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The Delaware Supreme Court Speaks to Boards and the Investment Banks

The Delaware Supreme Court earlier this week issued its much anticipated decision in the *Rural Metro* appeal. *RBC Capital Markets, LLC* v. *Jervis*, No. 140, 2015 (Del. Nov. 30, 2015). The opinion canvasses many important areas of Delaware fiduciary duty doctrine applicable to directors and the aiding and abetting liability exposure of investment bankers advising on transactions. The Supreme Court's decision is its first statement on the subject of banker conflicts and conduct since a series of recent Court of Chancery opinions sparked a debate about whether, and how, Delaware is breaking new ground in examining and potentially regulating the conduct of bankers and their conflicts (see *The Delaware Courts and the Investment Banks*, our memorandum of October 29, 2015).

The Supreme Court's opinion represents a carefully balanced intervention into that debate. The opinion contains clear messages for both boards and bankers.

To boards:

> "[D]irectors need to be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest. But, at the same time, a board is not required to perform searching and ongoing due diligence on its retained advisors in order to ensure that the advisors are not acting in contravention of the company's interests, thereby undermining the very process for which they have been retained. A board's consent to a conflict does not give the advisor a 'free pass' to act in its own self-interest and to the detriment of its client. Because the conflicted advisor may, alone, possess information relating to a conflict, the board should require disclosure of, on an ongoing basis, material information that might impact the board's process."
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> "A board's consent to the conflicts of its financial advisor necessitates that the directors be especially diligent in overseeing the conflicted advisor's role in the sale process."
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> "For instance, the board could, when faced with a conflicted advisor, as a contractual matter, treat the conflicted advisor at arm's-length, and insist on protections to ensure that conflicts that might impact the board's process are disclosed at the outset and throughout the sale process."

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To bankers:

> "[W]e do not adopt the Court of Chancery's description of the role of a financial advisor in M & A transactions. In particular, the trial court observed that '[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 carryout a sale process. Financial advisors provide these expert services. In doing so, they function as gatekeepers.' Although this language was *dictum*, it merits mention here. The trial court's description does not adequately take into account the fact that the role of a financial advisor is primarily contractual in nature, is typically negotiated between sophisticated parties, and can vary based upon a myriad of factors. Rational and sophisticated parties dealing at arm's-length shape their own contractual arrangements and it is for the board, in managing the business and affairs of the corporation, to determine what services, and on what terms, it will hire a financial advisor to perform in assisting the board in carrying out its oversight function. The engagement letter typically defines the parameters of the financial advisor's relationship and responsibilities with its client. … As became evident in the instant matter, the conflicted banker has an informational advantage when it comes to knowledge of its real or potential conflicts. … Adhering to the trial court's amorphous 'gatekeeper' language would inappropriately expand our narrow holding here by suggesting that any failure by a financial advisor to prevent directors from breaching their duty of care gives rise to an aiding and abetting claim against the advisor."

This is a welcome opinion that offers important practical guidance to bankers and boards. The decision makes clear that informed boards of directors can, in the exercise of their business judgment, retain conflicted investment advisors and that, if appropriate procedures are followed, neither the board nor the bankers will face liability for breach of fiduciary duty. The decision also reaffirms that contractual arrangements between companies and financial advisors will generally be respected. The decision thus provides a constructive pathway for well-counseled companies and well-counseled advisors to work through the issues of potential conflict that from time to time inevitably arise in the M&A context.

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