Aiding and Abetting Liability in Mergers and Acquisitions

Thursday, April 14, 2016

Moderator

Christopher N. Kelly, Potter Anderson & Corroon LLP

Speakers

Myron T. Steele, Potter Anderson & Corroon LLP

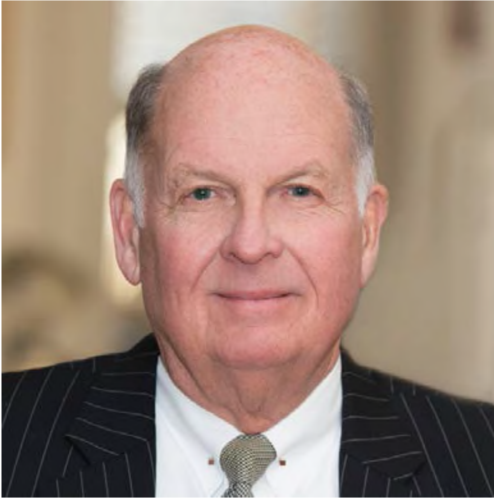
MEMBER BENEFIT

Business Law Section members can earn at least 10 free business law CLE credits each year by attending these hot-topic webinars developed by industry experts. Learn more at **ambar.org/intheknowweb**.

Aiding and Abetting Liability in Mergers and Acquisitions

Myron T. Steele
Christopher N. Kelly
Potter Anderson & Corroon LLP
April 14, 2016

Myron T. Steele



Myron T. Steele is a partner in the Corporate Group of Potter Anderson & Corroon LLP. He is the former Chief Justice of the Supreme Court of Delaware.

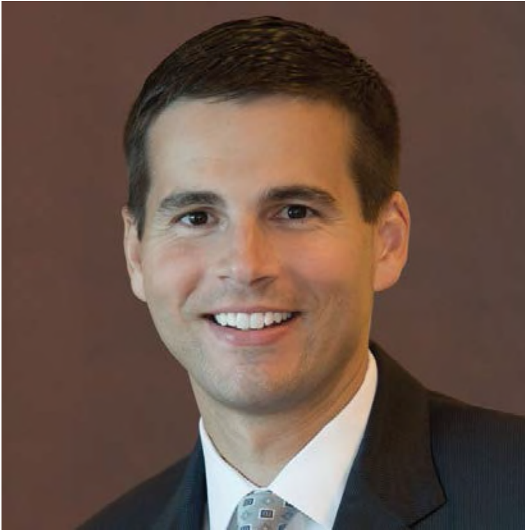
Previously, he served as a Judge of the Superior Court and a Vice Chancellor of the Delaware Court of Chancery after eighteen years in private litigation practice. He has presided over major corporate litigation and LLC and limited partner governance disputes, and writes frequently on issues of corporate document interpretation and corporate governance.

Chief Justice Steele has published over 400 opinions resolving disputes among members of limited liability companies, and limited partnerships, and between shareholders and management of both publicly traded and close corporations. He speaks and writes frequently on issues of corporate document interpretation and corporate governance. His thesis for the LL.M. degree, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, focused on the application of common law fiduciary duties within the contractual framework of alternative business organizations. It was published in the *Delaware Journal of Corporate Law* (32 Del. J. Corp. L. 1 (2007)). The November 2005 issue of *The Business Lawyer* included an article he co-authored with Sean J. Griffith entitled *On Corporate Law Federalism: Threatening the Thaumatrope* (61 Bus. Law. 1 (2005)). He co-authored an article with J. W. Verret entitled *Delaware's Guidance: Ensuring Equity for the Modern Witenagemot* published in the Fall 2007 issue of the Virginia Law & Business Review (2 Va. L. & Bus. Rev. 188 (2007)). That article formed the basis for a keynote speech to the Business Law Section at the 2007 ABA Annual Meeting.

For the last ten years he served as judicial advisor to the Mergers and Acquisitions Committee of the ABA Business Law Section. He also coauthored an article entitled *"Freedom of Contract and Default Contractual Duties in Delaware Limited Partnerships and Limited Liability Companies"* (46 Am. Bus. L.J. 221 (Summer 2009)) and an essay entitled *"The Moral Underpinning of Delaware's Modern Corporate Fiduciary Duties"* (26 Notre Dame J.L. Ethics & Pub. Pol'y 3 (2012)).

Chief Justice Steele serves as Adjunct Professor of Law at University of Pennsylvania Law School, University of Virginia Law School, and Pepperdine University Law School.

Christopher N. Kelly



Christopher N. Kelly practices in the Corporate Group of Potter Anderson & Corroon LLP, with a focus primarily on corporate and commercial litigation in the Delaware Court of Chancery.

His experience includes stockholder class and derivative litigation, takeover disputes, alternative entity litigation, internal corporate investigations, and statutory proceedings under the Delaware General Corporation Law, such as stock appraisals, indemnification and advancement actions, contested director elections, and demands to inspect corporate books and records.

Mr. Kelly also has written numerous articles and presented on Delaware corporate law topics.

Prefatory Remarks

- The views expressed by the speakers are not necessarily the views of Potter Anderson & Corroon LLP or any of its clients.
- This slide deck is for informational purposes only and is not to be cited or used in litigation.
- The facts discussed herein are those either found by the Court (with respect to post-trial and appellate opinions) or alleged in the complaint (for opinions deciding motions to dismiss).

The Elements of Aiding and Abetting

- A claim for aiding and abetting a breach of fiduciary duty has four elements:

  (1) the existence of a fiduciary relationship,

  (2) a breach of the fiduciary's duty,

  (3) knowing participation by a non-fiduciary in the fiduciary's breach, and

  (4) damages proximately caused by the breach.

  Malpiede v. Townson, 780 A.2d 1075, 1096 (Del. 2001).

Aiding and Abetting Requires Knowing Participation

- Knowing participation in a fiduciary's breach of duty requires that the third party act with the knowledge that the conduct advocated or assisted constitutes a breach. *Malpiede*, 780 A.2d at 1097; *see also RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 862 (Del. 2015).
- The Court of Chancery has applied Section 876 of the Restatement (Second) of Torts for purposes of determining whether a defendant knowingly participated in a breach of fiduciary duty. *See In re Rural Metro Corp.*, 88 A.3d 54, 98 (Del. Ch. 2014); *In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at *41-42 (Del. Ch. Aug. 27, 2015); *In re PLX Tech. Inc. S'holders Litig.*, C.A. No. 9880-VCL (Del. Ch. Sept. 3, 2015) (Tr. 49-52).
- Under this provision, a defendant can be liable for "harm resulting … from the tortious conduct of another" if the defendant:

  (a) does a tortious act in concert with the other or pursuant to a common design with him, or

  (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or

  (c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.

  Restatement (Second) of Torts § 876 (1979).

- Subsection (b) generally is the provision at issue in the cases applying Section 876.

Knowing Participation is a "Stringent" Standard

- Knowing participation is a "stringent" standard. *See Binks v. DSL.Net, Inc.*, 2010 WL 1713629, at *10 (Del. Ch. Apr. 29, 2010).
- Scienter is required. *RBC Capital Markets*, 129 A.3d at 862.
  - The aider and abettor, not the fiduciary, must act with scienter (*i.e.*, an "illicit state of mind"). *Id.*
  - The aider and abettor must act "knowingly, intentionally, or with reckless indifference." *Id.*
  - Gross negligence is insufficient. *Id.* at 875. Recklessness *is* sufficient. *See id.* at 862 & n.169.
- The aider and abettor must have "actual or constructive knowledge that their conduct was legally improper." *Id.* at 862.
  - Knowledge may be inferred where the fiduciary's breach was "inherently wrongful." *See Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 392 (Del. Ch. 1999). Examples include egregious transaction terms or excessive side deals. *See In re Telecommc'ns, Inc. S'holders Litig.*, 2003 WL 21543427, at *2 (Del. Ch. July 7, 2003).
  - Additionally, knowledge may be inferred where the aider and abettor gained an advantage from or induced the fiduciary's breach. *See id.*
  - Knowledge also may be found where the aider and abettor created or exploited a conflict of interest, conspired with the fiduciary, or misled the fiduciary. *See Malpiede*, 780 A.2d at 1097-98; *RBC Capital Markets*, 129 A.3d at 862.
- The secondary actor also must provide substantial assistance to the fiduciary to be liable for aiding and abetting. Knowledge by itself is insufficient.
  - Factors to consider in determining if a party has substantially assisted a fiduciary's breach of duty include: (1) the nature of the act encouraged; (2) the amount and kind of assistance given; (3) the defendant's absence or presence at the time of the breach; (4) the relationship to the tortious actor; (5) the defendant's state of mind; and (6) the duration of the assistance. *See Dole*, 2015 WL 5052214, at *42.
  - "If the encouragement or assistance is a substantial factor in causing the resulting tort, the one giving it is himself a tortfeasor and is responsible for the consequences of the other's act." Restatement (Second) of Torts § 876 cmt. d.

RBC Capital Markets, LLC v. Jervis
129 A.3d 816 (Del. 2015)

The Merger and Stockholder Litigation

- On June 30, 2011, Rural/Metro Corporation ("Rural" or the "Company") was merged into an affiliate of private equity firm Warburg Pincus LLC ("Warburg"). Rural common stockholders received $17.25 per share as a result of the merger.
- Stockholders of Rural filed suit alleging breaches of fiduciary duty by the Rural board of directors (the "Board") for approving the merger and failing to disclose material information in Rural's proxy statement. RBC Capital Markets, LLC ("RBC"), the primary financial advisor to the Board, and Moelis & Company LLC ("Moelis"), the secondary financial advisor to the Board, also were sued, for allegedly having aided and abetted the Board's breaches of fiduciary duty. The lead plaintiff ("Plaintiff"), on behalf of a class of Rural stockholders (the "Class"), settled with the Board and Moelis before trial.

The Trial Court's Liability Opinion

- In a post-trial decision issued on March 7, 2014, Vice Chancellor Laster held that RBC was liable for aiding and abetting the Board's breaches of fiduciary duty by, among other things, putting the Company in play without Board authorization, providing false and materially misleading information to the Board, and having an undisclosed conflict of interest in the transaction. The Vice Chancellor also held that an exculpatory provision contained in Rural's certificate of incorporation pursuant to Section 102(b)(7) of the Delaware General Corporation Law only covered the Rural directors and did not extend to the Board's advisors.

The Trial Court's Damages Opinion

- In a subsequent post-trial decision issued on October 10, 2014, Vice Chancellor Laster set the amount of RBC's liability at $75,798,550.33, finding that RBC was responsible for 83% of the $91,323,554.61 in total damages that the Class suffered, which amount represented the difference between the value the Company's stockholders received in the merger and Rural's going concern value. The trial court also awarded pre- and post-judgment interest.

RBC's Arguments on Appeal

- RBC raised the following arguments on appeal:
  - the trial court erred by holding that the Board breached its duty of care under the enhanced scrutiny standard enunciated in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del. 1986),
  - the trial court erred by holding that the Board violated its fiduciary duty of disclosure by making material misstatements and omissions in Rural's proxy statement,
  - the trial court erred by finding that RBC aided and abetted breaches of fiduciary duty by the Board,
  - the trial court erred by finding that RBC's conduct proximately caused damages,
  - the trial court erred in applying the Delaware Uniform Contribution Among Tortfeasors Act ("DUCATA"), and
  - the trial court erred in calculating damages.

The Supreme Court's Opinion

- In an *en banc* decision, the Delaware Supreme Court affirmed the principal legal holdings and final judgment of the trial court, finding, among other things, that RBC aided and abetted breaches of fiduciary duty by the Board in connection with the sale of Rural to Warburg and that RBC was liable to the Class for damages.
- The facts summarized in the succeeding slides are derived from the Supreme Court's opinion.

Rural

- Delaware corporation based in Scottsdale, Arizona.
- Ambulance and private fire protection service company.
- Seven-member board of directors:
  - Christopher Shackelton, Eugene Davis, Earl Holland, Henry Walker, Robert Wilson, Conrad Conrad, and Michael DiMino (President and CEO).
  - All board members but DiMino were facially independent and disinterested.
  - Shackelton (Chair), Davis, and Walker comprised the special committee, which was first formed in August 2010 to explore an acquisition of American Medical Response, Inc. ("AMR"), Rural's primary competitor and a subsidiary of Emergency Medical Services Corporation ("EMS"), and then re-formed in October 2010 to respond to an expression of interest from a consortium of private equity firms. Neither transaction came to fruition.

Rural's Business Plan

- DiMino was hired in May 2010 to pursue a growth strategy for the Company.
- The growth strategy was "reasonable and achievable" and could lead to "meaningful stock price appreciation."
- However, Davis (overboarded) and Shackelton (Coliseum overinvested) had personal reasons for achieving a near-term sale.
- DiMino initially favored keeping Rural a standalone company, but changed his mind after a negative performance review and realization that the sale of Rural to a financial buyer would work to his benefit.

The Special Committee

- In December 2010, EMS was rumored to be "in play."
- RBC recognized that if Rural engaged in a sale process led by RBC, then RBC could use its position as sell-side advisor to secure a buy-side financing role with the private equity firms bidding for EMS.
- On December 8, 2010, the Board re-activated the special committee to explore the Company's strategic alternatives (standalone, sale, and acquisition of EMS) and make a recommendation to the Board.

Engagement of RBC

- On December 23, 2010, the special committee interviewed three financial advisors—Houlihan Lokey, Moelis, and RBC.
  - Unlike the other firms, RBC devoted the bulk of its presentation to an immediate sale of Rural in conjunction with the EMS sale process, and only identified financial sponsors as potential bidders.
  - Also unlike the other firms, RBC hoped to provide staple financing to the potential buyers.
  - RBC did not disclose to the special committee that it planned to use its engagement as Rural's advisor to capture financing work from the bidders for EMS.
- The special committee selected RBC (primary) and Moelis (secondary) as its advisors.
- RBC hoped to generate up to $60 million in fees from the Rural and EMS deals, with the financing fees ($55M) more than 10 times the advisory fee ($5M).

RBC Capital Markets, LLC v. Jervis

Problems with the Timing of the Sale Process

- While there were identifiable benefits to initiating a sale process in December 2010 (Rural's stock was trading at a 5-year high, financial sponsors were interested in the industry, and debt markets were good), Rural encountered readily foreseeable problems associated with trying to induce financial buyers to engage in two parallel processes for targets that were direct competitors. These problems included:
  - Concerns regarding protection of Rural's confidential information if shared with EMS bidders;
  - Financial buyers had difficulties with participating in simultaneous auctions, and recommended that Rural delay its process until the EMS sale was completed;
  - Strategic buyers were internally focused; and
  - J.P. Morgan recommended to DiMino that Rural execute on its growth plan before being sold in order to drive further stock price appreciation.

The Initial Stages of the Auction

- RBC developed a two-track bidding process (EMS vs. non-EMS bidders) and scheduled first round bids for late January 2011 to track the EMS process.
- Twenty-eight potential buyers were contacted.
- Twenty-one potential buyers signed confidentiality agreements.
- Rural received six indications of interest between $14.50 and $19.00 per share.
- The special committee met on February 6, 2011. RBC's presentation at the meeting did not include valuation metrics.
- Prior to that meeting, Shackelton and RBC already had agreed to make a data room available to bidders and had scheduled meetings with the six private equity firms that submitted indications of interest.

The February 22, 2011 Committee Meeting

- The special committee met again on February 22, 2011.
- RBC made a presentation that included no valuation metrics.
- The special committee discussed the continued participation of Clayton, Dubilier & Rice ("CD&R")—the winner of the EMS sale—in the Rural process.
- Whereas RBC previously had recommended a near-term sale process to capture the interest of the winner of the EMS auction, the committee now balked at having CD&R participate because of confidentiality concerns (now that it was a competitor).
- While CD&R suggested that it could outbid other sponsors because of synergies with AMR, and asked for the bid deadline to be pushed back to April, the committee set a bid deadline of March 21.
- The committee also decided not to solicit interest from strategic acquirers.

The March 15, 2011 Board Meeting

- On March 15, 2011, the Board met to consider the special committee's progress for the first time since December 8, 2010.
- Like its previous presentations, RBC failed to include valuation metrics or any opinion on the quality of the bids.
- On the advice of RBC, Moelis, and its legal counsel, the Board decided to proceed with the March 21 bid deadline despite CD&R's request for more time and its ability to pay more for Rural due to synergies with AMR.
- The Board adopted a resolution ratifying the special committee's past actions and authorizing it to pursue a sale of the Company and report its findings and recommendations to the Board.

