



Delaware Chancery Court Holds Financial Advisor Liable for Aiding and Abetting Fiduciary Duty Breaches

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On March 7, 2014, Vice Chancellor Laster issued his decision in *In Re Rural Metro Corporation Stockholders Litigation*, holding that RBC Capital Markets, LLC was liable for aiding and abetting breaches of the duties of care and disclosure by the board of directors of Rural/Metro Corporation in connection with Rural's acquisition by Warburg Pincus LLC in 2011.¹ The opinion, like the Chancery Court decisions in 2011 with respect to the Del Monte Foods and El Paso Corporation acquisitions, serves as an important reminder that courts may closely examine the role and conduct of sell-side financial advisors and may determine that conflicts or potential conflicts of interest affecting a financial advisor, particularly if combined with less than vigorous board oversight and behavior, can taint an entire sale process.

According to the Court's findings, the Rural board of directors authorized a special committee to retain a financial advisor to review strategic alternatives for Rural, but the special committee did not follow this directive and instead hired RBC as financial advisor to sell the company. RBC made known its plan to offer staple financing to potential buyers in a company sale process but did not disclose its interest in cross-selling its engagement as sell-side advisor to Rural to try to secure financing work from bidders for the acquisition of Emergency Medical Services Corporation (EMS), a Rural competitor also for sale at the time. According to the Court, RBC recommended, and the special committee approved, an immediate launch of the Rural sale process despite what the Court viewed as "obvious and readily foreseeable disadvantages" to that schedule. The Court further criticized RBC for prioritizing its focus on potential bidders who also were participating in the EMS sale process.

After several bidders dropped out of the Rural process because of, among other things, the difficulty of simultaneously bidding for EMS, Rural's board of directors approved, in late March 2011, the sale of Rural to Warburg Pincus for \$17.25 per share, representing a 37.5% premium over Rural's share price. The Court criticized the Rural directors for failing "to provide active and direct oversight" of RBC during the final negotiations, noting in its findings RBC's repeated (but unsuccessful) efforts to secure a role to provide buy-side financing to Warburg Pincus without guidance or inquiry from the Rural directors on the subject. The Court also noted that the Rural directors did not receive any valuation analysis from RBC concerning Rural until shortly before the meeting to approve the transaction with Warburg Pincus and that the final

¹ Plaintiffs initially filed suit against the members of the Rural board of directors and its financial advisors, RBC and Moelis & Company LLC. Moelis had been hired as a second financial advisor. Shortly before trial, the Rural directors and Moelis settled the case.

analysis it did receive was inconsistent with RBC's previous presentation to the board (when it was seeking to be hired) and the board's business plan or was incorrect.²

Applying the enhanced scrutiny "reasonableness" standard of review under *Revlon*, Vice Chancellor Laster held that the Rural board of directors' decision-making process, including the information on which the directors based their decision, fell outside the range of reasonableness. In particular, he held that the decision to launch an immediate sale process was outside the range of reasonableness because the Rural board of directors had not authorized the sale process and, more generally, because RBC's motives with respect to the EMS auction undermined the integrity of the sale process. He noted that a well-informed board might have considered a variety of potential benefits to the timing of the path the special committee and RBC chose to follow, but that neither the board nor the special committee did so. He also appeared in part to be influenced by "personal circumstances" that confronted members of the special committee, which he suggested "helped shape the boardroom environment in which RBC operated." Focusing on the board's lack of oversight with respect to RBC's efforts to provide financing to Warburg Pincus, the absence of any preliminary valuation analysis and criticisms regarding the final valuation materials, he also concluded that the decision to approve the transaction with Warburg Pincus was outside the reasonableness range.

The Court concluded that RBC had knowingly participated in the Rural directors breach of fiduciary duty by creating an informational vacuum that misled the Rural directors into breaching the duty of care, though Vice Chancellor Laster noted that the Delaware Supreme Court has not explicitly ruled on whether an aiding and abetting claim can be made where the underlying breach of duty is based on a board's grossly negligent conduct. The Court also held that (i) the exculpatory provision in Rural's certificate of incorporation eliminating a director's personal liability for monetary damages for a breach of the duty of care did not apply to its financial advisors and (ii) Rural's general acknowledgment in its engagement letter with RBC that RBC may extend acquisition financing to other firms did not constitute a sufficiently specific waiver of RBC's conflicting interest to secure buy-side financing assignments.

Finally, the Vice Chancellor found that Rural's proxy statement relating to the merger did not disclose, among other things, RBC's motivation to use the Rural sale process to seek a role in the financing of the EMS acquisition or its efforts to participate in the Warburg Pincus financing, and repeated the materially misleading financial analyses previously presented to the Rural board.

The Court held that the value of Rural at the time of the sale to Warburg exceeded the deal price but has required revised expert submissions on valuation and additional briefing on RBC's contribution defense before reaching a decision on damages. Rural has since filed for bankruptcy.

² The decision highlights the care that a financial advisor must take in developing and modifying its valuation materials throughout a sale process.

The Court's decision reflects the skepticism that informs recent Chancery Court review of certain transactions involving conflicts or potential conflicts of interest and, in that regard, underscores the importance to the directors (and their advisors) in a *Revlon* process to identify, understand and carefully consider the implications of financial advisor arrangements, relationships and potential conflicts and, in the case of the directors, to maintain an active, engaged involvement in and oversight over the sale process. You can download a copy of the opinion by clicking [here](#).

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For more information about the opinion or related matters, please contact any of the members of our Mergers and Acquisitions or Litigation Practice, including those listed below.

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