

# Rural Metro: Another Shackelton Expedition Falls Short of the Podium

By Yvette Austin Smith and Torben Voetmann

An anxiously-awaited Delaware Chancery Court opinion may be a milestone in the evolving dynamics between corporate boards of directors and investment bankers. While the opinion was merely confirmatory on well-trodden subjects like staple financing, ethical walls, and unfortunate emails unearthed during discovery, the opinion may prove landmark in redefining the role of investment banks in facilitating the fiduciary duty of care in M&A transactions.

In the March 7th *Rural Metro* opinion<sup>1</sup>, Vice Chancellor Travis Laster found Royal Bank of Canada (RBC) liable for aiding and abetting breaches of fiduciary duty by Rural Metro's board of directors. RBC had been retained by a Special Committee<sup>2</sup> of the Board to advise Rural Metro on its ultimate sale to private equity firm Warburg Pincus in June 2011. Faulting RBC's "full court press" to provide buy-side financing, a self-interested and "unreasonable" sale process, and RBC's creation of "information gaps" among the company's directors, the Vice Chancellor concluded that RBC was liable in connection with breaches of the duty of care and the duty of disclosure by Rural Metro directors.

Vice Chancellor Laster's detailed opinion has the potential to fundamentally alter the relationship between corporate directors and the investment banks they retain to advise on M&A transactions. After the Delaware Court's then-landmark 1985 *Smith v. Van Gorkom* decision<sup>3</sup>, corporate directors were put on notice that they are obligated to a duty of care in approving an M&A transaction. Though not strictly required following *Van Gorkom*, fairness opinions issued by the investment banking advisors to the board became *de rigueur* to confirm that the directors had met their duty of care in the context of an M&A transaction. Following *Rural Metro* (and on the heels of *Del Monte*<sup>4</sup>), investment banks – at least those who want to avoid shareholder liability – will have a vested interest in ensuring that directors fulfill this fiduciary duty of care. Furthermore, the *Rural Metro* opinion implicates a wide range of investment banker conduct and professional judgment calls that could, in hindsight, result in liability for aiding and abetting a breach of a corporate director's duty of care.

## ROLE OF THE GATEKEEPER

From the perspective of investment bankers, one of the most sobering edicts of the *Rural Metro* opinion is the banker's role as "gatekeeper," charged with "provid[ing] sound advice, monitor[ing] clients, and deter[ing] client wrongs." By emphasizing a near-term sale of the company, RBC was said to have perpetuated a situation in which the directors

<sup>1</sup> *In Re Rural Metro Corporation Stockholders Litigation*, 6350-VCL (Del. March 7, 2014)

<sup>2</sup> The chair of the Special Committee of the Rural Metro board of directors was Christopher Shackelton.

<sup>3</sup> *Smith v. Van Gorkom* (The Trans Union Case) 488 A.2d 858 (Del. Jan. 29, 1985)

<sup>4</sup> *In re Del Monte Foods Company Shareholders Litigation*, C.A. No. 6027-VCL (Del. Ch. Feb. 14, 2011)

were not sufficiently informed about the value of the company's other strategic options, including an option not to engage in a transaction at all. Notwithstanding that the special committee and the CEO also appeared to favor a near-term sale, RBC appears to have been implicated in this breach of fiduciary duty, in part, because "[d]irectors are not expected to have the expertise to determine a corporation's value for themselves, or to have the time or ability to design and carry out a sale process. Financial advisors provide these expert services." Vice Chancellor Laster repeatedly criticized RBC for not providing the special committee with valuation analysis until the night before the board voted to approve the transaction. In doing so, the Court reasoned, RBC "knew that the Board and the Special Committee were uninformed about [the company's] value when making critical decisions." The Vice Chancellor had further criticism for the actual valuation analysis.

This banker-as-gatekeeper role represents a significant departure from *Smith v. Van Gorkom*. Since the 1985 case, investment banks have been routinely called upon to issue fairness opinions in M&A transactions. Corporate directors have come to rely on fairness opinions to help demonstrate the fulfillment of their duty of care in the context of an M&A transaction. However, a banker's fairness opinion only speaks to a specific transaction. It is not a comparative analysis between a proposed transaction and other strategic alternatives. If an investment bank finds a transaction "fair," that does not ensure that the proposed transaction is the course of action that will maximize value to the company or its shareholders. While a director's duty of care may have always encompassed this broader analysis, the role of investment banks in facilitating a director's duty of care was more narrowly drawn, until *Rural Metro*.