RBC's Efforts to Secure Staple Financing

- RBC's engagement letter with Rural stated, in pertinent part, that "RBC shall have the sole and exclusive right to offer stapled financing" to any potential purchaser of the Company.
- The engagement letter also provided that RBC "may arrange and extend acquisition financing … to purchasers that may seek to acquire companies … that offer products and services that may be substantially similar to those offered by the Company."
- On March 18, 2011, RBC sent Warburg (one of the final six bidders) executed commitment papers for staple financing, but Warburg did not respond.
- Following Warburg's submission of its bid, RBC continued to seek a buy-side financing role with Warburg, and RBC did not disclose those last-minute efforts to the Board.
- Among other things, as an inducement to secure Warburg's business, RBC offered to fund a $65 million revolver for a different Warburg portfolio company.

Final Round Bids

- On the extended bidding deadline of March 22, 2011, Warburg submitted a bid at $17.00 per share (with fully committed financing from other banks), and CD&R submitted an indication of interest at $17.00 per share, subject to further diligence.
- On March 23, 2011, the special committee met to discuss the offers.
  - The only valuation information the committee was provided was a one-page transaction summary comparing the metrics implied by the $17.00 per share offers to the metrics implied by Rural's stock price of $12.38.
  - The committee ultimately rejected both proposals, decided not to engage further with CD&R, and directed RBC and Moelis to engage in final negotiations with Warburg over price.
- On March 25, 2011, Warburg increased its bid to a "best and final" $17.25 per share. Its bid materials did not include any financing from RBC.

RBC Makes Changes to its Valuation Analysis

- On March 26, 2011, RBC's fairness opinion committee discussed Warburg's bid and recommended changes to make the bid look more attractive, including:
  - Decided not to rely on a single comparable company for valuation purposes;
  - Modified its precedent transaction analysis by reducing the low-end EBITDA multiple; and
  - Lowered the "consensus" Adjusted EBITDA by not adding back one-time expenses and stated that "Wall Street research analysts … do not make pro forma adjustments."
- RBC coordinated between its deal team working on the fairness opinion and its bankers lobbying Warburg for buy-side financing work.

The Board Accepts Warburg's Offer

- On Sunday, March 27, 2011, the Board met to consider Warburg's revised offer. The Board received written valuation analyses for the first time at 9:42 p.m. (Eastern time), only a couple of hours before the meeting.
- "At 11 p.m. that evening, without knowledge of RBC's downward modifications to its [valuation] analysis, back-channel communications with Warburg, and late push to get on the private equity firm's financing tree, the Board and Special Committee held a joint meeting."
- After midnight, the Board approved the merger with Warburg.

The Rural Proxy

- RBC used the lower Adjusted EBITDA figure ($69.8M) that did not add back one-time expenses for its precedent transaction analysis, but the proxy referred to the higher Adjusted EBITDA figure ($76.8M) and stated that RBC's analysis did adjust for one-time expenses.
- The proxy omitted any discussion of RBC's staple financing efforts—in either the Rural or EMS deals—or its last-minute efforts to reserve a place on Warburg's financing tree. The proxy similarly neglected to disclose that RBC sought to use its Rural sell-side engagement to obtain EMS buy-side financing work.
- The proxy disclosed that the special committee concluded that RBC's willingness to offer staple financing could significantly enhance a potential sale process because such financing could be offered efficiently and on terms that might not otherwise be available. However, neither the Board nor the committee ever concluded that this was in fact the case.

RBC Capital Markets, LLC v. Jervis

Revlon – The Trial Court's Ruling

- Vice Chancellor Laster found that the decision to initiate a sale process in December 2010 was unreasonable because the Board did not make the decision to launch a sale process, nor did it authorize the special committee to start one.
- The trial court further concluded that the initiation of the sale process was unreasonable because RBC did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS. It found that RBC designed a process that favored its own interest in gaining financing work from bidders for EMS. RBC's sale process design prioritized the EMS participants so they would include RBC in their financing trees. RBC did not disclose the disadvantages of this design of the sale process.
- The trial court also found that the Board failed to oversee the special committee, failed to become informed about strategic alternatives and about potential conflicts of interests faced by the advisors, and approved the merger without adequate information, including the value of not engaging in any transaction.
- The Supreme Court affirmed.

Revlon – Applicable

- The Supreme Court rejected RBC's argument that the business judgment rule—not *Revlon*—applied to the Board's decision to explore strategic alternatives in December 2010.
- The Court concluded that "the most faithful reading of the record before us is that the Court of Chancery, as a factual matter, found that there was no exploration of strategic alternatives" but, rather, "the initiation of a sale process" "without Board authorization."
- The Court also rejected RBC's legal argument that *Revlon* was not triggered until a sale of the Company had become "inevitable," holding that *Revlon* was triggered by the initiation of an active bidding process seeking a sale of the Company.

Revlon – Initiation of Process was Unreasonable

- The Supreme Court rejected RBC's alternative argument that, assuming *Revlon* applied, the decision to initiate the sale process in December 2010 was reasonable.
- The Court found that "the evidence fully supports the trial court's findings that the solicitation process was structured and timed in a manner that impeded interested bidders from presenting potentially higher value alternatives."
- The Supreme Court agreed with the trial court that "RBC designed the sale process to run in parallel with a process being conducted by EMS, and that 'RBC did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS,' . . . [or] that there were material barriers, including confidentiality restrictions, that would have impeded or prevented a bidder from making an offer" for Rural.

Revlon – Post-Signing Market Check Not a Cure

- The Court next rejected RBC's contention that, pursuant to its recent decision in *C & J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust*, 107 A.3d 1049 (Del. 2014), the post-signing market check cured any shortcomings of the sale process.
- The Court reasoned that the Board and stockholders were not fully informed because they were unaware of RBC's conflicts and how they potentially impacted the Warburg offer, and that "[a] confluence of factors undercut the reliability and competitiveness of the Rural sale process," including (1) the Company was just beginning to implement new growth strategies and the market did not understand its prospects, and (2) private equity firms were tied up in the EMS process and logical strategic bidders were focused on their own change of control transactions.

Revlon – Violation Constitutes Due Care Breach

- The Court rejected RBC's final contention—that the trial court erred by finding a due care violation without gross negligence.
- The Court explained that, while gross negligence is required in order to sustain a monetary judgment against disinterested directors, "[t]hat does not mean, however, that if they were subject to *Revlon* duties, and their conduct was unreasonable, that there was not a breach of fiduciary duty."
- The Court stated that, here, "[t]he Board violated its situational duty by failing to take reasonable steps to attain the best value reasonably available to the stockholders."

RBC Capital Markets, LLC v. Jervis

The Board Violated its Disclosure Obligations

- Vice Chancellor Laster concluded that the Board violated its disclosure obligations because the Rural proxy contained false and misleading information about RBC's incentives as well as false financial information that RBC presented to the Board. The Supreme Court affirmed.
- The Court rejected RBC's argument that the trial court incorrectly scrutinized whether the valuation analysis it performed was proper, and not whether that analysis was accurately described in the proxy, agreeing with the trial court that the proxy did not accurately represent RBC's analysis and that the information RBC provided for the proxy about its analysis was material and false.
- The Court also rejected RBC's contentions that its last-minute efforts seeking to provide financing to Warburg were not material and did not need to be disclosed in the proxy, and that the disclosure of RBC's potential conflict was sufficient. The Court agreed with the trial court that the proxy contained false and misleading information about RBC's incentives, emphasizing that, "[w]hen viewed in conjunction with the potential fees RBC was to receive for its financing services, the investment bank's pursuit of Warburg's financing business was demonstrative of a conflict that was unquestionably material, and necessitated full and fair disclosure for the benefit of the stockholders."

RBC Capital Markets, LLC v. Jervis

Aiding and Abetting – The Trial Court's Ruling

- The trial court found that RBC aided and abetted the Board's breaches of fiduciary duty. According to the trial court, RBC:
  - "*created* the unreasonable process and informational gaps that led to the Board's breach of duty,"
  - "knew that it was not disclosing its interest in obtaining a role financing the acquisition of EMS or how it intended to use the Rural process to capture the EMS financing business,"
  - "similarly knew that the Board and the Special Committee were uninformed about Rural's value when making critical decisions" as RBC had not provided any valuation information since its December 23, 2010 pitch, and
  - "never disclosed to the Board its continued interest in buy-side financing and plans to engage in last minute lobbying of Warburg."

RBC Capital Markets, LLC v. Jervis

Aiding and Abetting – The Supreme Court Affirms

- The Supreme Court affirmed, agreeing with the trial court's "narrow holding" that "[i]f [a] third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating [an] informational vacuum, then the third party can be liable for aiding and abetting."
- In so doing, the Court rejected RBC's arguments that a third party cannot "knowingly participate" in a board's exculpated breach of the duty of care or a breach that is not "inherently wrongful," that a third party cannot knowingly participate in a breach of the duty of care when it "misleads directors into breaching their" fiduciary obligations, and that a third party cannot be liable for aiding and abetting without having agreed to a joint course of conduct with the primary actor.
- The Court explained: "[i]t is the aider and abettor that must act with *scienter*," and, "[t]o establish *scienter*, the plaintiff must demonstrate that the aider and abettor had 'actual or constructive knowledge that their conduct was legally improper.'"
- The Court held that the record supported the trial court's finding that "RBC acted with the necessary degree of *scienter* and can be held liable for aiding and abetting," stating: "[t]he manifest intentionality of RBC's conduct—as evidenced by the bankers' own internal communications—is demonstrative of the advisor's knowledge of the reality that the Board was proceeding on the basis of fragmentary and misleading information."

RBC Capital Markets, LLC v. Jervis

Proximate Cause – The Trial Court's Ruling

- The trial court found that RBC proximately caused the Board's breaches and the damages to the Class.
- The trial court stated, among other things, that "RBC's self-interested manipulations caused the Rural process to unfold differently than it otherwise would have," and that "RBC's faulty design [of the sale process] prevented the emergence of the type of competitive dynamic among multiple bidders that is necessary for reliable price discovery."
- The trial court found that, as a result, "the value of Rural as a going concern exceeded what stockholders received in the merger."

RBC Capital Markets, LLC v. Jervis

Proximate Cause – The Supreme Court Affirms

- The Supreme Court affirmed, rejecting RBC's argument that, because of Moelis's financial analysis and involvement in the negotiations, the trial court erred in determining that RBC proximately caused the harm suffered by the Company's stockholders from the Board's approval of the sale of the Company at a price below fair value and the stockholders' approval of the deal based on false and misleading information in the proxy statement.
- The Court explained that "[t]he Board's receipt of Moelis's financial analysis—which the Special Committee treated as 'secondary' to that of RBC—does not remedy RBC's improper conduct, nor destroy the causal link between RBC's actions, the Board's failure to satisfy itself of its fiduciary obligations, and the harm suffered by the Company's stockholders."
- The Court also stated that "Moelis's fairness opinion does not cure RBC's aiding and abetting of the Board's breach of the duty of disclosure[,] . . . [because] [h]ere, the stockholders went to the ballot box on the basis of the deficient Proxy Statement, the insufficiency and misleading nature of which was due to RBC's failure to be forthcoming."

RBC Capital Markets, LLC v. Jervis

Financial Advisors Are Not Gatekeepers

- The Court emphasized that its holding was "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."
- Importantly, the Court rejected the trial court's *dictum* describing financial advisors in mergers and acquisitions as "gatekeepers."
- The Supreme Court stated: "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.'"
- The Court criticized this description as "not adequately tak[ing] 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," and stated that "[r]ational 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 Court continued: "The banker is under an obligation not to act in a manner that is contrary to the interests of the board of directors, thereby undermining the very advice that it knows the directors will be relying upon in their decision making processes. 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."

RBC Capital Markets, LLC v. Jervis

Calculation of Damages and DUCATA

- The trial court determined that the Class suffered damages of $4.17 per share, and that RBC was responsible for 83% of those damages. The trial court found that Shackelton and DiMino breached their duty of loyalty by pursuing a near-term sale of the Company to further their own self-interests, and thus they would not have been entitled to exculpation had they not settled. The trial court held that they were responsible for 10% and 7% of the damages suffered by the Class, respectively, and that RBC was entitled to a settlement credit of 17% under DUCATA. The Supreme Court affirmed.
- The Supreme Court rejected RBC's argument that the trial court erred by applying a quasi-appraisal remedy when calculating damages, reasoning that the Court of Chancery has "broad discretionary powers in fashioning a remedy and making its award of damages."
- The Court also held that the trial court properly applied DUCATA. The Court affirmed the trial court's *pro rata* allocation of fault and its having assigned 83% of the responsibility for the damages to the Class to RBC, rejecting RBC's argument that the statute's use of "*pro rata*" required an "equal" allocation of responsibility for damages to each joint tortfeasor.
- The Court also held that the Section 102(b)(7) exculpatory provision in Rural's charter did not shield RBC from liability, agreeing with the trial court that the statutory provision does not extend to third parties such as RBC.
- The Court affirmed the trial court's determination that the doctrine of unclean hands precluded RBC from seeking a settlement credit for the disclosure claim or for the sale process claim relating to the Board's final approval of the merger, agreeing with the trial court that "RBC forfeited its right to have a court consider contribution . . . by committing fraud against the very directors from whom RBC would seek contribution."

RBC Capital Markets, LLC v. Jervis

Takeaways for Boards of Directors

- A board should play an active and direct role in the sale process.
  - Sole reliance on advisors or management can "taint the design and execution of the transaction."
- A board should be "reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest."
  - A board should vet prospective financial advisors prior to engagement to uncover actual or potential conflicts of interest.
  - A board should determine the proper timing and manner of financial advisor disclosure of conflicts in light of the number of potential counterparties and type of sale process, and should require updates to the disclosures on an ongoing basis as the sale process unfolds.
  - Oftentimes, the financial advisor with the most industry experience will have conflicts. Many conflicts can be consented to or waived if properly disclosed and monitored.
  - "[A] board is not required to perform searching and ongoing due diligence on its retained advisors in order to ensure that [they] are not acting in contravention of the company's interests, thereby undermining the very process for which they have been retained."
  - However, "[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."
  - A board should consider documenting its efforts to identify, monitor, and respond to an advisor's conflicts in meeting minutes and the proxy.
- Retention of a second financial advisor may not always have a salutary effect on a sale process.
  - A second financial advisor may not cleanse a conflict of interest or fix deficiencies in a sale process if its role is "secondary" and it is "paid on the same contingent basis as the primary bank" (and thus has a financial interest in seeing a sale go through).
- A post-signing market check may not cure a deficient sale process in all cases, including potentially where the board and stockholders approved the merger without being fully informed.

RBC Capital Markets, LLC v. Jervis

Takeaways for Financial Advisors

- Financial advisors are not "gatekeepers."
  - Aiding and abetting liability generally will be limited to "fraud on the board." *Scienter* is a necessary element. Gross negligence is not sufficient to find aiding and abetting liability.
  - The relationship between the board and its financial advisor is contractual in nature. Financial advisors do not have a responsibility to monitor the conduct of the board of directors or to prevent directors from breaching their duties. Rather, "[t]he banker is under an obligation not to act in a manner that is contrary to the interests of the board of directors, thereby undermining the very advice that it knows the directors will be relying upon in their decision making processes."
- A charter provision adopted pursuant to 8 *Del. C.* § 102(b)(7) does not shield a board's advisors from potential monetary liability for aiding and abetting a board's exculpated breach of the duty of care.
  - A Section 102(b)(7) charter provision essentially will shift all of the liability for a board's breach of the duty of care to the aider and abettor of that breach.
  - An exculpated director is not a "joint tortfeasor" under DUCATA, so the aider and abettor cannot seek contribution or a settlement credit. Unclean hands may bar contribution as well.
- Banks can minimize their litigation risk by implementing systems and controls to ensure that conflicts are identified and disclosed at the outset of engagement and throughout the sale process.
  - While identifying conflicts may not be easy or straightforward due to the size, various lines of business, and number of clients of large banks, perfection is not necessary.
  - If timely and fully disclosed, a conflict of interest may not be disabling.
- Internal emails, pitch books, and board decks (including drafts thereof and changes thereto) will be scrutinized by plaintiffs' lawyers and the Court, and could be used as evidence to establish *scienter*.
- Keep the entire board or committee informed and involved throughout the sale process.
- Provide valuation analyses and other information to the board with sufficient time for review.
- Financial advisors should disclose any actual or attempted involvement in buy-side financing, obtain board approval for such involvement, update the board regarding efforts to provide buy-side financing, and include provisions governing such involvement in the engagement letter.
- Disclosure of banker conflicts must be specific. General acknowledgements that, in the ordinary course of business, a bank engages in certain activities or offers certain products and services will not suffice.

In re TIBCO Software Inc. S'holders Litig.
2015 WL 6155894 (Del. Ch. Oct. 20, 2015)

In re TIBCO Software Inc. S'holders Litig.

