary of Emergency Medical Services Corporation (EMS). The board subsequently re-formed the special committee to evaluate strategic alternatives after hearing a presentation by the committee chair as to three options available to the company: (1) continuing to pursue the standalone growth strategy; (2) pursue a sale; or (3) pursue some alternative business combination, including the acquisition of AMR. The board then unanimously agreed at a December meeting that the company should "engage an appropriate strategic advisory team and pursue an in-depth analysis of the alterna-

*tives discussed during the meet*ing." *Id.* at 5. Absent, however, was any authorization for the committee to pursue a sale.

The special committee then proceeded to interview various financial advisors, including RBC. In contrast to the other firms, RBC focused its presentation on a sale of Rural and recommended that the process be coordinated with the recently announced strategic review being undertaken by EMS. RBC recognized that a private equity buyer for EMS "might decide to buy Rural rather than sell AMR." *Id.* at 5. Consequently, RBC was simultaneously discussing internally how it could use a position as a "sell side" advisor for Rural to secure for itself a buy-side role with private equity firms bidding for EMS." RBC did disclose to the committee its desire to provide "financing to potential buyers of Rural and that the committee minutes reflected a discussion of "the pros and cons of retaining an investment banker as a financial advisor if that advisor would also seek to provided so called 'stapled financing.'" *Id.* at 7. Unfortunately, while the committee followed the advice of its counsel that it should retain a second firm not involved in such financing, the court found the evidence supported the chancery court's finding that the committee and the board failed to follow the balance of the advice that the directors be "especially active and vigilant" in monitoring potential conflicts. *Id.* at 16.

The chancery court also found that RBC did not disclose to the committee or the board that it planned to use its engagement as Rural's advisor to obtain financing work from the bidders for EMS at any time. Nor did the proxy ever disclose this conflict to stockholders when they voted to approve the transaction. The court found that the evidence supported the chancery court's findings not only with respect to the undisclosed conflict but also with respect to other flaws in the process and the board's oversight of that process. For example, the court found the evidence supported the chancery court's finding that the board acted without adequate information as to value or alternatives available to the company, including the standalone option.

Although the committee met twice in February, there was no presentation with respect to any valuation metrics despite the receipt of initial bids. Notwithstanding the lack of valuation metrics or any detailed information concerning the quality of the bids, the committee set a final bid deadline of March 21 and decided not to solicit any interest from strategic acquirers even though RBC had only identified financial buyers up to that point. As to the full board, which had not had a single meeting to discuss the process since early December and had yet to authorize a sales process, it did not meet again to discuss the committee's progress until March 15. Just as with the February presentations to the committee, the presentations by RBC to the full board failed to provide any valuation metrics and provided no opinion on the quality of the bids received.

The court then went on to discuss two more flaws in the process undisclosed to either the board or to Rural's stockholders in the company's proxy. First, the court discussed at some length the intensive efforts made by RBC to secure a role for itself in the financing by Warburg Pincus, who eventually emerged as the winning bidder. Indeed, just days before final bids were due, RBC sent Warburg executed commitment papers for stapled financing, an offer to which Warburg did not respond. Undeterred, RBC continued to press for a role in the financing of Warburg's bid but did not disclose this fact to the committee when it directed RBC to engage in final price negotiations with Warburg. Second, the court reviewed the chancery court's finding that RBC "manipulated the valuation process" and found that the record evidence "supports the trial court's factual finding that ... RBC worked to lower the analysis in its fairness presentation so Warburg's bid looked more attractive." *Id.* at 17. Significantly, none of the changes detailed by the court were disclosed to the committee, the board or to stockholders.

Given its determination that the evidence supported the chancery court's findings, it should come as no surprise that the court affirmed the judgment, albeit in a narrow manner. Citing to its earlier decision in *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001), the court reiterated that aiding and abetting liability requires, amongst other elements, "knowing participation", which demands "that the third party act with knowledge that the conduct advocated or assisted constitutes such a breach." *RBC*, 2015 WL at 32. The "knowing" element requires the aider and abettor to act with "scienter" that is "knowingly, intentionally, or with reckless indifference ... an illicit state of mind." *Id.* at 33. The court noted that a bidder, for example, could have the required state of mind if the bidder "attempts or exploits conflicts of interest in the board." *Id.* at 32. Under the chancery court's analysis, a third party who "knows the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum ... can be liable for aiding and abetting." *Id.* The Delaware Supreme Court affirmed.

While the court concluded that the evidence supported the chancery court's conclusion that RBC "purposely misled the Board so as to proximately cause the Board to breach its duty of care", it emphasized that its "narrow" holding "should not be read expansively to suggest that any failure on the part of a financial advisor to be prevent directors from breaching their duty of care gives rise to a claim for aiding and abetting." *Id.* at 35. To the contrary, the court affirmatively rejected the chancery court's "gatekeeper" description of the role of a financial advisor in M&A transactions.

Despite the narrow nature of the court's aiding and abetting ruling, it would be a mistake for practitioners to treat this opinion as an anomaly. It bears emphasizing that the court did rule that the board breached its duty of care, one of the prerequisites for the imposition of aiding and abetting liability on advisors. Moreover, the court flatly rejected appellant's argument that "the trial court erred by finding a due care violation without finding gross negligence." *Id.* at 29. While acknowledging that to impose liability on disinterested directors, there must be a finding of gross negligence, the court left no doubt that directors subject to *Revlon* duties breach those duties when engaging in conduct that falls "outside the range of reasonableness ... sufficient [as a] predicate for ... aiding and abetting liability" *Id.* The court also made clear that directors' immunity from damages or contribution under Section 102(b)(7) does not preclude damages being assessed against a third party for knowingly participating in the directors' breach, particularly since the third party is entitled to a judgment reduction under Delaware's Uniform Contribution Among Tortfeasors Act for the share of liability for any directors not entitled to exculpation. *Id.* at 38-43. Significantly for practitioners, the court expressly noted in a footnote the chancery court's finding that, but for the settlement, the committee chair and CEO's conflicts were significant enough that they would have "shared a common liability with RBC to the class." *Id.* at 4.

RBC has a number of significant takeaways for practitioners. First, practitioners should carefully review potential conflicts of all transaction participants at the start of the process, update that review as matters develop, and document that review and all efforts to eliminate or mitigate those conflicts. Second, be sure to provide directors with valuation analysis even on a preliminary basis as early as possible and continue to update that analysis on a frequent basis. Third, directors need to actively participate in overseeing the process at least through the receipt of updates that are well documented, regardless of whether or not they are on transaction committees. Fourth, stapled financing, while not improper, adds conflict risk to a transaction that needs to be carefully monitored and managed throughout the process, all of which begins by a discussion of how such financing can increase value to stockholders in a potential transaction. Lastly, directors cannot be afraid to take reasonable risks, even in Revlon land. Courts are not looking for perfect decisions, just decisions within the range of reason that reflect "a good faith attempt to secure the highest value reasonably attainable."

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