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Delaware Supreme Court Affirms *Rural/Metro* Decision, Including Aiding and Abetting Liability

The Delaware Supreme Court has issued its much anticipated opinion in *RBC Capital Markets* v. *Joanna Jervis,* affirming all of the principal holdings of the Court of Chancery's series of decisions in *In re Rural/Metro Corp. S'holder Litig*. The opinion speaks to a multitude of issues, but we focus on the breach of fiduciary duty and aiding and abetting liability claims in this update.

In *In re Rural/Metro*, the Court of Chancery found that the directors of Rural/Metro Corporation had breached their duty of care under the enhanced *Revlon* standard of review by failing to act within a range of reasonableness in overseeing the sale of the company in 2011. Among other things, the Court of Chancery found fault with (i) the board's decision to run its sale process concurrently with that of a competitor (which effectively reduced the number of potential bidders for Rural/Metro because some bidders would be prevented by confidentiality agreements or otherwise from bidding on both companies at the same time), (ii) the board's allowing its special committee to put the company in play prior to full board approval of such action and (iii) the board's failure properly to supervise its financial advisor. Further, the Court of Chancery found the financial advisor liable for aiding and abetting the fiduciary duty breaches of the board in connection with the sale because, among other things, the financial advisor (i) allowed its interest in pursuing buy-side financing to affect Rural/Metro's sale process, (ii) failed to adequately inform the board of its conflicts of interest and (iii) provided a flawed valuation analysis, which, in addition, was not delivered until immediately before the board meeting to approve the transaction. Notwithstanding that the directors would ultimately have been exculpated from their breaches of fiduciary duties, the financial advisor was nevertheless liable for aiding and abetting such breaches.

Key takeaways from the Supreme Court's opinion include the following:

- ***Where directors breach their fiduciary duties under Revlon by engaging in conduct outside the range of reasonableness, such breach is a sufficient predicate for post-closing third-party aiding and abetting liability, even if the underlying breach would not result in monetary liability for directors.*** Defendant had argued that intermediate scrutiny under *Revlon* exists to determine whether stockholders should receive pre-closing injunctive relief, but not to establish a breach of fiduciary duty that warrants post-closing damages,[1] and that the Court of Chancery erred by finding a due care violation without finding gross negligence. The Supreme Court disagreed with the defendant and affirmed the Court of Chancery's ruling that the directors had

[1] This argument appeared to be consistent with the Delaware Supreme Court's statements in its recent *Corwin* v. *KKR Financial Holdings* opinion that standards of review under *Revlon* and *Unocal* are primarily designed to give the stockholders and the Court of Chancery the ability to enjoin a merger before closing, but were not designed with post-closing money damages claims in mind. For more detail on *Corwin* v. *KKR Financial Holdings*, see our alert here.

breached their fiduciary duties under a *Revlon* standard of review by engaging in conduct that fell outside the range of reasonableness, and that this was a sufficient predicate for its finding of post-closing aiding and abetting liability against the defendant. Notably, the Supreme Court found that that company's stockholders were not fully informed when they voted to accept the deal.[2] While the Supreme Court acknowledged that gross negligence is required to sustain monetary damages against disinterested directors, it states that a board may nonetheless still be in breach of its fiduciary duties under *Revlon*'s reasonableness standard of review, and as such *Revlon* may continue to apply in the context of post-closing aiding and abetting claims.

- ***Consistent with existing law, the Revlon standard of review begins to apply from the time that a board initiates a sale process to the exclusion of other strategic alternatives.*** The Court of Chancery had found that, under the specific circumstances of the case, the board's initiation of a sale process in late 2010 fell outside the range of reasonableness, and thus was a breach of its fiduciary duties under *Revlon*. On appeal, the defendant argued that during such period the company was merely exploring strategic alternatives and that the business judgment rule—not *Revlon*—applied. The Supreme Court disagreed, finding that the record showed that the company was for sale from the outset. Among other things, the court noted that there was no exploration of other strategic alternatives, the financial advisors understood that they were being hired for a sell-side engagement, the special committee had authorized the negotiation of the sale of the company at an early stage in the process, and, although the board was not initially aware of the special committee's authorization of the sale of the company, the board ultimately purported to ratify the special committee's actions. The Supreme Court was careful to state that this ruling is premised on the case's "unusual facts" and is not meant to effect any shifts in the *Revlon* landscape. We believe that boards may still initiate a general strategic review without triggering *Revlon*, so long as various alternatives are being explored (as opposed to focusing only on a sale).

- ***A board may still consent to a conflict, but it must then be "especially diligent" in overseeing the conflicted advisor in the sale process. Further, a board's consent to a conflict does not give the advisor a "'free pass' to act in its self-interest or to the detriment of its client."*** A board should take steps to address or mitigate the conflicts, which could include insisting, as a "contractual matter[, . . .] on protections to ensure that conflicts that might impact the board's process are disclosed at the outset and throughout the sale process." The opinion does not address the financial advisors' obligations to disclose conflicts to the board, but this case and the long line of other Delaware decisions scrutinizing financial advisory conflicts greatly incentivizes financial advisors to disclose all material conflicts to its clients at the outset and throughout the engagement.

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[2] This is in contrast to *Corwin,* where the Supreme Court found that the transaction had been approved by a fully informed, uncoerced vote of disinterested stockholders, which in turn invoked the business judgement rule, to the exclusion of other heightened standards of review, such as *Revlon* and *Unocal*. In subsequent cases applying *Corwin*, the Court of Chancery further confirmed that once the stockholder vote has shifted the standard of review to business judgement, a complaint must contain well pleaded allegations of facts that the directors were grossly negligent in order to maintain a claim for a breach of fiduciary duty of care. For more detail of these cases, see our alert here.

- ***A financial advisor must be wary of creating an "informational vacuum" that leads to a board's breach of its fiduciary duties, but does not have to act as a "gatekeeper" for the board.*** If the financial advisor is aware that a board is proceeding on "fragmentary and misleading information" and allows such action to continue, especially where a financial advisor may be motivated by improper motives, this may be sufficient to establish scienter for an aiding and abetting claim. However, the Supreme Court was careful to disavow the Court of Chancery's statements that financial advisors are "gatekeepers" for the board, stating that such an amorphous term would inappropriately expand the role of a financial advisor so that any failure by a financial advisor to prevent directors from beaching their duty of care could give rise to an aiding and abetting claim. The Supreme Court clarified that a financial advisor's role is primarily contractual in nature, negotiated between sophisticated parties and can vary upon a myriad of factors. Financial advisors must not act in a manner that is contrary to the interests of the board, but do not necessarily serve as "gatekeepers" to the board. The Supreme Court explicitly states that the holding is a "narrow one that should not be read expansively to suggest that any failure on the part of a financial advisor to prevent directors from breaching their duty of care gives rise to a claim for aiding and abetting a breach of the duty of care."

While recent decisions suggest that financial advisory aiding and abetting cases will be more difficult to sustain once a transaction is approved by a fully informed, uncoerced vote of disinterested stockholders, the *Rural/Metro* line of decisions shows that these types of claims remain a possible risk against which financial advisors should protect, including by fully disclosing all material conflicts.

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