TIBCO Decides to Explore a Sale

- TIBCO Software Inc. ("TIBCO" or the "Company") is a Delaware corporation based in Palo Alto, California.
- During the first half of 2014, several private equity firms contacted TIBCO's then-Chairman and CEO to express interest in, among other things, a potential acquisition of the entire Company. TIBCO's board of directors (the "Board") did not immediately pursue these inquiries.
- On June 3, 2014, TIBCO reported lower-than-expected financial results.
- Three days later, the Board held a special meeting to discuss the Company's financial outlook and a potential sale. Goldman, Sachs & Co. ("Goldman"), the Company's financial advisor, attended the meeting and gave a presentation on TIBCO's market position and strategic alternatives.
- On July 11, 2014, the Board held a second special meeting, at which it instructed Goldman to engage in a comprehensive review of strategic alternatives.
- On July 29, 2014, at a third special meeting, the Board formally decided to explore a possible sale of the entire Company and decided to reach out to the financial sponsors that had expressed interest earlier in the year.

In re TIBCO Software Inc. S'holders Litig.

The Board Forms a Special Committee

- On August 16, 2014, the Board held a fourth special meeting, at which it formed a special committee (the "Special Committee") to review the strategic alternatives available to the Company and to make a recommendation to the Board regarding a course of action.
- On August 18, 2014, the Special Committee held its first meeting, at which it directed Goldman to contact a list of prospective buyers that would potentially buy the entire Company.
- Goldman had been analyzing strategic alternatives since June 2014 and negotiating with potential buyers since August 2014, but did not sign an engagement letter until September 1, 2014 (the "Engagement Letter").
- The Engagement Letter entitled Goldman to a $500,000 retainer, which would be the only compensation Goldman would receive if no transaction occurred, and to a transaction fee of 1% of the "aggregate consideration" paid for the Company's equity securities, assuming a transaction was done at $24.50 per share or less. That is, almost 99% of Goldman's total fee of $47.4 million was contingent on closing a transaction.

The Initial Stage of the Sale Process

- Goldman handled negotiations with potential acquirers, managed TIBCO's data room, and responded to bidders' diligence-related questions.
- Goldman had discussions with 24 potential acquirers. Two serious bidders emerged: Vista and Sponsor B. They were the only bidders to receive access to the data room.
- On August 30, 2014, Vista submitted a non-binding indication of interest for "an all-cash transaction at $23.00 to $25.00 per share of common stock and common stock equivalents."
- Vista's initial proposal included an express assumption about the approximate number of shares of outstanding common stock and stock-based awards to be acquired.

In re TIBCO Software Inc. S'holders Litig.

The First and Second Cap Tables

- In late August, Vista and Sponsor B sought information about TIBCO's share count. They were provided a spreadsheet containing share count information for TIBCO as of August 15, 2014 (the "First Cap Table").
  - The First Cap Table did not list the number of fully diluted shares.
  - Instead, the table listed (i) the total number of shares of common stock outstanding and (ii) line items detailing options and various categories of stock-based equity awards outstanding.
    - One line item stated there were approximately 4.3 million unvested restricted shares outstanding.
    - Those 4.3 million unvested restricted shares also were included in the outstanding common stock total.
  - Thus, these restricted shares were being double-counted.
- In mid-September 2014, Vista and Sponsor B requested updated share count information. They were provided an updated spreadsheet reflecting the Company's share count as of September 19, 2014 (the "Second Cap Table").
  - The Second Cap Table contained the same error as the First Cap Table.
  - The Second Cap Table was sent to the bidders on September 21, 2014.

Vista and Sponsor B Make Additional Bids

- On September 23, 2014, Sponsor B submitted a proposal to acquire TIBCO for $21 per share.
- On September 24, 2014, Vista submitted a bid at $23 per share.
- On September 25, 2014, Sponsor B raised its bid to $22.50 per share.
- On September 25, 2014, after Sponsor B raised its proposal, Goldman asked the bidders to submit final proposals by early afternoon on September 26, 2014.
- The morning of September 26, 2014, the Board and Special Committee held a joint meeting attended by Goldman and Company management.
  - At this meeting, Goldman reviewed Vista's $23 per share and Sponsor B's $22.50 per share proposals.
  - The Board told Goldman to maximize the consideration offered by the competing bidders, and discussed the financial model and forecasts that Goldman would use in preparing a fairness opinion.

Vista Calculates its Maximum Bid

- The morning of September 26, 2014, an internal committee of Vista responsible for approving acquisition bids (the "Vista Committee") met to discuss the maximum bid Vista could make yet still achieve its target internal rate of return ("IRR") for the investment.
  - According to plaintiff, in calculating the maximum bid that would permit this target rate to still be realized, "the total enterprise and equity valuation necessarily comes first, and the per-share price is calculated thereafter."
- At the end of the meeting, the Vista Committee approved a proposal to acquire TIBCO for up to the maximum aggregate value that would allow Vista to achieve its target IRR. That amount was $4.237 billion of equity value, which represented a $4.305 billion enterprise value.
- Based on the share count information Vista had received, the $4.237 billion in equity value translated to a maximum price of $24.25 per share.

TIBCO Discovers the LTIP Share Count Error

- On September 26, after the Vista Committee met but before Vista submitted its final bid, TIBCO discovered an error in the Second Cap Table.
  - The Second Cap Table omitted approximately 3.7 million shares in the Company's Long Term Incentive Plan ("LTIP"), and thus understated the common stock outstanding by approximately 3.7 million shares.
- TIBCO and Goldman revised the Second Cap Table to reflect the Company's share count as of September 25, 2014 (the "Final Cap Table").
  - The Final Cap Table properly identified the 3.7 million LTIP shares as a separate line item within the outstanding stock-based awards category, but the unvested restricted shares (which now totaled 4,147,144 shares) still were being double counted.

In re TIBCO Software Inc. S'holders Litig.

Vista Revises Its Maximum Bid

- After discovery of the LTIP share count error, bidding was suspended.
- Later in the afternoon on September 26, Goldman sent Vista summary share count data, which corrected the LTIP share count error, but which still double-counted the unvested restricted shares.
- Vista responded that it wanted an updated table "in the exact format" used for the prior tables. Goldman then sent the Final Cap Table to the bidders.
- After receiving the Final Cap Table, Vista reran its internal leveraged buyout financial model.
- Because correction of the LTIP share count error meant there were more shares than previously understood, the maximum Vista could bid and still meet its target rate of return decreased from $24.25 to $23.97 per share.
- Vista submitted a proposed final bid of $23.85 per share, which implied an aggregate equity value of $4.217 billion and an enterprise value of $4.284 billion—each about $21 million lower than the maximum aggregate value that the Vista Committee had authorized earlier in the day.

In re TIBCO Software Inc. S'holders Litig.

Vista Wins The Auction

- Sponsor B submitted its final proposal of $23.75 per share.
- Goldman told Vista and Sponsor B that their bids "were not materially differentiated," and asked them to submit "best and final" bids that evening.
- Vista raised its bid from $23.85 to $24 per share (Vista's "Final Bid"), which implied an aggregate equity value of $4.244 billion and an aggregate enterprise value of $4.311 billion based on the share data known at the time.
- Late in the evening on September 26, 2014, Goldman told Vista that it had won the auction with its Final Bid.
- A few minutes after midnight on September 27, 2014, Vista's counsel emailed Vista's equity commitment letter to TIBCO's counsel (the "Equity Commitment Letter"), which contemplated financing the merger from Vista's cash on hand in an aggregate amount up to $4.859 billion.
- A spreadsheet attached to the email showed that the largest component of that amount was the equity value payable to stockholders of $4.244 billion. This amount was calculated by multiplying $24 per share by approximately 176.8 million fully diluted shares outstanding, which number of shares had been derived from the Final Cap Table.

TIBCO Accepts Vista's Offer

- On September 27, the Special Committee and Board met to review Vista's Final Bid of $24 per share and Sponsor B's final bid of $23.75 per share.
- Goldman presented its opinion on the fairness of Vista's Final Bid to the Board. Goldman's presentation utilized the erroneous share count derived from the Final Cap Table when opining that $24 per share was fair.
- After its presentation, Goldman delivered its written opinion that Vista's Final Bid was fair from a financial point of view (the "Fairness Opinion").
- After Goldman's presentation, the Special Committee unanimously recommended that the Board approve the merger.
- The Board then unanimously approved the merger, adopted and approved the merger agreement, and recommended that TIBCO's stockholders vote in favor of adoption of the merger agreement.

The Merger Agreement

- Later in the morning of September 27, 2014, TIBCO and Vista signed the merger agreement.
- The merger agreement did not state an aggregate purchase price or implied equity value. Rather, it provided that, at the effective time, each share of TIBCO common stock would be "automatically converted into the right to receive cash in an amount equal to $24.00, without interest."
- Provisions of the merger agreement (including a representation as to TIBCO's capitalization (the "Cap Rep")) accurately set forth the share count data needed for Vista to calculate that, based on the $24 per-share price, it would need to acquire 172,670,009 fully diluted shares in the merger—not the 176,817,153 fully diluted shares it believed it would need to acquire.
- Two provisions of the merger agreement, however, were negotiated by TIBCO and Vista as a percentage of an assumed equity value of $4.244 billion—the termination fee and a liability cap.

The Parties' Public Statements About the Merger

- On September 29, 2014, Vista and TIBCO announced the merger in a joint press release. TIBCO, Vista, and Goldman each participated in drafting the joint press release, and had the opportunity to review and sign off on the final version. The joint press release stated:

  > "[U]nder the terms of the agreement, TIBCO stockholders will receive $24.00 per share in cash, or a total of approximately $4.3 billion, including the assumption of net debt.... The total enterprise value for the transaction represents more than 18 times TIBCO's earnings before interest, depreciation and amortization (EBITDA) for the 12 months ending August 31, 2014."

- Vista (in draft presentations to potential lenders) and Goldman (in marketing materials) each expressed the belief that the implied enterprise value of the merger was $4.3 billion.

In re TIBCO Software Inc. S'holders Litig.

The Error in the Final Cap Table is Discovered

- On Sunday, October 5, 2014, TIBCO's counsel circulated a draft of the proxy (the "Preliminary Proxy"), which included enterprise and equity values for the transaction based on the share count numbers set forth in the merger agreement.
- A Goldman employee reviewed the draft and commented in an email that "[t]he aggregate value calculation doesn't look right" compared to the number used in Goldman's analysis. Goldman then emailed TIBCO's counsel to discuss whether, in light of the data in the Final Cap Table, the "equity value and aggregate value [in the Preliminary Proxy] should come out to a different number."
- After conversations between TIBCO and Goldman, it was discovered that the capitalization data that was provided to Vista (and Sponsor B) in the Final Cap Table (and its earlier versions) had double-counted 4,147,144 unvested restricted shares.
- Decreasing the number of the fully diluted shares had the effect of reducing the total implied equity value of the transaction by about $100 million, from approximately $4.244 billion to approximately $4.144 billion.
- Goldman and TIBCO allegedly did not make immediate inquiry to determine whether Vista or Sponsor B had relied on the incorrect data.

The October 11, 2014 Board Meeting

- On October 11, 2014, after the Board was informed of the share count error, it convened a special meeting to consider the situation.
- TIBCO management and representatives of Goldman attended the meeting.
- Goldman presented a revised analysis of the merger with the corrected capitalization numbers. Goldman's analysis assumed that the $24 per-share price would remain the same.
- After discussions with the Board, Goldman stated that there was no change to its previous Fairness Opinion.
- Following Goldman's presentation, the Board concluded that the revised analysis Goldman had provided did not impact its recommendation in favor of the merger.
- The Preliminary Proxy was revised to include a disclosure addressing the share count error.

In re TIBCO Software Inc. S'holders Litig.

Vista is Informed of the Share Count Error

- On October 14, 2014, Vista was informed about the share count error when TIBCO's counsel told Vista's counsel that the equity value in the Preliminary Proxy should be $100 million less. Vista was confused, believing it had agreed to pay $4.311 billion.
- The next morning, Vista forwarded to Goldman "the email that [Vista] used for the calculation of equity value" in connection with its Final Bid: a September 26, 2014 email from Goldman to Vista attaching the Final Cap Table, which included the share count error.
- Goldman allegedly never told the Board that Vista had admitted relying on the inaccurate share count data in preparing its Final Bid.
- The COO of Vista testified that once he learned of the windfall Vista would get as a result of the change in share count—which made the deal cheaper and increased Vista's expected return—he felt "pleasure."

The Share Count Error Is Made Public

- On October 16, 2014, TIBCO filed the Preliminary Proxy, which disclosed information about the share count error and explained that, based on the accurate share count, the $24 per share consideration implied an enterprise value of approximately $4.2 billion, or approximately $100 million less than the $4.3 billion that was initially announced.
- The financial press commented on the magnitude of the reduction in equity value, the minimal disclosure regarding the circumstances surrounding the error, and the lack of any indication that TIBCO would attempt to recover the $100 million for stockholders.

In re TIBCO Software Inc. S'holders Litig.

The Board Further Discusses the Share Count Error

- On October 23, 2014, the Board met to further discuss the share count error.
- According to the Complaint, no member of the Board ever asked Goldman: (i) how the share count error was made; (ii) who was at fault; (iii) whether Goldman had discussed with Vista the error or its implications; or (iv) whether Vista should or would pay the full $4.244 billion.
- Goldman allegedly never informed the Board that, more than one week earlier, Vista had acknowledged that it had relied on the inaccurate share count data in making its Final Bid.
  - The Board did not learn of this until the litigation was advanced.
- This lack of information was a motivating factor for the Board in deciding not to challenge Vista on the aggregate purchase price.
- On October 29, 2014, TIBCO scheduled a special meeting for stockholders to consider the merger.
- The stockholders approved the merger on December 3, 2014, and the merger closed two days later.

In re TIBCO Software Inc. S'holders Litig.

Goldman's Transaction Fee

- Goldman was paid a total of $47.4 million, about 99% of which was contingent on the closing of the merger.
- Goldman's fee was 1% of the "aggregate consideration" for any transaction where common stockholders received up to $24.50 per share.
- "Aggregate consideration" was defined in Goldman's Engagement Letter as: "[i]n the case of the sale, exchange or purchase of the Company's equity securities, the total consideration paid for such securities (including amounts paid to holders of options, warrants and convertible securities, net of the exercise price thereof)."
- Goldman's fee was calculated based on aggregate consideration of $4.74 billion, which included the $600 million principal amount of TIBCO's convertible notes.
- Goldman allegedly should not have been entitled to a fee on the convertible notes because (i) Vista did not agree to purchase the notes as part of the merger, and thus no consideration was paid to the noteholders in the merger, and (ii) in any event, Goldman was only entitled to a fee on 1% of that amount "net of the exercise price thereof," and no noteholder received compensation exceeding the exercise price.
- Vista allegedly did not account for any payment to Goldman related to the $600 million in convertible notes. However, Vista did not challenge Goldman's inclusion of the value of the convertible notes in the final calculation of its fee.

In re TIBCO Software Inc. S'holders Litig.

Procedural History

- On October 6, 2014, the first putative class action lawsuit was filed.
- On November 5, 2014, plaintiff filed his initial complaint seeking to enjoin the closing of the merger until the merger agreement was reformed to reflect an additional $100 million in consideration.
- On November 8, 2014, the Court granted plaintiff's motion for consolidation and appointment as lead counsel, and his motion for expedited proceedings.
- On November 16, 2014, plaintiff filed an amended complaint.
- On November 25, 2014, the Court denied plaintiff's motion for preliminary injunction.
- On March 10, 2015, plaintiff filed a second amended complaint (the "Complaint").
- In April 2015, the defendants filed motions to dismiss.
- On July 23, 2015, plaintiff voluntarily dismissed his aiding and abetting claim against Vista (Count III).
- With the voluntary dismissal of Count III, six claims remained: (1) reformation of the merger agreement (Count I); (2) breach of fiduciary duty against the TIBCO directors (Count II); (3) aiding and abetting against Goldman (Count IV); (4) professional malpractice and professional negligence against Goldman (Count V); (5) unjust enrichment against Vista (Count VI); and (6) unjust enrichment against Goldman (Count VII).

In re TIBCO Software Inc. S'holders Litig.

The Reformation Claim

- Count I of the Complaint sought reformation of the Merger Agreement due to an alleged mutual mistake.
- According to plaintiff, the Merger Agreement should be reformed "to reflect [an implied enterprise value] of $4.311 billion and [an implied equity value] of $4.244 billion to stockholders, which on a per-share basis equals approximately $24.57."
- The Court dismissed this claim because, while plaintiff adequately alleged that Vista and TIBCO both mistakenly believed before signing the Merger Agreement that Vista would pay $4.244 billion to acquire the equity of TIBCO, there were not sufficient facts in the Complaint indicating that "Vista and TIBCO ***had specifically agreed*** that the Merger would be at an aggregate equity value of $4.244 billion."
- According to the Court: "[T]he Complaint is devoid of any allegation that Vista specifically offered to pay $4.244 billion (or any other aggregate amount) for the equity of TIBCO or that TIBCO accepted any offer expressed in terms of an aggregate value. Instead, as plaintiff admits, Vista's Final Bid was expressed in terms of a per-share price of $24 unaccompanied by any express assumption about the implied equity value of that bid. The final Merger Agreement accurately reflected the per-share price Vista offered and that TIBCO accepted, and accurately reflected (in the Cap Rep) the number of TIBCO's shares outstanding on a fully diluted basis."