Post-*Rural Metro*, investment banks and boards of directors may need to decide on a relationship and business model that provides for, and contemporaneously documents that, directors were fully informed about the value of a range of strategic options that include, but are not limited to, a specific transaction. Furthermore, in light of the heightened risk of an aiding and abetting claim, investment banks may feel the need to reach an *independent* assessment of whether directors are sufficiently informed to fulfill their duty of care. From the perspective of the investment bank, even a well-intentioned but unsophisticated board will present new risks. A successfully pled breach of fiduciary duty claim against the directors will open the door for an aiding and abetting claim against the bank. This is true even when, as in *Rural Metro*, the directors have been exculpated for the breach under section 102(b)(7) of the Delaware General Corporation Law. Vice Chancellor Laster found that the protection of section 102(b)(7) does not extend to "aiders and abettors."

## BOARD BOOKS CONTINUE TO BE LANDMINES

If there was still any doubt, *Rural Metro* also confirms that investment banker presentations can be a significant liability in M&A litigation. Over the last few years, the Delaware Courts have increasingly focused on so-called board books to scrutinize the valuation analyses performed by bankers. Cases such as *Steinhardt v. Howard-Anderson (Occam Networks)*<sup>5</sup> ushered in the Court's time series analysis of these books, comparing earlier and later versions of these presentations and highlighting analytical differences that appeared questionable in hindsight. *Rural Metro* continues this time series analysis. However, by comparing RBC's board books to presentations prepared by other investment banks, *Rural Metro* adds another potentially troubling dimension to the Court's review of banker analysis.

RBC's early presentations to the Rural Metro board included its initial pitch book (to win the advisory assignment) and draft versions of the final board book that supported the fairness opinion presentation. The Court's reference to RBC's initial pitch book may signal that the Court has grown less receptive to the idea that pitch books contain a degree of puffery that is distinguishable from board presentations that are subsequent to the retention of the investment banking firm. Nonetheless, the Court was clearly troubled by some of the differences it noted in its longitudinal analysis

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<sup>5</sup> In *Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL (Del. Ch. Jan. 6, 2012)

of RBC's board presentations. The Vice Chancellor described RBC's valuation analysis as "manipulated," with a goal to making the Warburg acquisition appear fair. However, the Court also appeared troubled by a comparison of RBC's board presentations to pitch materials prepared by three other investment banks. Two of the banks, JPMorgan Chase and Houlihan Lokey, were not actually retained to advise Rural Metro's special committee and, therefore, the preliminary opinions and analyses reflected in those presentations would not have reflected information obtained by RBC during the sale process. The third bank, Moelis & Company, was retained in a secondary role and later settled shareholder claims against it in this litigation. According to the *Rural Metro* opinion, RBC's presentation differed from those of the other banks in regards to the emphasis and timing of a sale of the company. These differences were not only noted in the *Rural Metro* opinion, but appear to have been viewed negatively by the Court.

Such comparisons create a dilemma for corporate directors and bankers. Directors have an interest in hearing a multiplicity of, albeit, expert and well-reasoned opinions from investment banking firms. But if a risk of liability attaches to the contrarian opinion, what investment bank will step into that role? *Rural Metro* may actually stifle a fulsome consideration of a company's strategic options by encouraging the investment banking firm with the contrarian opinion to remain silent. If a Court later finds that the directors breached their duty of care by embarking on the contrarian path, the investment bank will face the risk of aiding and abetting that breach for having advised the company on that contrarian path. As a result, corporate directors may find it increasingly difficult to find a differentiated opinion among its investment banking advisors.

## **BAD FACTS MAKE BAD LAW?**

One early response to *Rural Metro* has been that "bad facts make bad law." The authors of this article are not attorneys and have no qualifications to speak to the veracity of the law. However, we do note that the same might have been said for *Smith v. Van Gorkom*. As described in the 1985 opinion, the actions of the corporate directors in *Van Gorkom* appear almost implausible today – "bad facts," indeed. Nonetheless, corporate directors and investment bankers have been living with fairness opinions ever since. However, *Rural Metro* may have a more unfortunate distinction. Bad facts may be to blame for a bad outcome. RBC was essentially excluded from the buy-side financing in the completed transaction and Warburg's equity stake in Rural Metro was reportedly wiped out after the company filed for Chapter 11 in August 2013.

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