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The Delaware Courts and the Investment Banks

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A doctrinal innovation in Delaware law that first appeared a year ago is threatening to mature into a full-on trend: through the tort of "aiding-and-abetting" fiduciary breach, the Delaware courts, accepting the invitation of the stockholder-plaintiffs' bar, have begun to take on the task of regulating the M&A advisory function of investment banks. In October 2014, the Court of Chancery awarded stockholder plaintiffs $76 million in damages against an investment bank for aiding and abetting breaches of the duty of care by the directors of Rural Metro, an ambulance company that was sold for a 37% premium in 2011 and was bankrupt by the time of trial. The novel theory of the decision was that conflicted bankers dispensed self-interested advice, which left Rural Metro's directors uninformed and hence induced them to breach their duty of care in approving the sale. Although the directors were not liable for the breach (because they had settled and were exculpated at any rate), the court found that the bankers were.

Rural Metro initially appeared to be an outlier, driven by bad facts. But the Court of Chancery has recently applied the *Rural Metro* analysis in a variety of procedural and factual settings. In the course of these decisions, the court has suggested that certain banker conflicts may be unwaivable, even if independent directors believe that a waiver reflects sound business judgment, and that independent directors may breach their duty of care by failing to investigate a bank's representation that it does not have a material conflict.

Among the difficult policy and doctrinal questions raised by this line of decisions: Can aiding-and-abetting, which is historically akin to civil conspiracy, fairly be extended to regulate banker conduct? Does imposing aiding-and-abetting liability based on exculpated director conduct undermine the Delaware legislature's determination to authorize charter provisions that exculpate directors from liability for breaches of the duty of care and the stockholders' vote to adopt such provisions? Does the use of tort principles to allow stockholder plaintiffs to directly challenge the work of bankers impair the ability of boards and financial advisors to privately order their affairs through contract? Does recognizing this new form of banker liability induce courts to find due care violations by directors that would seem unjustified were the reviewing court being asked to hold directors themselves personally liable? What are the unintended consequences—to duty-of-care doctrine, to litigation incentives, to the character and price of financial advice, to banker indemnification practices, to the role of other advisors—of this doctrinal departure?

The Delaware Supreme Court has now heard argument in *Rural Metro*, and its decision, expected in the coming months, will likely answer some of these questions. In the meanwhile, the cases suggest practical lessons for dealmakers. The first is that disclosure matters: under the Supreme Court's recent*KKR Financial* ruling, approval of a transaction by a fully informed stockholder electorate requires deferential judicial review and will likely lead to dismissal of aiding-and-abetting claims based on a breach of the duty of care. Directors should also consider more detailed inquiry into their investment banks' dealings with potential transaction partners and more searching examination of their bankers' advice. And banks must take account not only of the potential for exposure, and consider internal conflict processes to limit it, but also of the much greater likelihood, conflicts aside, that they and their work product will be targeted by the stockholder-plaintiffs' bar in any case.

We hope that the Delaware Supreme Court's decision will enable us to give definitive advice to boards of directors and their bankers and other advisors that will foreclose this type of litigation.