In re TIBCO Software Inc. S'holders Litig.

The Breach of Fiduciary Duty Claim

- Count II of the Complaint asserted that the TIBCO directors breached their fiduciary duties by failing to correct, or even to approach Vista in an attempt to correct, the share count error once it was discovered, and by failing to adequately inform themselves in the wake of this discovery.
  - Plaintiff alleged that these failures violated the directors' duty under *Revlon* to obtain the highest value reasonably obtainable for the Company in a change of control transaction.
  - Plaintiff also advanced two theories to plead a non-exculpated fiduciary duty claim: (1) "the Board did not even *attempt* to recover the $100 million in consideration that Vista had agreed to pay TIBCO"; and (2) the Board "failed to adequately inform itself about the circumstances of the Share Count Error and what options and strategies it had to potentially capture some or all of the $100 million."
- The Court found that the TIBCO directors were exculpated from monetary liability for a breach of the duty of care under TIBCO's Section 102(b)(7) charter provision. The Court also found that plaintiff failed to plead a non-exculpated claim, observing that "[i]n the transactional context, a very extreme set of facts would seem to be required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties."

In re TIBCO Software Inc. S'holders Litig.

The Breach of Fiduciary Duty Claim (Cont.)

- As to plaintiff's first theory, the Court held that the Board's decision not to engage with Vista in an effort to recover some or all of the additional $100 million was not so far beyond the bounds of reasonable judgment as to be inexplicable on any ground other than bad faith.
- The Court observed that "[t]he obvious risk of engaging with Vista to seek to modify the Merger Agreement was that Vista might have used such an overture as an opportunity to repudiate the $24 per share transaction reflected in the Merger Agreement—one that Goldman had opined was fair … and that over 96% of TIBCO's stockholders voted to approve."
- The Court viewed the Board as facing a difficult decision "whether it was worth putting at risk a binding $24 per share transaction that would yield $4.144 billion for TIBCO stockholders (about 97.5% of a $4.244 billion equity value) to try to obtain some or all of an additional $0.57 per share (about 2.5% of such a value)."
- The Court stated: "Even if one viewed the risk of jeopardizing the transaction on the table by engaging with Vista to be minor, it was a risk that a reasonable person could not ignore, and the significance of which reasonable minds could disagree on in good faith."

In re TIBCO Software Inc. S'holders Litig.

The Breach of Fiduciary Duty Claim (Cont.)

- As for plaintiff's second theory, the Court found that it was "reasonably conceivable that the allegations underlying the second theory would sustain a duty of care claim for which the Director Defendants would be exculpated but that could form the predicate breach for an aiding and abetting claim."
  - The Court found plaintiff's allegations that the Board never considered a reformation claim and failed to ask Goldman basic questions to be "troubling." But, given the Board met twice after the error was discovered to assess and respond to the situation, including at least once with Goldman, the Court found that it was not reasonably conceivable the Board entirely disregarded its fiduciary duties or "utterly failed to attempt to obtain the best sale price."
  - The Court did find, though, that plaintiff's allegations stated an exculpated claim against the Board for breach of the duty of care that could form the predicate for an aiding and abetting claim because the allegations "portray a sufficiently wide gulf between what was done and what one rationally would expect a board to do after discovering a fundamental flaw in a sale process such that it is reasonably conceivable plaintiff could meet the gross negligence standard."
  - The Court stated that the Board's alleged failure to make "basic inquiries does raise litigable questions over whether the Board acted in a grossly negligent manner and thus failed to satisfy its duty of care ...."

In re TIBCO Software Inc. S'holders Litig.

The Aiding and Abetting Claim

- Plaintiff alleged that Goldman:
  - with full knowledge of the TIBCO directors' duties to obtain the highest value reasonably attainable for TIBCO's stockholders, "knew from its participation in the October 11 board meeting that the Board had failed to inform itself about the share count error because the Board 'did not ask Goldman any relevant questions about how the error occurred or what might be done about it.'"
  - "learned on October 15, through email correspondence with Vista, that Vista had relied on the erroneous share count in the Final Cap Table in making its Final Bid, but never informed the Board about this critical fact."
- The Court found that these allegations stated a claim for aiding and abetting.

In re TIBCO Software Inc. S'holders Litig.

The Aiding and Abetting Claim (Cont.)

- According to the Court, because Goldman allegedly knew that the Board did not ask it basic questions about the circumstances of the share count error, it was reasonably inferable that Goldman knew that the Board was not fulfilling its duty of care to gather all material information reasonably available about the error.
- The Court observed that, "having that knowledge and having served as the primary negotiator with Vista during the bidding process, Goldman then allegedly concealed from the Board … that Vista had confirmed that it relied on the erroneous share information in the Final Cap Table when it made its Final Bid."
- Based on these allegations, it was reasonably conceivable that Goldman's alleged failure to disclose this material information to the Board "created an informational vacuum at a critical juncture when the Board was still assessing its options vis-à-vis Vista or Goldman to secure some or part of the $100 million equity value shortfall."
- The Court noted that the contingent nature of Goldman's fee allegedly provided it a "powerful incentive" to refrain from disclosing this information to the Board, as it "potentially would jeopardize what Goldman likely perceived to be a 'done deal,'" may have led the Board to seek a fee reduction or forfeiture from Goldman depending on whether it was to blame for the error, and may have led Vista to contest the $6 million component of Goldman's fee tied to the convertible notes.

In re TIBCO Software Inc. S'holders Litig.

The Remaining Claims

- Professional Malpractice against Goldman
  - The Court dismissed this claim, holding that California law did not afford TIBCO's stockholders standing to sue Goldman on a negligence theory for an economic loss. The Court explained that "liability for professional service firms to third parties under California law tends to be limited to instances of physical harm or property damage, rather than economic loss."
- Unjust Enrichment against Vista
  - The Court dismissed this claim because a contract—the Merger Agreement—comprehensively governed the parties' relationship, particularly the provision setting forth the per-share price to be paid by Vista for each outstanding share of TIBCO common stock.
- Unjust Enrichment against Goldman
  - Likewise, the Court dismissed this claim because the Engagement Letter between Goldman, TIBCO, and the Special Committee "entirely controlled" the issue regarding the $6 million Goldman was paid with respect to the TIBCO convertible notes.

In re TIBCO Software Inc. S'holders Litig.

Takeaways for Boards and Financial Advisors

- **For Boards of Directors**
  - Maintain active and direct oversight of the sale process. Asking questions of advisors is part of a board's duty to be reasonably informed when carrying out its oversight function.
  - Conflicts of interest can arise during a sale process, including with respect to board advisors and contingent compensation. Act reasonably to learn of and respond to such conflicts and document those efforts.
  - Bad faith in the transactional context will not be found absent extreme facts. Thus, a disinterested director's risk of personal liability is very low.
- **For Financial Advisors**
  - Keep the board fully informed throughout the sale process.
    - Gross negligence standard/business judgment rule applicable to director conduct following fully informed stockholder approval is high but attainable threshold.
      - *Compare In re TIBCO Software Inc. S'holders Litig*., 2015 WL 6155894 (Del. Ch. Oct. 20, 2015)(finding predicate breach), *with In re Zale Corp. S'holders Litig*., 2015 WL 6551418 (Del. Ch. Oct. 29, 2015)(finding no predicate breach).
  - Section 102(b)(7) exculpatory charter provisions do not protect advisors.
  - An exculpated breach by the board of its duty of care can be the predicate for an aiding and abetting claim against its advisor.
  - Review engagement letter provisions concerning the accuracy of and/or reliance on information furnished by the company. Also review indemnification and contribution provisions to ensure that they provide sufficient protection.
  - Be careful with communications, including oral communications and internal emails.

In re Zale Corp. S'holders Litig.
2015 WL 5853693 (Del. Ch. Oct. 1, 2015)

In re Zale Corp. S'holders Litig.

The Parties

- Plaintiffs were common stockholders of Zale Corporation ("Zale" or the "Company")
  - Zale was a Delaware corporation headquartered in Irving, Texas and a leading retailer of jewelry in North America.
- Defendants included:
  - Zale's board of directors (the "Board" or the "Director Defendants")
    - Neale Attenborough, Yuval Braverman, Terry Burman (Chairman), David F. Dyer, Kenneth B. Gilman, Theo Killion (CEO), John B. Lowe, Jr., Joshua Olshansky, and Beth M. Pritchard
    - Burman, Olshansky, Dyer, and Gilman served on the Board's Negotiation Committee
  - Signet Jewelers Limited ("Signet"), which acquired Zale.
  - Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), financial advisor to Zale's board of directors.
- Non-party Golden Gate Capital ("Golden Gate") owned a 23.3% stake in Zale and was the Company's largest stockholder.
  - Golden Gate had two designees on the Board (Attenborough and Olshansky).
  - Golden Gate had a $150 million loan outstanding to Zale through which it received warrants for 25% of the Company's common stock.

The Financial Crisis and Zale's Turnaround Program

- Zale was severely impacted by the 2008 financial crisis and suffered declining sales that forced it to shutter a number of its retail stores.
- Zale launched a long-term turnaround program in 2010 and implemented certain changes to its business operations designed to improve profitability.
- These turnaround efforts proved successful.

Golden Gate Proposes a Secondary Offering

- In September 2013, Golden Gate notified Zale that it intended to sell its shares to the public in an IPO-like secondary offering (the "Secondary Offering").
- Golden Gate and Zale engaged Merrill Lynch as lead underwriter and filed a preliminary registration statement on October 2, 2013 with the SEC, proposing an offering price of $15.035 per share.
- The Complaint alleged that, prior to the Secondary Offering, and as a result of the turnaround program, Zale's share price had been rising and that the upward trend was halted and capped by the proposed offering price.

In re Zale Corp. S'holders Litig.

Signet Proposes an Acquisition of Zale

- In 2006, Burman, then-CEO of Signet, contacted Richard Marcus, then-Chairman of Zale, to discuss a possible strategic acquisition. These negotiations progressed to some degree, but did not result in a definitive agreement.
- In 2011, Burman left his post as Signet's CEO and was replaced by Michael Barnes.
- In early 2013, Attenborough and Olshansky approached Burman about joining Zale's Board as Chairman. He assumed that role in May 2013.
- On October 6, 2013, Barnes approached Olshansky to discuss a potential merger. Olshansky indicated that any proposal should be communicated to Burman.
- On November 6, 2013, Barnes contacted Olshansky to tell him that Signet was finalizing a proposal for the Board.
- The next day, the Board received an offer from Signet to purchase all of Zale's outstanding common stock for $19 per share in an all-cash deal. The proposal also stated that Signet would require Golden Gate to enter into a voting agreement (the "Voting Agreement").
- Golden Gate cancelled its secondary offering as a result of Signet's offer, but the cancellation was not disclosed to the public.

In re Zale Corp. S'holders Litig.

The Negotiation Committee and Merrill Lynch

- On November 8, 2013, the Board met to consider Signet's proposal. At that meeting, the Board retained Cravath, Swaine & Moore LLP ("Cravath") as its legal advisor and formed the Negotiation Committee to consider financial advisor candidates.
- On November 11, 2013, the Negotiation Committee met with Merrill Lynch, which made a presentation describing its history with Zale and good relationship with management.
  - Merrill Lynch represented that its previous relationship with Golden Gate in connection with the Secondary Offering would not impact its ability to advise the Board and that it had "limited prior relationships and no conflicts with Signet."
  - Merrill Lynch, however, received $2 million in fees from Signet from 2012 to 2013.
  - Merrill Lynch also had—just one day after Barnes indicated to Olshansky that Signet was interested in a transaction and while Merrill Lynch was working on the Secondary Offering—made a presentation to Signet regarding a possible acquisition of Zale.
    - The presentation was aimed at soliciting business from Signet and proposed an acquisition of Zale at a value of between $17 and $21 per share.
    - Jeffrey Rose, a managing director at Merrill Lynch, was a senior member of both the team that pitched Signet and the team engaged to advise the Zale Board.
    - Neither Rose nor Merrill Lynch disclosed to the Board that they made this presentation to Signet until March 23, 2014—after the merger agreement was signed.
- The Negotiation Committee, without interviewing any other candidates, recommended that the Board engage Merrill Lynch as financial advisor.
- The Board adopted this recommendation on November 18, 2013.
- Most of Merrill Lynch's transaction fee was contingent upon the consummation of a merger.

The November 18, 2013 Board Meeting

- On November 18, 2013, the Board met to discuss the potential sale of the Company.
- The Board first addressed its potential conflicts, including: (1) Burman's former service as CEO of Signet and ownership of 1,850 shares of its stock; (2) Attenborough's and Olshansky's employment at Golden Gate, which had an outstanding loan to Zale that would earn a prepayment fee upon a change of control; and (3) Killion's and Burman's compensation arrangements that would allow early vesting of their restricted Zale shares upon a change of control. The Board determined that none was material and that each Director Defendant's interests were aligned with those of the other Zale stockholders.
- Merrill Lynch then made a presentation that included a "Summary Valuation of Strategic Alternatives" "project[ing] the share price of Zale under different alternative scenarios [including five standalone options and a leveraged buyout option] and then calculated the present value of that future stock price." Merrill Lynch evaluated each of these strategic alternatives using "upside case" projections (based on management's projections) and "base case" projections (based on Merrill Lynch's less optimistic projections).
- After considering the strategic alternatives, the Board decided to pursue a merger with Signet.
- The Board asked Merrill Lynch to consider the potential for transactions with other strategic buyers. The Board decided, however, to "defer any decisions regarding the nature of the market check to be undertaken until a later time after further discussion."

In re Zale Corp. S'holders Litig.

The Merger Negotiations

- On December 3, 2013, Signet increased its offer to $19 in cash plus $1.50 in common stock.
- On December 5, 2013, the Board met and decided to enter into a confidentiality agreement with Signet and to allow Signet to perform due diligence. The Board also discussed whether to pursue a transaction with other strategic buyers.
  - According to the Complaint, Merrill Lynch advised the Board throughout the process that a transaction with another strategic buyer was unlikely.
  - Zale received only one indication of interest during this time, from Gitanjali, an Indian jewelry company. Gitanjali did not pursue a transaction beyond this initial overture.
- On January 16, 2014, Barnes informed Killion that Signet planned to keep Zale a separate division and wanted Killion to lead that division. Killion stood to earn more in that capacity.
- On February 10, 2014, Signet informed the Board that the offer of $20.50 per share would be all cash rather than a mix of cash and stock. The Board countered this offer by notifying Signet that it would be willing to proceed with a transaction at $21 per share in cash.
- On February 11, 2014, Signet increased its offer to $21 in cash.
- On February 15, 2014, as part of their ongoing negotiations over the Voting Agreement, Golden Gate requested assurances that "it [would] be compensated by Signet in the event that Golden Gate's exercise of its warrants prior to the record date would result in effective proceeds to Golden Gate of less than the $21.00 per share deal price."
- On February 18, 2014, Merrill Lynch delivered its opinion to the Board that the merger would be fair to Zale from a financial perspective.

In re Zale Corp. S'holders Litig.

Merrill Lynch Discloses its Prior History with Signet

- On February 19, 2014, Zale and Signet announced that they had reached a $690 million deal, pursuant to which Signet would acquire all of Zale's outstanding common stock at a price of $21 per share. The merger agreement contained standard deal protection devices.
- Golden Gate and Signet entered into the Voting Agreement, which required Golden Gate to vote its shares in favor of the merger.
- After the merger was announced, Merrill Lynch advised the Board of its prior history with Signet.
- The Board held three meetings regarding Merrill Lynch's putative conflict and determined that it did not affect its evaluation of the merger.

Zale's Stockholders Criticize but Approve the Merger

- After the proxy was filed, several large Zale stockholders spoke out against the merger, criticizing the deal for numerous reasons, including:
  - the participation of Golden Gate's representatives in the Negotiation Committee allegedly created a conflict of interest between a stockholder looking to sell (Golden Gate) and the Board's obligation to maximize value;
  - Merrill Lynch's prior involvement with Signet allegedly tainted the sales process;
  - the financial projections relied on by the Board and Merrill Lynch in assessing the sale allegedly were stale and included "a lower alternative case" created by the Board "to justify the deal price";
  - Signet's indication to Killion that it preferred he remain as Zale's CEO post-merger purportedly created a conflict of interest;
  - Zale's standalone prospects allegedly were more compelling than a merger, given the success of the turnaround efforts; and
  - the synergies provided to Signet by the merger purportedly were not being allocated equitably among the stockholders.
- On May 29, 2014, the stockholder vote on the merger took place, with 53.1% of Zale's stockholders approving the merger. The next day, Zale announced completion of the merger.
- Thereafter, numerous Zale stockholders filed petitions seeking appraisal of their shares in the Court of Chancery under Section 262 of the Delaware General Corporation Law.

In re Zale Corp. S'holders Litig.

Procedural History

- Shortly after the announcement of the merger, several stockholders filed complaints seeking to enjoin it. The actions were consolidated and plaintiffs moved for expedition in anticipation of a motion for preliminary injunction.
- The parties engaged in expedited discovery, during which Zale produced board minutes and materials and plaintiffs deposed Burman and Rose.
- On May 23, 2014, after the parties had briefed the motion for preliminary injunction, the Court heard argument on that motion and delivered an oral ruling denying it.
- On September 30, 2014, plaintiffs filed the Complaint, which they had amended to include a claim against Merrill Lynch for allegedly having aided and abetted the Director Defendants' putative breaches of fiduciary duties as well as additional allegations based on discovery taken during the preliminary injunction stage.
- Each of the Defendants moved to dismiss under Rule 12(b)(6).
- The parties briefed those motions, and the Court heard argument on May 20, 2015.

In re Zale Corp. S'holders Litig.

The Fiduciary Duty Claims Against the Board

- The Court first considered which standard of review to apply to plaintiffs' claims against the Board.
  - Because this remained an unsettled area of law at the time the Court issued its opinion, the Court chose to evaluate plaintiffs' claims under *Revlon*, notwithstanding the fact that a fully informed, disinterested majority of Zale's stockholders approved the merger.
- The Court next considered whether the Director Defendants breached their duty of loyalty:
  - The Court found that plaintiffs failed to allege that the Board as a whole was conflicted, as plaintiffs had not alleged any facts that would support a reasonable inference that the four allegedly conflicted directors had dominated the five other directors.
  - The Court next found that the Board did not act in bad faith during the merger process, that it agreed to a reasonable merger price, and that the deal protections to which it agreed were reasonable.
  - The Court also found that hiring a conflicted financial advisor did not constitute a breach of the duty of loyalty because the Board made an inquiry to discover Merrill Lynch's conflicts before hiring the bank and considered the implications of and remedies for the conflict after learning of it.
  - Because there was no breach of the duty of loyalty and the Director Defendants were protected by a Section 102(b)(7) provision in Zale's charter, the Court dismissed plaintiffs' claims against the Board.

In re Zale Corp. S'holders Litig.

The Fiduciary Duty Claims Against the Board (cont.)

- The Court then analyzed, for purposes of determining if a predicate breach of fiduciary duty existed to support plaintiffs' aiding and abetting claims, whether the Zale directors violated their duty of care by not acting in an informed manner when choosing a financial advisor given Merrill Lynch's conflicts.
  - The Court stated that when detecting preexisting conflicts held by a financial advisor, the Board could have required representations and warranties in the engagement letter or asked probing questions regarding conflicts. The Court also noted that the Board quickly decided to use Merrill Lynch without considering other candidates.
  - The Court found that plaintiffs' allegation that Rose was a senior member of both the Merrill Lynch team that made the pitch to Signet regarding a possible acquisition of Zale and the team that advised the Board in the merger, but the Director Defendants did not realize that until after the merger agreement was signed, conceivably could constitute a breach of the duty of care in the *Revlon* context.
  - The Court also concluded that plaintiffs conceivably could have suffered damages as a result of this putative breach because the conflict of interest potentially hampered the ability of Merrill Lynch and the Board to seek a higher price and that damages may have occurred even if the Board had used its fiduciary out to back out of the transaction.

In re Zale Corp. S'holders Litig.

The Aiding and Abetting Claim Against Signet

- The Court dismissed the aiding and abetting claim against Signet because there were no allegations in the Complaint that would support an inference that Signet knowingly participated in the Board's duty of care breach.
  - The Court stated that, "[b]ecause the Board's duty of care breach was predicated on Merrill Lynch's nondisclosure of the presentation to Signet to Zale's Board, rather than the presentation itself, Signet could not have participated knowingly unless it was aware of such non-disclosure."
  - Plaintiffs, however, did not allege that Signet knew that Merrill Lynch had failed to disclose its conflict to the Zale Board, and the Court found it reasonable to infer that Signet "believed that Merrill Lynch already had disclosed the presentation to the Board either before it was engaged as its financial advisor or, at least, before the final Merger Price was negotiated."
  - The Court also observed that, as Zale's counterparty to the merger negotiations, Signet was under no obligation to reveal Merrill Lynch's presentation.

In re Zale Corp. S'holders Litig.

The Aiding and Abetting Claim against Merrill Lynch

- The Court refused to dismiss plaintiffs' aiding and abetting claim against Merrill Lynch, finding that plaintiffs had alleged sufficient facts from which it reasonably could be inferred that the bank knowingly participated in the Board's breach of the duty of care by making a conscious decision not to disclose the prior pitch to Signet to the Board until after the merger agreement was signed.
- The Court found that, as alleged in the Complaint, Rose was on "both the team that presented to Signet and the team that advised the Board, which satisfies the 'knowledge' component of the inquiry." The Court noted that the Complaint also alleged that Rose made a conscious decision not to disclose the conflict.
  - According to the Court, Rose's purported reliance on advice from Merrill Lynch's conflicts department in not disclosing the conflict did not absolve the bank or make it inconceivable that Rose purposefully avoided disclosure out of self-interest.
- The Court also found, "[a]s to the 'participation' prong of the inquiry, [that] it was Merrill Lynch's decision to delay disclosure of the conflict … that caused me to find that the Director Defendants' breach of their duty of care conceivably damaged stockholders."
- The Court concluded: "I can only speculate as to why the topic of Merrill Lynch and Rose's prior presentation to Signet apparently did not come up in connection with the decision of the Board to make a counter offer of $21 per share as opposed to something higher, in response to Signet's all cash offer of $20.50 per share. As a result, I conclude that Plaintiffs adequately have alleged that Merrill Lynch knowingly participated in, and therefore aided and abetted, the Director Defendants' duty of care breach."

In re Zale Corp. S'holders Litig.

The Subsequent Letter Opinion

- Notwithstanding the fully informed vote of Zale's stockholders approving the merger, the Court applied enhanced scrutiny under *Revlon*, not the business judgment rule, relying on *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).
- Following the Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015), wherein the Supreme Court affirmed the Court of Chancery's dismissal of a purported class action challenging an acquisition and held that the approval of a merger by a fully informed, disinterested stockholder majority invoked the business judgment rule standard of review, Merrill Lynch moved for reargument.
- In a letter opinion, *In re Zale Corp. Stockholders Litigation*, 2015 WL 6551418 (Del. Ch. Oct. 29, 2015), the Court of Chancery granted Merrill Lynch's motion for reargument and dismissed the aiding and abetting claim against Merrill Lynch, finding that plaintiffs had not alleged sufficient facts to make it reasonably conceivable that the Director Defendants were grossly negligent in failing to become informed of Merrill Lynch's conflicts when engaging it as financial advisor.
- The Court explained that the Board's alleged failure to take additional steps to learn of Merrill Lynch's conflicts, such as negotiating for representations and warranties in the engagement letter or asking probing questions of Merrill Lynch about its past interactions with known potential buyers, did not amount "to 'reckless indifference or a gross abuse of discretion' or … 'suggest a *wide* disparity between the process the directors used ... and [a process] which would have been rational.'"

In re Zale Corp. S'holders Litig.

Takeaways for Boards of Directors

- A board should act reasonably to investigate, identify, address, and monitor a financial advisor's potential conflicts of interest.
  - However, if the transaction is approved by a fully informed, disinterested majority of company stockholders, then the board's conduct will be reviewed under the business judgment rule for gross negligence, not for reasonableness under *Revlon.*
  - And, assuming there is a Section 102(b)(7) provision, disinterested directors are unlikely to face personal liability because bad faith in the transactional context requires extreme facts indicating a conscious disregard of duty or inexplicably unreasonable conduct.
- A board should consider interviewing multiple banks to create a favorable record with respect to its selection of a financial advisor (even if it ultimately selects its initial preferred choice).
- While the *Zale* Court suggested that a board should consider seeking representations and warranties from a financial advisor in the engagement letter regarding the advisor's interactions and relationships with potential buyers, conflicts typically still are disclosed by other methods (such as in a memorandum to the board or in a board book).
  - Disclosure should be in writing (so there is an evidentiary record), but it is the accuracy and completeness of the disclosure rather than the method of it that matters most.
- A board faced with a financial advisor's belated disclosure of a conflict of interest should consider the implications of the conflict, evaluate whether the conflict affected the sales process, and determine whether (and what) remedial steps should be taken.
- Boards can consent to or waive most financial advisor conflicts if such conflicts are timely disclosed and properly managed. The *Zale* Court noted that, "had Merrill Lynch disclosed the Signet presentation to the [Zale] Board up front, it … probably still could have obtained the engagement."

In re Zale Corp. S'holders Litig.

Takeaways for Financial Advisors

- A financial advisor should timely disclose to the board of directors any current or former relationships with known potential buyers (and promptly update such disclosure if necessary).
  - In a single-bidder process like that in *Zale*, the banker should disclose to the target board its relationships with the potential acquiror at the time of engagement and not undertake any new relationships with the potential acquiror until after the sale process concludes.
- Many banker conflicts are consentable or waivable if timely disclosed and properly managed.
  - In *Zale*, the Court indicated that Merrill Lynch probably still could have advised the Zale board despite the prior Signet pitch.
- Belated disclosure may not cleanse a banker conflict, particularly if such disclosure comes after the signing of the merger agreement.
  - The *Zale* Court noted that the Zale board's options to remedy the putative conflict—exercising its fiduciary out and backing out of the merger or obtaining a fairness opinion from a second bank—would incur additional costs that arguably harmed the stockholders.
- A financial advisor's potential liability for aiding and abetting may depend on the standard of review applied by the Court to the board's conduct.
  - The fully informed approval of the target company's stockholders could result in the Court's application of the deferential business judgment standard of review.
  - Because of this, it is important that the proxy disclose all material information, including information about any banker conflicts, so that the stockholder vote is fully informed.
  - Even if belated, as long as a financial advisor discloses its conflicts in time for the company to include them in the proxy, the board (and the financial advisor) can obtain the benefit of business judgment review following a fully informed stockholder vote.

In re PLX Tech. Inc. S'holders Litig.
C.A. No. 9880-VCL (Del. Ch. Sept. 3, 2015) (TRANSCRIPT)

In re PLX Tech. Inc. S'holders Litig.

Overview of the Merger and the Litigation

- Effective August 12, 2014, Avago Technologies Ltd. ("Avago") acquired PLX Technology Inc. ("PLX" or the "Company") through a medium-form merger conducted pursuant to 8 *Del. C.* § 251(h).
- The acquisition valued the Company at approximately $300 million.
- PLX common stockholders received $6.50 per share.
- Plaintiffs alleged that members of PLX's board of directors (the "Board") breached their fiduciary duties by making decisions during the sale process that were unreasonable and by issuing a Schedule 14D-9 that contained materially misleading statements and omissions.
- Plaintiffs contended that Avago, the acquiror, Deutsche Bank Securities ("Deutsche"), the Board's financial advisor, and Potomac Capital Partners II ("Potomac"), an activist hedge fund, aided and abetted the Board's breaches of fiduciary duties.
- Defendants moved to dismiss the complaint pursuant to Rule 12(b)(6).
- The Court (Vice Chancellor Laster) granted the motion as to Avago and two of the members of the Board. The Court otherwise denied the defense motions to dismiss.

In re PLX Tech. Inc. S'holders Litig.

The Events Leading to the Aborted IDT Deal

- Prior to the merger, PLX was a Delaware corporation headquartered in Sunnyvale, California. The Company designed, developed, manufactured, and sold integrated circuits.
- In February 2012, Balch Hill Partners, an activist hedge fund, announced that it had acquired 9.7% of the Company's stock, publicly accused the Board and management of mismanagement, and argued that the solution was to sell the Company.
- The Board initially resisted Balch Hill's efforts to sell the Company, contending that its standalone strategy would generate greater value. Balch Hill then launched a proxy contest.
- Weeks later, on April 30, 2012, the Company announced that it had entered into a merger agreement with Integrated Device Technology ("IDT"), which contemplated that PLX stockholders would receive a mix of cash and IDT stock valued at $7.05 per share. The merger, however, was blocked by the Federal Trade Commission and it never was consummated. Deutsche advised PLX on the aborted IDT deal and received $750,000 for delivering a fairness opinion; Deutsche did not receive its full contingent fee of $2.6 million.

The Events Leading to the Avago Deal

- In January 2013, Potomac announced that it had acquired 5.1% of the Company's stock and publicly advocated for a sale of the Company.
- On February 26, 2013, Avago submitted an indication of interest at $6 per share. The Board rejected the offer as substantially undervaluing the Company. The Board believed that the price should be at least $7 per share given the Company's growth prospects.
- Over the ensuing months, Potomac intensified its activism, increasing its stake in the Company, advocating for a sale, threatening litigation and a proxy contest. The Board retained a third party to investigate Potomac and determined that it was looking for a "quick fire sale" that was contrary to the best interests of the Company's stockholders.
- Like it did with Balch Hill and IDT, the Board reversed itself and, in August 2013, formed a committee to explore a sale.

The Special Committee Retains Deutsche

- The committee retained Deutsche as its financial advisor, partly due to a tail provision in the engagement letter relating to the IDT transaction.
- When retaining Deutsche, the committee did not ask about its relationships with likely acquirors (according to the complaint, Avago was perhaps the most likely acquiror), and thus the committee did not learn about Deutsche's contemporaneous representation of Avago in its efforts to acquire LSI Corporation or its significant other relationships with Avago, including its receipt of $56.2 million in fees from Avago since 2011, its $90 million position in an Avago credit facility, and a $159 million fronting position in a term loan.
- The committee contended that it was "generally aware" of Deutsche's relationships because of prior discussions that took place in connection with Deutsche's engagement for the IDT process.

The Initial Stage of the Sale Process

- In August and September 2013, Deutsche reached out to 15 parties about a transaction; eight signed confidentiality agreements with standstills.
- In September, the Company provided projections to the potential bidders that assumed conservative growth rates lower than its historical growth rates and management's backup information.
- The special committee instructed Deutsche to use these projections to assess the value of PLX. Deutsche derived a valuation range of $8.31 to $11.06 per share.
- On October 1, 2013, one of the bidders provided a written indication of interest at $6.50 to $7.50 per share, but, according to the complaint, PLX management allegedly disliked that company, instead preferring Avago because PLX management believed it was more likely to be retained if Avago were the acquirer.

In re PLX Tech. Inc. S'holders Litig.

Potomac Runs, and Wins, a Proxy Contest

- On October 25, 2013, Potomac released a letter attacking the Board and management and announcing that it would seek to replace three members of the Board.
- On November 25, 2013, the Board responded to Potomac's letter and accused Potomac of being a "self-interested activist investor" "focused only on short-term gains and potentially harmful to other stockholders."
- On December 18, 2013, PLX stockholders elected Potomac's three nominees to the eight-member Board.
- After being elected to the Board, one of Potomac's nominees (Singer) allegedly pushed to be added to the special committee and to take over as its chair.
- Despite its previously expressed views about Potomac's self-interested agenda, on January 23, 2014, the Board purportedly acquiesced and Singer took over as chair of the special committee.

The Sale Process Continues

- From February to May 2014, Deutsche and other PLX representatives engaged with four parties (Companies 1, 2, 3, and 9), one of which was a new potential bidder, as well as Avago.
- During this period, PLX provided updated financial projections (approved by the Board in December 2013) that were moderately lower than the September 2013 projections.
- On May 22, 2014, Avago provided an expression of interest at $6.25 per share. Deutsche prepared a draft response containing a counterproposal of $6.75 per share.
- On May 23, 2014, Deutsche asked PLX's CEO (Raun) about the December 2013 projections and whether there were "any major changes … in the out years." Raun responded "no." Using these projections, Deutsche prepared a base case DCF analysis valuing PLX at $6.90 to $9.78 per share.
- On May 24, 2014, Raun allegedly changed his mind and created an alternative set of projections that applied a 10% haircut to the top line figures in the December 2013 projections. Using these new May 2014 projections, Deutsche derived a valuation range for PLX of $5.48 to $7.67 per share. Avago's proposal of $6.25 fell squarely within that range. Later that day, Raun sent Avago a letter with a counterproposal of $6.75 per share.
- On May 27, 2014, Avago made a revised offer of $6.50 per share.
- On May 30, 2014, the Board agreed to negotiate exclusively with Avago.

In re PLX Tech. Inc. S'holders Litig.

Alleged Issues with the Sale Process

- Before agreeing to exclusivity, the Board, management, and Deutsche allegedly did not make any meaningful effort to explore higher offers.
  - Deutsche and PLX management only contacted Company 2, which had been advised only three weeks earlier that there was no time pressure and no need to rush. Company 2 was given less than a week to submit a final bid.
  - No one contacted Company 1, which had previously indicated a willingness to pay up to $7.50 per share.
  - No one contacted Company 3, which had engaged seriously and expressed a desire to discuss a transaction in June and July.
  - No one contacted Company 9, which told PLX it had real interest and which had been told earlier that month that there was no timetable for bids and no reason to rush.
- PLX management and Deutsche allegedly took steps to make the $6.50 Avago offer look more attractive.
  - On June 4, 2014, PLX management discussed the fact that it needed to prepare "a new haircut five-year plan for Deutsche Bank."
  - On June 13, 2014, PLX management gave Deutsche yet another set of projections that were lower than the December 2013 projections.
  - Deutsche used these June 2014 projections for its fairness opinion.

In re PLX Tech. Inc. S'holders Litig.

Alleged Issues with the Sale Process (Cont.)

- On June 19, 2014, one day before the Board was scheduled to meet, Deutsche disclosed its various relationships with Avago:
  - Received $56 million in fees from Avago during the four prior years;
  - Financial advisor for Avago in its acquisition of LSI Corporation;
  - $90 million position in Avago's credit revolver; and
  - $160 million position in Avago's term loan.

  Deutsche allegedly did not disclose that one of the bankers working for Avago on the LSI deal served on the fairness committee for the PLX deal.
- After learning of this information, the special committee decided to move forward without any changes.
  - The committee considered retaining a second banker to provide an additional fairness opinion, but ultimately decided not to do so.
  - The committee allegedly did not consider the potential risk that Deutsche's putative conflicts and management's preference for Avago affected the sale process.
  - Nor did the committee consider releasing bidders from standstills or modifying the deal protections.

The Approval and Announcement of the Merger

- On June 20, 2014, Deutsche rendered its fairness opinion. The DCF was based on the June 2014 projections, which were prepared solely for the fairness analysis. Deutsche's base case valuation range was $5.09 to $6.99 per share.
- On June 23, 2014, the parties executed the merger agreement and issued a joint press release announcing the deal.
  - The merger agreement contained a no-shop provision, a matching rights provision, a 3.5% termination fee, as well as tender and support agreements for 14.7% of the Company's stock.
- Internally, Deutsche allegedly made an announcement that described the transaction as demonstrating its "continued strong relationship with Avago."
- Senior management of PLX was retained by Avago.
  - Raun had felt it "very important" for him to continue as CEO. During the sale process, he allegedly sought assurances from bidders that he would receive long-term employment and solicited an open board position from one of the bidders.
  - Avago allegedly indicated to Raun that it would keep PLX as a separate division post-merger.

In re PLX Tech. Inc. S'holders Litig.

The Sale Process Claims

- The Court, applying *Revlon*, found that plaintiffs had stated a claim that the Board breached its fiduciary duties by engaging in conduct falling outside the range of reasonableness.
- The Court found that three putative conflicts of interest may have tainted the sale process:
  - Singer's status as a dual fiduciary to beneficiaries with divergent interests. Singer was a co-managing member of Potomac, which sought "a short-term sale event from which it would benefit primarily because of its low [cost] basis" in its PLX stock. Singer also was a member of the Board and special committee, and PLX stockholders may have been better served by PLX remaining independent or pursuing a sale at a later time.
  - Deutsche's relationships with Avago, particularly as buy-side advisor to Avago on the LSI deal, which were not disclosed "until the last minute, where it was difficult for the board to take corrective action."
  - Raun's use of the sale process "to further his own career interests by seeking continuing positions with other companies, including soliciting an open board position and seeking and obtaining post-acquisition employment with Avago, something he described as very important to him."
- The Court also found certain Board decisions fell outside the range of reasonableness at the pleading stage:
  - The Court first determined that it was reasonably conceivable that the Board "favored Avago at the expense of generating greater value through a competitive bidding process or by remaining a standalone company."
  - The Court also concluded that it was reasonably conceivable that the Board acted unreasonably with regard to its interactions with Deutsche, including its failure to (1) identify Deutsche's conflicts of interest earlier in the process, (2) take sufficient steps while overseeing the process to determine whether conflicts for Deutsche emerged, and (3) respond adequately to the conflicts once they were disclosed.

In re PLX Tech. Inc. S'holders Litig.

The Sale Process Claims (Cont.)

- The Court found that Raun and Singer could not invoke the Company's Section 102(b)(7) provision at the pleading stage because of the well-pled allegations that they were conflicted.
- Similarly, the Court found that four other members of the Board could not invoke the Company's exculpatory charter provision because, while they were facially independent and disinterested, the allegations in the complaint supported a pleading-stage inference that they "did not decide to sell and did not engage in the sale process entirely because it was in the best interests of the stockholders but rather … did so in part because of Potomac and Singer's badgering and the fact that this was the second control contest they had faced." The Court noted that it was unlikely they ultimately would face liability. The Court explained:
  - "What tips the line for me -- and I have thought about this a lot, and I think it was very close. What tips the line for me is the back-and-forth on the sale/no sale. If they had originally said, 'We are independent,' and then said, 'You know what? We have thought about it a little bit more. We are going to sell,' that I don't think would create an inference. But what I have got here is a pattern where they say, 'No, we are going to remain independent. Standalone value is higher,' and then as soon as there is a proxy contest threat, they flip and say, 'We are going to sell.' Then when that deal craters, they are back to the we-are-going-to-stay-independent stance, and they identify numbers higher than where they ultimately ended up. But then once again, as soon as there is an activist who threatens a proxy contest, there is a flip, and now they are selling again. And they end up at a price below where they took the stance on standalone. It is the double flip-flop that I think gets the plaintiffs by the pleading stage[.]"
- The Court did dismiss the claims against the last two Board members due to the Company's exculpatory charter provision. These two outside directors were nominated by Potomac and elected in the proxy contest, and thus there was not "this pattern of back-and-forth, back-and-forth and sort of strange resist-cave, resist-cave that I think allows the inference to be drawn [as to the other directors] at the pleading stage."

In re PLX Tech. Inc. S'holders Litig.

The Aiding and Abetting Claim against Deutsche

- The Court concluded that plaintiffs had stated a claim for aiding and abetting against Deutsche. The Court explained:

  "By withholding material information from the directors about its conflicts and disclosing at the last minute, Deutsche Bank, at least at the pleading stage, inferably induced the breaches which, for reasons I have already explained, flow from actions that arguably fell outside or inferably fell outside the range of reasonableness.

  So Deutsche by withholding that information had reason to know that by allowing the directors to proceed in an unknowing fashion, that they were breaching their duties, and by withholding the information, they didn't only give substantial assistance or encouragement; they created the situation."

In re PLX Tech. Inc. S'holders Litig.

The Remaining Aiding and Abetting Claims

- The Court found that plaintiffs also had stated a claim for aiding and abetting against Potomac for allegedly having acted in concert with Singer:

  "I don't think Potomac is secondarily liable under [Section 876(b) of the Restatement (Second) of Torts]. I don't see anything where Potomac gives substantial assistance to Singer once he got on the board. Rather, I think Potomac is potentially liable for aiding and abetting under [Section 876(a)]. Recall, (a) is where you actually act in concert. You have an agreement. The allegation here is that Singer got on the board, Potomac put him on the board with the idea of driving a near-term sale to the detriment of all of the stockholders. As Potomac's comanaging member, Singer's knowledge is imputed to Potomac. They are presumed by law to have a meeting of the minds on this issue and hence an agreement for purposes of Section 876(a) of the Restatement (Second) of Torts. So I think Potomac remains in."

- The Court dismissed the aiding and abetting claim against Avago, concluding that the complaint failed to allege any facts suggesting that Avago knew that Deutsche was steering the PLX sale process in Avago's favor given Deutsche's relationships with Avago.

  "If it could be shown that Avago actually knew and thought it was a great thing that Deutsche was simultaneously its financial advisor on a different deal and also working the sell side for its target and used that to get information, then I think Avago is in the mix. But … I don't think the complaint pleads that."

In re PLX Tech. Inc. S'holders Litig.

The Disclosure Claims

- The Court found that plaintiffs also had stated viable disclosure claims at the pleading stage, stating, in pertinent part:

  > "I think the … pattern of [downward revisions to] the projections create[s] serious questions as to what the most reliable forecast was and what information should have been disclosed to stockholders. I also think that if it is proven at trial that people did have these contrary interests and acted with these contrary purposes, that's a disclosure problem."

- The Court noted that, as to the disclosures, the remaining director defendants, "particularly the nonmanagement directors," potentially would have a "very good" Section 141(e) defense, in that they likely were entitled "to rely on members of management as well as attorney advice regarding which projections to put in, even Deutsche advice regarding which projections to put in."

In re PLX Tech. Inc. S'holders Litig.

Takeaways for Boards of Directors

- Before appointing a director designee or representative of a large stockholder to a transaction committee or having that director lead a sale process, the board should evaluate whether the stockholder has interests that conflict with those of the company's other stockholders.
- Even if a board recently used a financial advisor and previously asked about potential conflicts, the board should inquire again because the potential list of bidders may have changed and/or new conflicts may have emerged.
- When faced with a banker's "last-minute" disclosure of a conflict, a board should evaluate whether the conflict may have tainted the sale process and should consider a variety of options, not only whether to obtain a second fairness opinion.
  - The Court listed the following options: "firing [the banker], seeking legal remedies and starting all over[,] … [the banker] paying for the retention of a second bank to review the process and recommend any corrective action and carry it out[,] … reaching out again to particular competing bidders, providing them with additional time or releasing them from their standstills[,] … [and/or] contacting new bidders."
- If a company's executive officers are involved in a sale process or merger negotiations, a board should consider restricting their discussions with potential buyers regarding post-merger employment until the key terms of a transaction have been agreed upon.
- Document in meeting minutes and the proxy the reasons for changes to management projections, including if downward revisions are made during a sale process.
- Section 141(e) "fully protect[s]" directors from a breach of the duty of due care when they rely in good faith upon information and advice provided by management and advisors.

In re PLX Tech. Inc. S'holders Litig.

Additional Takeaways

- **For Financial Advisors**
  - Bankers should timely disclose to the board of directors any current or former relationships with any parties that may be potentially interested in acquiring the company. Belated disclosure (even pre-signing) may not cleanse the conflict.
  - If there is a potential conflict of interest, prompt disclosure of the conflict, board consent to and oversight of the conflict, and implementation of safeguards to address the conflict (if necessary) can minimize litigation risk for all parties.
  - Like a Section 102(b)(7) charter provision, Section 141(e) does not protect board advisors from potential liability for aiding and abetting a board's due care breach.
- **For Activist Hedge Funds**
  - In *PLX*, the Court suggested that the general rule that large stockholders are presumed to want to maximize the sale price just like other stockholders, and that their support for a transaction in which they receive the same consideration as other stockholders is evidence of fairness, may not apply to an activist hedge fund when there is evidence indicating that the fund is a short-term investor desirous of a near-term sale event. However, activist hedge funds will not be presumed to have such a disparate interest.
  - In *PLX*, the Court imputed the knowledge of a board designee to the stockholder for whom he was a co-managing member to find concerted action under Section 876(a) of the Restatement.
- **For Acquirors**
  - An acquiror potentially could face aiding and abetting liability if it knowingly exploits a financial advisor's conflict of interest, such as if the financial advisor steers the target company's sale process in the acquiror's favor or discloses the target company's confidential information or negotiating strategy to the acquiror.

In re Dole Food Co., Inc. S'holder Litig.
2015 WL 5052214 (Del. Ch. Aug. 27, 2015)

In re Dole Food Co., Inc. S'holder Litig.

Overview

- In November 2013, David Murdock paid $13.50 per share to acquire all of the common stock of Dole Food Company, Inc. ("Dole" or the "Company") that he did not already own.
- Before the transaction, Murdock owned approximately 40% of Dole, and was its chairman, CEO, and *de facto* controller.
- In his initial letter to Dole's board of directors (the "Board"), Murdock offered $12.00 per share and conditioned his proposal on the approval of a disinterested and independent special committee (the "Committee") and the affirmative vote of holders of a majority of the unaffiliated shares.
- The Committee negotiated an increase in price to $13.50 per share, which its financial advisor, Lazard Frères & Co. LLC ("Lazard"), opined fell within a range of fairness.
- Stockholders approved the merger, with a narrow majority (50.9%) of unaffiliated stockholders voting in favor of the deal. The transaction closed on November 1, 2013.
- Shortly after the transaction was announced, Dole stockholders filed suit.
- Following a nine-day trial, the Court found that Murdock and C. Michael Carter, Dole's ex-president and general counsel, breached their fiduciary duties and were jointly and severally liable for damages of more than $148 million, or an incremental value of $2.74 per share.
- All other defendants were found not liable. Pertinently, the Court found that Deutsche Bank Securities, Inc. and Deutsche Bank AG (jointly, "Deutsche"), Murdock's financial advisor and lead financing source, were not liable for aiding and abetting Murdock's breaches of fiduciary duty.

In re Dole Food Co., Inc. S'holder Litig.

Murdock and Dole

- Dole is one of the world's largest producers and marketers of fruit and vegetables.
- Murdock became involved with Dole in 1985 when Flexi-Van Corporation merged with Castle & Cooke, which owned all of Dole's stock. Murdock became Chairman, CEO, and 14% owner of the combined company.
- In 2003, Murdock took Dole private in a leveraged buyout. However, the Company suffered during the financial crisis, and Murdock, whose real estate ventures also suffered, decided to sell a portion of Dole's equity to the public in an October 2009 IPO at $12.50 per share.
- The newly public Dole operated three business segments: Fresh Fruit; Fresh Vegetables; and Packaged Foods.
- After Dole became public, Murdock regularly considered taking it private again.
- Murdock testified at trial that he "never really wanted" to sell equity to the public, but "it was a necessity" because of the financial issues he faced.
- According to the Court: "Murdock's goal was to take Dole private again, and … Murdock and his team saw some form of break-up as a key step in the process. The basic premise was to separate Dole's higher-margin businesses (predominantly Packaged Foods) from its lower margin businesses (predominantly Fresh Fruit), realize the value of the higher-margin businesses, and then pursue a transaction involving the remainder of the Company. Although Murdock was open to other ideas for the remainder, the primary option was for Murdock to buy it."

Dole's Strategic Review

- In the spring of 2012, Dole retained Deutsche and Wells Fargo, two of Murdock's longstanding banks, as financial advisors.
- Deutsche and Murdock discussed a sequence involving two transactions: a Dole spin-off of Packaged Foods in an Asian IPO and then a take-private by Murdock of the remaining company. The latter potential take-private transaction was not disclosed to the Board.
- At the same time, Wells Fargo was working with the Board on a spinoff of Packaged Foods.
- On May 3, 2012, Dole announced a strategic business review. Dole primarily was looking to sell Packaged Foods or other specific businesses to pay down debt.
- Two potential transactions were explored: a sale of Fresh Vegetables to private equity firm Apollo; and a joint venture with ITOCHU, which had worked with Dole in Asia for decades.
- On June 14, 2012, Deutsche provided Dole management with a presentation that analyzed both Apollo's offer for Fresh Vegetables and the potential ITOCHU joint venture. Deutsche calculated that selling Fresh Vegetables would increase Dole's stock price by 8.5%, whereas selling half of the Asian joint venture to ITOCHU would increase the stock price by 35.9%.
- After the meeting, Dole ceased discussions with Apollo to focus on the ITOCHU deal.

In re Dole Food Co., Inc. S'holder Litig.

Discussions Between Murdock and Deutsche

- During the strategic business review, Deutsche acted as Dole's financial advisor and reported to the Board.
- During this same time, Deutsche also acted as advisor and lender to Castle & Cooke and to Murdock personally. Deutsche also acted as purchasing agent for Murdock's trades in Dole stock and as margin lender to Murdock.
- According to the Court, using these other relationships as cover, Deutsche had conversations with Murdock "that it should not have been having as the Board's advisor" and it "should not have been secretly helping Murdock plan to acquire Dole" in a going-private transaction.

In re Dole Food Co., Inc. S'holder Litig.

The ITOCHU Transaction

- In late summer 2012, Dole's discussions with ITOCHU shifted to ITOCHU possibly acquiring Dole Asia (the "ITOCHU Transaction").
- On September 17, 2012, ITOCHU agreed to acquire Dole Asia for $1.685 billion in cash.
- Dole announced the agreement that day, and the price of Dole stock increased to over $14.00 per share.
- Shortly thereafter, Murdock met with Deutsche to discuss a freeze-out.
- On January 11, 2013, Deutsche sent a presentation about a freeze-out to Dole's Treasurer, Beth Potillo. Deutsche asked that she review it and "let us know if you catch anything awry."
- According to the Court: "The sending of the freeze-out presentation to Potillo illustrated how difficult it was for Deutsche Bank to maintain the fiction that it could differentiate between its roles. In this instance, while working for Dole and reporting to its Board, Deutsche Bank sent a presentation about Murdock's acquisition bid to a Dole officer and asked the Dole officer for comment. No one passed the information on to the Board."

Carter Takes Over

- As part of the ITOCHU Transaction, David DeLorenzo, who was Dole's CEO at the time, committed to leave Dole, join ITOCHU, and run Dole Asia for at least two years.
- In anticipation of DeLorenzo's resignation, the Board agreed that Murdock would start functioning as CEO, and Carter would start functioning as President and COO, join the Board, and retain his positions as general counsel and corporate secretary.
- Both formally assumed their roles in February 2013, but the transition effectively took place in December 2012.
- According to the Court: "With the ITOCHU Transaction wrapping up, a freeze-out was the next step in the long-term plan Murdock had been pursuing. Dole had split off its higher-margin businesses, achieved a premium valuation, and used the proceeds to pay down debt. This created an opportunity to take the remaining business private."

Carter Guides the Market Downward

- Dole management knew that the Company could achieve significant cost savings after the ITOCHU transaction.
- Deutsche had advised the Board that Dole could achieve $50 million in annual cost savings. Dole management estimated annual cost savings of as much as $125 million. An analysis by Deloitte indicated savings of $50-90 million per year.
- The figure of approximately $50 million in annual cost savings was communicated to the market.
- In January 2013, however, Carter indicated to investors that Dole would only achieve $20 million in annual cost savings.
- In a Dole press release three weeks later, Carter indicated that Dole's Adjusted EBITDA would be at the low end of the guidance range and that Dole had lowered its valuation of certain assets by hundreds of millions of dollars.
- And, in February 2013, Carter announced that the Fresh Fruits division was "continuing its declining trend …."
- Dole's stock price dropped materially after these announcements.
- According to the Court, while Carter was guiding the market downward, Murdock's freeze-out plans were "heating up."

Dole Considers a Self-Tender

- In January 2013, Murdock, Carter, and Potillo met with Deutsche about a potential share repurchase program for Dole. Deutsche's presentation discussed Dole repurchasing \$25–\$200 million of its shares, but also contained a section on a potential self-tender for 100% of the Company's outstanding stock.
- On January 25, 2013, Deutsche sent another presentation and discussed in the cover email how the different programs would affect Murdock's ownership and ability to gain control.
- In February 2013, Deutsche provided Dole management with a presentation analyzing the choice between a self-tender and a program of open market purchases.
- Murdock and management favored the self-tender, and Dole hired Bank of America Merrill Lynch ("BAML"), another bank that Dole had used in the past, to advise it.
- Two members (Conrad and Weinberg) of the nine-member Board opposed the self-tender. BAML also viewed the self-tender as "ridiculous and terrible corporate finance." Murdock, however, "kept pressing for a self-tender," and left indelicate voicemails for Conrad and Weinberg.
- On May 8, 2013, the full Board met (except for Murdock) and unanimously approved open market repurchases. A few days later, Carter asked Weinberg to resign.
- On May 14, 2013, Weinberg and Murdock's son, Justin, resigned from the Board, leaving it with seven members—three management directors (Murdock, Carter, and DeLorenzo), and four non-management directors (Conrad, Chao, Lansing, and Dickson).

Carter Cancels The Repurchase Program

- According to the Court, "Murdock did not get his way on the self-tender, but he and Carter made sure that the outside directors did not get their way either. Two weeks later, Carter used the pretext of funding new ships to cancel the repurchase program."
- Dole used three ships to transport its bananas to North America. By 2013, those ships needed replacing.
- In May 2013, Dole management recommended commissioning new ships for $168 million.
- The Board approved the new ships, and Carter issued a press release announcing the decision on May 28, 2013. In the same press release, he announced that share repurchases had been "suspended indefinitely."
- Carter did not inform the Board about his decision to suspend the repurchase plan before he made the public announcement, nor did he suggest any connection between the ships and the repurchase plan.
- Dole's outside directors learned of the cancellation of the repurchase program from public sources. The Board previously had determined that the ship acquisition and the share repurchase program were both feasible (as did BAML).
- After the announcement, Dole's stock price dropped 10%.

Murdock Makes His Freeze-Out Proposal

- In April and May, 2013, Murdock "was making his final preparations for the freeze-out."
- On May 15, 2013, Murdock met with Deutsche and said he wanted a "highly confident" letter on May 29 and would "approach the board on the 31st."
- Murdock and Carter spoke with Deutsche again on May 20. They discussed "arranger fees" for Deutsche to finance the take-private transaction.
- On June 10, 2013, Murdock delivered his initial proposal to the Board.
  - Murdock's letter contemplated a transaction at $12.00 per share.
  - The stock had most recently traded at $10.20.
  - Murdock stated that he was "a buyer, not a seller," effectively preventing the Board from seeking a higher price from a third party interested in buying the entire Company.
  - Murdock set a deadline of July 31, 2013, for the Board to respond to his offer.
  - Murdock admitted at trial that the July 31 deadline was artificial so that the Board would have to act quickly.

The Committee

- On June 11, 2013, the Board formed the Committee, which consisted of Conrad, Chao, Dickson, and Lansing.
  - All four had ties to Murdock, with Conrad having the most extensive relationship.
  - Murdock, Carter, and DeLorenzo wanted the Board to pick the Chair of the Committee, and they wanted it to be Conrad. The Committee members, however, wanted to pick their own Chair.
  - Because the Committee members comprised a majority of the Board, they were able to include the power to select their Chair in the resolutions. Murdock, Carter, and DeLorenzo voted against that provision.
  - The disagreement over who should pick the Chair ultimately did not matter, because the Committee chose Conrad.
- According to the Court: "Before trial, Conrad's role as Chair was not a reassuring fact. It was reasonable to infer from Conrad's ties to Murdock, the events surrounding Weinberg's resignation, and the insiders' desire to have Conrad as Chair that Conrad would be cooperative, if not malleable, when facing Murdock. But after hearing Conrad testify and interacting with him in person at trial, I am convinced that he was independent in fact. Dickson, Lansing, and Chao did not testify at trial, but having considered the Committee's performance, I have no concerns about their independence."

In re Dole Food Co., Inc. S'holder Litig.

Carter Interferes with the Committee

- Carter objected to the Committee's desire that its mandate include considering alternatives to Murdock's proposal, including the authority to continue considering alternatives even if Murdock withdrew his proposal. Carter told the Committee:

  "The Dole Board created the Special Committee ... specifically to deal with Murdock's proposal and for no other purpose. That's the only delegated authority from the Board. That's why the resolutions have a termination provision, so that the Special Committee's mandate ends if the proposal is withdrawn.... [T]he Board did not replace itself with a charge to sell the company other than in the context of the proposal."

  According to the Court, "[t]he Committee members decided not to force the issue because they believed that if push came to shove, they comprised a majority of the Board and could have a new vote at the Board level."
- Another confrontation was over the Committee's ability to enter into nondisclosure agreements with other potential bidders. Carter insisted on controlling the terms of those agreements. "As a result, Carter always knew whenever the Committee provided confidential information to an interested party…. [S]o Murdock knew as well."
- A third dispute concerned the Committee's choice of advisors, including its selection of Lazard as financial advisor and the scope of Lazard's engagement.
- "Meanwhile, Murdock was preparing to launch a hostile tender offer if the Committee did not respond favorably by the July 31 deadline." Carter assisted Murdock in these preparations.

Carter Gives False Information to the Committee

- The Court found that "Carter used his control over Dole's management to provide false information to the Committee."
  - Under DeLorenzo, Dole management had prepared a set of three-year projections in December 2012.
  - In July 2013, Lazard met with Dole management to discuss the December 2012 projections and asked that they be updated and extended out to five years.
  - Carter took charge of revising the projections, instructing division heads to create modified projections from the top down and then reverse engineer supporting budgets.
  - The July 2013 projections were significantly lower than the December 2012 projections, and did not account for the full $50 million in post-ITOCHU annual cost savings. The July 2013 projections also did not forecast additional income from Dole's planned purchases of farms.
  - The July 2013 projections "were so low that Lazard did not think they would support Murdock's $12.00 offer, much less provide a basis for negotiating a higher price."
  - In contrast to what he gave the Committee, Carter provided much more positive information to Murdock's bankers at a meeting involving Dole's senior management, Deutsche, BAML, Scotiabank, and Murdock's counsel on July 12, 2013 (the "Lender Meeting"). The Committee and its advisors were not told of this meeting, nor were they given the more positive information disclosed during it.
- According to the Court, Carter's provision of false information to the Committee "proved fatal to the process."
- The Court also found that Murdock and Carter, by holding the Lender Meeting and providing Deutsche with access to a data room without the Committee's authorization, violated the protective procedures established by the Committee.

In re Dole Food Co., Inc. S'holder Litig.

The Committee Projections

- The Committee and Lazard determined that they could not rely on the July 2013 projections.
- Consequently, they decided to prepare their own forecasts (the "Committee Projections") using the December 2012 projections as a starting point and then replicating Dole's normal bottom-up budgeting process, drawing on Dole materials used to secure financing, public statements, and Board presentations.
- "Notably, because Lazard relied on guidance provided by Dole management, the Committee Projections did not include upward adjustments for achieving the final $30 million of the $50 million in cost savings or from the purchases of additional farms."
  - Lazard did include a sensitivity analysis that contemplated an additional $30 million in annual cost savings. Lazard calculated that achieving these additional cost savings would increase its estimate of Dole's value by $345 million, or $3.80 per share.
  - Because management had not provided specific guidance, Lazard did not include a sensitivity analysis for the acquisition of additional farms.

Other Bidders Indicate Their Interest in Dole

- After the announcement of Murdock's proposal, the Committee and its advisors received overtures from a number of third parties, the most serious of which came from two private equity firms, Apollo and Platinum Equity, and two potential strategic buyers, ITOCHU and Chiquita.
- ITOCHU and Apollo never made an offer.
- Platinum Equity expressed an interest at $14 per share, but did not make a formal offer.
- Chiquita was viewed as the most promising bidder, but Murdock refused the Committee's request to allow it to entertain an offer from Chiquita.

In re Dole Food Co., Inc. S'holder Litig.

The Committee and Murdock Negotiate

- The Committee and Lazard met with Murdock initially on June 24, 2013.
- On July 27, 2013, the Committee sent Conrad to meet with Murdock at Murdock's home.
  - Conrad was not authorized to make a counteroffer or accept a proposal.
  - Conrad told Murdock that the July 31 deadline "was unrealistic unless there was a sensational offer that would wow the committee" and that otherwise the Committee was going to continue its process.
  - Murdock became upset and began negotiating against himself, increasing his offer to $12.25, then to $12.50. When Conrad started to leave, Murdock offered $13.05. Conrad reiterated that he was not authorized to accept an offer. He then left.
- The Committee met with Murdock on August 1, 2013. Conrad and Lansing attended in person, with the rest of the Committee and its advisors available by phone.
  - Murdock increased his offer to $13.25, stating "That's it, I'm not going to pay any more."
  - Conrad and Lansing, after having teleconferenced with the Committee and its advisors, countered at $14.00, citing the expression of interest from Platinum Equity.
  - Murdock then countered at $13.50.
  - Conrad and Lansing teleconferenced with the Committee and its advisors, and accepted the offer.
- Lazard's DCF analysis valued Dole at between $11.40 and $14.08, and the $13.50 price exceeded the ranges of values generated by Lazard's public company and precedent transaction analyses.
- The Committee and its advisors thought it was a good outcome.

The Merger Agreement

- Following their agreement on price, the Committee and Murdock negotiated the terms of the merger agreement.
  - Murdock pressed for a two-step transaction with strong deal protections.
  - The Committee insisted on a one-step transaction, a go-shop period, a small breakup fee, and an additional equity commitment from Murdock to ensure the transaction would close.
- "During the negotiations, without receiving permission from the Committee, Carter and other members of Dole's senior management advised Murdock[,] [and] … [t]hey took steps to conceal their involvement by minimizing their written communications[.]"

The New Budget

- While negotiations over the merger agreement still were ongoing, Carter started Dole's annual budgeting process and instructed division leaders "to correct certain unreasonable assumptions" made only weeks earlier in the July 2013 projections.
- An internal Dole management memorandum noted that all operating divisions except Europe would exceed the July 2013 projections. The memo was "not to be circulated outside of this distribution group."
- The Committee did not see the new budget or know about the different assumptions.
  - When asked about the budgeting process, Carter lied to the Committee's advisors, saying that he knew nothing about a management team meeting and that "[t]here are no changes to the operating budget."
- The Committee recommended Murdock's proposal to the Board, which met and approved the transaction.
- After the merger agreement was signed, Dole made presentations to rating agencies in September 2013 and to lenders in October 2013 that were significantly higher than the July 2013 projections that Carter gave Lazard.

The Transaction Closes

- Lazard contacted more than 60 parties during the go-shop period, but received no topping bids.
- Deutsche was one of the lenders in Murdock's financing syndicate.
- Dole held a special meeting of stockholders on October 31, 2013. A narrow majority of 50.9% of the disinterested shares voted in favor of the transaction.
- The transaction closed on November 1, 2013.

Dole's Performance After the Transaction

- After the merger closed, Dole achieved well more than the $50 million in annual cost savings predicted after the ITOCHU transaction.
- Dole purchased approximately $100 million worth of farms in 2014, which increased EBITDA by approximately $23 million once the farms were fully integrated.

In re Dole Food Co., Inc. S'holder Litig.

The Merger Was Not Entirely Fair

- The Court held that the merger was not entirely fair, finding that it was not the product of fair dealing and that the plaintiff-stockholders were entitled to a "fairer" price than was paid pursuant to the merger.
- Standard of Review: The Court applied the entire fairness standard to the merger (not the business judgment rule) because the defendants failed to make the necessary pretrial showing to change the standard of review under *MFW*. Specifically, the Court stated that "despite mimicking *MFW*'s form, Murdock did not adhere to its substance." The Court also held that the defendants were not entitled to a burden shift.

The Merger Was Not Entirely Fair (cont.)

- Fair Dealing: The Court found that the merger was not a product of fair dealing because "Carter engaged in fraud," which "rendered useless and ineffective the highly commendable efforts of the Committee and its advisors …."
- Analyzing the factors established by the Supreme Court in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the Court found that:
  - the timing and initiation of Murdock's proposal were unfair because it was made at a time when Dole's stock was trading at a low price after "Carter first primed the market by pushing down the stock" through his "subterranean estimate of Dole's anticipated cost savings" from the ITOCHU transaction and "his unilateral and pretextual cancellation of the stock repurchase program."
  - the transaction negotiation was unfair because Carter, among other things, (1) provided "knowingly false" financial projections to the Committee, (2) "intentionally tried to mislead the Committee for Murdock's benefit," and (3) "interfered with and obstructed the Committee's efforts" in other ways, thereby undermining the efforts of the Committee and its advisors.
  - the transaction structure and approval were unfair because:
    - with respect to transaction structure, because Murdock "was not a seller," the go-shop provision, low breakup fee, and lack of a topping bid did not support a finding of fairness in this case.
    - as for approval of the merger, "Carter's fraud tainted the approval of the Merger by the Committee, as well as the stockholder vote" because the Committee and stockholders lacked full information.

In re Dole Food Co., Inc. S'holder Litig.

The Merger Was Not Entirely Fair (cont.)

- Fair Price: The Court found that, taking into account information about Dole's cost savings and planned farm purchases, the $13.50 per share merger price "fell towards the low end of the range of fairness and may have dropped below it." The Court determined that a reasonable estimate of the cost savings added $1.87 per share, and a reasonable estimate of the value of the planned farm purchases added $0.87 per share, for a total of $2.74 per share.
- The Unitary Determination of Fairness: According to the Court: "Carter's conduct rendered the Merger unfair…. Assuming for the sake of argument that the $13.50 price fell within a range of fairness, the plaintiffs are entitled under the circumstances to a 'fairer' price…. This is because by engaging in fraud, Carter deprived the Committee of its ability to obtain a better result on behalf of the stockholders, prevented the Committee from having the knowledge it needed to potentially say 'no,' and foreclosed the ability of the stockholders to protect themselves by voting down the deal."

In re Dole Food Co., Inc. S'holder Litig.

The Liability of Murdock

- The Court found that Murdock was personally liable for damages resulting from the merger.
- Murdock was found liable both as a controlling stockholder and as a director of Dole.
- "As Dole's controlling stockholder, Murdock 'breached his duty of loyalty to ... the plaintiff shareholder class, by eliminating [Dole's unaffiliated] stockholders for an unfair price in an unfair transaction.... For that breach of duty [Murdock] is liable.'"
- Murdock also breached his duty of loyalty as a director "by orchestrating an unfair, self-interested transaction" in which, "as the buyer, he 'derived an improper personal benefit.'"
- Murdock was not entitled to exculpation because Dole's exculpatory charter provision does not apply to a defendant in his capacity as a controlling stockholder, nor does it exculpate an interested director who acted disloyally.
- DFC Holdings, LLC, an entity Murdock controlled and used as one of the acquisition vehicles for the merger, was found liable as an aider and abettor to the same extent as Murdock.

The Liability of Carter and DeLorenzo

- The Court also found that Carter was personally liable for damages resulting from the merger.
  - Carter was found liable both as a director and as an officer of Dole, having engaged in "a course of conduct permeated by bad faith and disloyalty."
  - "In support of Murdock's plan to privatize Dole, Carter (i) pushed down the stock price, (ii) advocated for the self-tender, (iii) participated in calls and meetings concerning Murdock's plans to launch a hostile tender offer, (iv) sought at the outset to restrict the authority of the Committee and its advisors, (v) created falsely low forecasts for the Committee to use, (vi) convened the secret Lender Meeting and lied to the Committee about his supposed compliance with the Process Letter, (vii) disregarded the Committee's instructions to terminate Deutsche Bank's access to the data room, (viii) provided advice to Murdock, Deutsche Bank, and Murdock's counsel, and (ix) started a new budgeting process using quite different and more positive assumptions and estimates without telling the Committee."
  - The Court found that Carter was not entitled to exculpation as a director because he breached his duty of loyalty and acted in bad faith. The Court also observed that Dole's exculpatory charter provision did not protect Carter when acting in his capacity as an officer of Dole.
- The Court found that DeLorenzo was not personally liable to the plaintiff-stockholders. The Court concluded that, notwithstanding DeLorenzo's knowledge about the value of Dole, including the cost savings to be realized from the ITOCHU transaction and the planned farm purchases, he "was entitled to rely on the Committee's recommendation of the Merger" because he "did not personally participate in or know about the specific misconduct in which Murdock and Carter engaged."

In re Dole Food Co., Inc. S'holder Litig.

The Aiding and Abetting Claim against Deutsche

- The Court found that "the plaintiffs did not prove that Deutsche Bank knowingly participated in the breaches of duty giving rise to fiduciary liability."
  - The Court explained: "The critical breaches of duty involved fraud regarding Dole's cost-cutting and purchases of farms. The tortious conduct was serious, its wrongfulness was clear, and the extent of the consequences was obvious, but Deutsche Bank did not know about or participate in those acts. Deutsche Bank did not make any of the misrepresentations, was not present for them, and did not conceal information from the Committee. Deutsche Bank was not directly involved, nor even secondarily involved, in the critical breaches of duty."
  - The Court found that Deutsche's participation in the Lender Meeting did not constitute knowing participation because "the plaintiffs did not prove that Deutsche Bank knew about the [protective procedures established by the Committee] or that the meeting violated [their] terms." Similarly, "Deutsche Bank did not have any reason to think that the information it received at the Lender Meeting was different than the information that the Committee received."
  - The Court noted that, while Deutsche "might have had some reason to be concerned that something may have been amiss" at the Lender Meeting, "it is important to consider that when the Lender Meeting took place, Deutsche Bank was acting as Murdock's advisor and lead financier." Given that role, the Court determined that it was not Deutsche's "job to call the Committee, its counsel, or Lazard to make sure everything was OK…. The same analysis applies to Deutsche Bank's access to the Committee's data room and its communications with Carter, Potillo, and other Dole officers."

In re Dole Food Co., Inc. S'holder Litig.

The Aiding and Abetting Claim against Deutsche (cont.)

- The Court rejected the plaintiffs' argument that Deutsche knowingly participated in Murdock's breaches by having knowingly received confidential Dole information that it used to help Murdock plan the freeze-out, reasoning that there is no bright-line rule prohibiting a fiduciary from sharing information with an affiliated stockholder and his advisors.
  - The Court observed, however, that "[i]f I am incorrect and Murdock's sharing and use of Dole's confidential information was prohibited, then Deutsche Bank knowingly participated in the breach." "Deutsche Bank knew that it was receiving confidential information from Murdock, Carter, Potillo, and other Dole insiders, and it used the information to assist Murdock in planning for the freeze-out and on other issues that affected his personal interests as a stockholder…. Deutsche Bank knew it should not have [had] access to Dole's confidential information."
  - Nonetheless, the Court concluded that these preparatory activities in formulating Murdock's proposal did not amount to a breach of fiduciary duty, and that the actions taken by Deutsche did not result in harm to Dole stockholders.
  - "In my view, the scope of Deutsche Bank's exposure to liability depends on their knowing participation in the breaches of duty that gave rise to causally related damages, namely Carter's interference with and fraudulent misrepresentations to the Committee. The aiding and abetting claim against Deutsche Bank therefore fails."

In re Dole Food Co., Inc. S'holder Litig.

Damages

- The Court held that Dole stockholders were entitled to a "fairer" price, determined by the Committee Projections and Lazard's analysis, "with adjustments where Murdock and Carter misled the Committee" with respect to the cost savings from the ITOCHU transaction and the additional income from the planned farm purchases.
- The Court calculated that the full cost savings from the ITOCHU transaction and the potential increased income from the planned farm purchases "could support an award of damages as high as $6.84 per share." The Court noted that, generally speaking, "uncertainties in damages calculations are resolved against the wrongdoer." However, the Court found that such a level of damages was "unrealistic and harsh" and, consequently, adopted "a reasonable middle-ground estimate" of $2.74 per share.
  - The Court then added $2.74 per share to Lazard's DCF valuation range, increasing it to $14.14 to $16.82 per share, with a midpoint of $15.48, which the Court characterized as "approximat[ing] the result of an arm's-length negotiation between parties having equal information."
  - "The result is a price $1.98 per share higher than the $13.50 per share Murdock paid. But because the defendants engaged in fraud, and in light of the Delaware Supreme Court's guidance regarding damages calculations for loyalty breaches, the plaintiffs are entitled to the full incremental $2.74 per share in damages."
  - The Court noted that the damages award was consistent with the findings of a study analyzing earnings manipulation before management-led buyouts, and that the award would imply a "relatively modest" premium of 16% over Dole's trading price shortly after the ITOCHU transaction.
- The Court awarded pre- and post-judgment interest on the money damages.

In re Dole Food Co., Inc. S'holder Litig.

Takeaways for Directors and Officers

- **For Boards of Directors**
  - The potential for fraud and other misconduct by a controller and corporate fiduciaries aligned with the controller makes it imperative that a special committee hire independent and qualified financial and legal advisors.
    - In certain contexts, a special committee may need to assess the accuracy and completeness of financial projections and other information provided by company management, as well as consider ways to ensure that management and employees adhere to the protective devices established for negotiations with the controller.
    - Even excellent work by a special committee and its advisors cannot cleanse a process undermined by fraud.
  - There is no bright-line rule prohibiting a director from sharing information with an affiliated stockholder. On the contrary, "[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director." *Kalisman v. Friedman*, 2013 WL 1668205, at *6 (Del. Ch. Apr. 17, 2013).
- **For Corporate Officers**
  - Officers owe fiduciary duties to the corporation and its stockholders.
  - Officers, however, are not exculpated by a Section 102(b)(7) charter provision.

Takeaways for Controllers and Financial Advisors

- **For Controlling Stockholders**
  - *MFW* is not a panacea. The *MFW* procedural protections must be followed in both form and substance in order to obtain business judgment review of a controlling stockholder going-private transaction.
  - Entire fairness review is highly contextual. Even if the price is fair, in cases of fraud or egregious misconduct, a breach of fiduciary duty may be found and minority stockholders may be entitled to a "fairer" price. *Cf. In re Trados Inc. S'holder Litig.*, 73 A.3d 17 (Del. Ch. 2013) (no fiduciary duty breach; merger at fair price was entirely fair despite unfair process); *In re Nine Sys. Corp. S'holders Litig.*, 2014 WL 4383127 (Del. Ch. Sept. 4, 2014) (fiduciary duty breach; recapitalization at fair price was not entirely fair because of "grossly unfair dealing").
- **For Financial Advisors**
  - A financial advisor will not be liable for aiding and abetting a breach of fiduciary duty if it was unaware of and did not participate in the fiduciary's misconduct, or if the fiduciary duty breach in which it knowingly participated did not proximately cause any damages.
  - A bank should be cognizant of its relationships with a corporation, its board, and its controlling stockholder, and evaluate whether a court might find that one or more of those relationships presents a potential conflict of interest.
  - Because they may face protracted litigation due to their clients' wrongdoing and despite not having engaged in any wrongdoing of their own, financial advisors should review and revise as appropriate the indemnification provisions in their engagement letters to ensure that they are fully protected in such situations.

Other Recent Developments of Note

- Financial advisor valuation analyses are facing increasing scrutiny from the Delaware Court of Chancery.
  - In *RBC/Rural Metro*, the trial court found (and the Supreme Court affirmed on appeal) that the financial advisor manipulated its valuation analysis by making a number of changes to its fairness opinion to make the acquiror's bid look more attractive.
  - In *In re El Paso Pipeline Partners, L.P. Derivative Litigation*, 2015 WL 1815846 (Del. Ch. Apr. 20, 2015), which challenged related-party dropdown transactions, the Court criticized the work of the financial advisor to a limited partnership's conflicts committee, stating that the advisor's "actions demonstrated that the firm sought to justify Parent's asking price and collect its fee."
  - In *Fox v. CDX Holdings, Inc*., 2015 WL 4571398 (Del. Ch. July 28, 2015), the Court of Chancery found that a valuation firm's report "reached a new low" and was "so flawed as to support both an inference of bad faith and a finding the process was arbitrary and capricious."
  - *See also In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 441 (Del. Ch. 2012) (noting "questionable aspects to [financial advisor's] valuation of the spin-off"); *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 771-73, 803-04 (Del. Ch. 2011) (noting misleading analyses performed by financial advisor).

Other Recent Developments of Note (cont.)

- Many dead-hand proxy puts have been removed from debt instruments.
  - A "proxy put" requires a corporation to pay off or redeem its debt in the event that more than half of an incumbent board of directors is replaced through an actual or threatened contested election. Proxy puts can take a "dead hand" form, rendering a board powerless to avoid application of the provision (unless it is waived by the lender).
  - There are legitimate business reasons for lenders to include these provisions. However, many dead-hand proxy puts have been removed, possibly due to litigation challenging them as entrenchment devices, including the *Healthways* case, which, at the pleading stage, suggested that a lender potentially could face aiding and abetting liability.
- In at least one case, stockholders have sued a company's outside counsel for allegedly having aided and abetted the board's putative breaches of fiduciary duty. The law firm recently settled the claims against it. A trial currently is being held on the claims against the board.
  - We also are aware of another case in which a company's outside counsel may get added as a defendant in an amended complaint on an aiding and abetting theory.
- Anti-reliance provisions will bar fraud claims based on extra-contractual statements if expressed from the point of view of the buyer. *See, e.g., FdG Logistics LLC v. A&R Logistics Holdings, Inc.*, 131 A.3d 842 (Del. Ch. 2016); *Prairie Capital III, L.P. v. Double E Holdings Corp.*, 2015 WL 7461807 (Del. Ch. Nov. 24, 2015).
  - Absent an effective anti-reliance provision, a seller's advisor potentially could be sued on the putative theory that it aided and abetted the seller's fraud based on extra-contractual statements made during due diligence.

Practice Points

Practice Points for Boards of Directors

- A board of directors evaluating whether to explore a sale process may want to consider interviewing multiple banks to create a favorable record in the event of stockholder litigation. The board still can choose the bank with which it has a longstanding relationship if reasonable under the circumstances.
- A board of directors should act reasonably to learn of its financial advisor's current and former relationships with known potential buyers (and any other potential conflicts) prior to engagement.
- A board of directors may consent to many financial advisor conflicts. However, "[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." *RBC Capital Markets*, 129 A.3d at 855 n.129.
  - Appropriate safeguards (*e.g.*, information walls; second advisor; etc.) should be employed.
- When informed of a conflict and asked to consent to it, a board may want to consider requesting some benefit for stockholders in exchange. *See In re Del Monte Foods Co. S'holders Litig*., 25 A.3d 813, 833 (Del. Ch. 2011); *In re Morton's Rest. Grp., Inc. S'holders Litig*., 74 A.3d 656, 673 (Del. Ch. 2013).
  - For example, in *Morton's*, the target board allowed its financial advisor to provide buy-side financing after the potential buyer had difficulty securing financing; in exchange, the financial advisor recused itself from the negotiations, reduced its fee, and still provided a fairness opinion. 74 A.3d at 673. The target board used the money it saved to hire a second advisor. *Id.*
- Conflicts of interest can arise during a sale process. While a board has no obligation to perform ongoing due diligence of its own advisor, a board should act reasonably to identify and respond to such conflicts.
- A board of directors faced with its financial advisor's belated conflict disclosure should evaluate whether the conflict may have tainted the sale process and consider a variety of options to address it.
  - Retention of a second financial advisor may not always cleanse the first advisor's conflict or remedy deficiencies in the sale process.
- The board should document in meeting minutes and in the proxy its efforts to learn of, evaluate, monitor, and address its financial advisor's conflicts.

Practice Points for Financial Advisors

- Banks would be well served to implement systems and controls to track and clear potential conflicts.
  - Conflicts can come in many forms: advisory engagements; prior pitches; lending activities; personal stock holdings and relationships of bankers; etc.
- A financial advisor should timely, fully, and specifically disclose to the board of directors any current or former relationships with any known potential buyers, and it should update such disclosure as the sale process unfolds.
  - While written disclosure is preferable, whether it is in a board book, memo, questionnaire or otherwise is less important than the accuracy and completeness of the disclosure.
  - Generic, boilerplate disclosures in an engagement letter will not suffice.
- Banks, especially the larger ones, generally will have conflicts of interest. Most conflicts are consentable. Thus, disclosure of a conflict may not cost a bank an engagement. In fact, some financial advisor conflicts generate value for stockholders (*e.g.*, industry knowledge).
- Fulsome and timely disclosure of conflicts is in a financial advisor's best interest.
  - Whereas a board likely will be exculpated for failing to become informed of its advisor's conflict (a duty of care breach), an advisor could face monetary liability for aiding and abetting.
  - Where undisclosed conflicts of interest exist, decisions made in a sale process are viewed more skeptically. *In re Rural Metro Corp.*, 88 A.3d 54, 91 (Del. Ch. 2014); *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 434 (Del. Ch. 2012).
  - Potential monetary liability could exceed the advisory fee on the transaction.
  - A financial advisor's conflict disclosure need not be perfect. The failure to disclose a conflict simply must not be knowing, intentional, or reckless. Gross negligence is insufficient.
- Keep the board fully informed and involved during a sale process.
- Provide the board adequate time to review and consider valuation analyses and other information.
- Document and explain the reasons for any changes to valuation analyses during a sale process and make those changes clear in the board book.

Practice Points for Financial Advisors (cont.)

- In *RBC Capital Markets*, the Delaware Supreme Court made clear that financial advisors to corporate boards of directors are not "gatekeepers." 129 A.3d at 865 n.191.
  - Aiding and abetting liability generally will be limited to cases involving "fraud on the board" or purposefully creating an "informational vacuum."
- A financial advisor is under no obligation to monitor the conduct of directors or to prevent directors from breaching their fiduciary duties. *See id.* Rather, a financial advisor's duties are contractual, and are defined in its engagement letter with the board. *See, e.g., Houseman v. Sagerman*, 2014 WL 1600724, at *10 (Del. Ch. Apr. 16, 2014) (holding that KeyBanc's agreement "to provide limited services in connection with the transaction, rather than the panoply of financial services—including a fairness opinion—it could have provided had the parties contracted for such, is not sufficient to support the inference that KeyBanc knew the Universata Board was breaching its fiduciary duties in selling the Company and abetted that breach").
- A financial advisor's failure to perform its contractual obligations under its engagement letter may be a breach of contract, but generally will not be aiding and abetting. *See id.*
- The combined effect of Section 102(b)(7) and DUCATA is to shift all liability for a board's breach of the duty of care to a board advisor found to have aided and abetted that breach.
  - A Section 102(b)(7) provision does not protect board advisors (nor does Section 141(e)).
  - An exculpated director is not a "joint tortfeasor" under DUCATA.
  - An aider and abettor generally may seek contribution or a settlement credit based on a director's non-exculpated breach of the duty of loyalty, but must comply with the procedural requirements of DUCATA.
- Evaluate whether any changes to engagement letter provisions are appropriate, including those regarding: (1) indemnification; (2) contribution; (3) assumption of defense; and (4) settlement.

Q & A

Questions?

Contact Information

Myron Steele

Email: msteele@potteranderson.com

Phone: 302-984-6030

Chris Kelly

Email: ckelly@potteranderson.com

Phone: 302-984-6178

For a recording of this program and to register for our upcoming free CLE webinars, please visit:

In The Know
www.ambar.org/intheknow

Business Law Basics
www.ambar.org/basics

AMERICAN BAR ASSOCIATION
Center for Professional Responsibility