SHEARMAN & STERLING LLP

CLIENT PUBLICATION

LITIGATION and M&A | December 4,2015

Delaware Supreme Court Decision in *Rural/Metro* Affirms $76 Million Judgment Against Third-Party Advisor for Aiding and Abetting Breaches of Fiduciary Duty by Board, but Rejects Suggestion of 'Gatekeeper' Duties

On November 30, 2015, the Delaware Supreme Court affirmed post-trial decisions by the Delaware Court of Chancery (i) holding RBC Capital Markets, LLC liable to Rural/Metro Corp. shareholders for nearly $76 million based upon a finding that RBC had aided and abetted the Rural/Metro board of directors' breach of fiduciary duty by manipulating Rural/Metro's 2011 sale process, and (ii) limiting the parties from whom RBC could claim settlement contribution to those who had been adjudicated joint tortfeasors based on the record at trial – a group that was held to exclude director defendants who would have qualified for exculpation from money liability under the corporation's certificate of incorporation. *RBC Capital Markets, LLC v. Jervis* ("*Rural/Metro"*), No. 140, 2015, 2015 WL 7721882 (Del. Nov. 30, 2015). This ruling represents the first time Delaware's highest court has held a financial advisor liable to shareholders for aiding and abetting a corporate board's breach of the duty of care, continuing its recent string of rulings applying closer scrutiny to investment banker conflicts. It also confirms that the protections afforded to director defendants under § 102(b)(7) can in some circumstances operate to increase the damages imposed against other defendants who do not qualify for exculpation. The Court's decision also expressly disavowed the lower court's suggestion that financial advisors were "gatekeepers" with an obligation to affirmatively prevent fiduciaries from breaching their duties of care to constituents.

A. Background Facts

Rural/Metro Corp. ("Rural") is a leading national provider of ambulance and private fire protection services. On March 28, 2011, Rural announced it had agreed to sell itself to an affiliate of private equity fund Warburg Pincus LLC ("Warburg"). Shareholder class action litigation followed, with the plaintiff class pursuing breach of fiduciary duty claims against six Rural directors who had approved the transaction, as well as aiding and abetting claims against Rural's financial advisors, RBC Capital Markets, LLC ("RBC") and Moelis & Company, LLC ("Moelis"). Following submission of pre-trial opening briefs by all parties, the director defendants and Moelis reached settlements with the plaintiff class. The case proceeded to trial solely against RBC.

On March 7, 2014, Vice Chancellor Travis Laster of the Delaware Court of Chancery issued an opinion finding that Rural's board of directors (the "Board") had breached its duty of care, and that RBC had aided and abetted those breaches. *In re Rural Metro Corp.* ("*Rural I*"), 88 A.3d 54, 95 (Del. Ch. 2014). The opinion found that RBC had timed Rural's sale process to coincide with the ongoing sale of Emergency Medical Services Corporation ("EMS") –

owner of Rural's lone national competitor in the ambulance business – in the hopes of (i) leveraging its sell-side role with Rural to secure buy-side roles with firms bidding for EMS, and (ii) offering staple financing to Rural's potential buyers. The trial court also found that RBC disclosed only this latter intent to Rural. Furthermore, RBC's engagement letter with Rural contained no non-reliance disclaimer precluding claims against RBC for failures to inform the Board about specific conflicts of interest. Warburg was the only bidder to submit a final bid for Rural, and RBC was directed to engage in final negotiations over price. According to the trial court's factual findings, RBC solicited Warburg for a role in the buy-side financing during these negotiations and did not disclose its efforts and interests to the Board. Warburg ultimately declined to use RBC to finance its offer, but the court concluded that RBC's solicitations had affected Rural's negotiating position over the final sale price. Rural accepted Warburg's final offer of $17.25 per share. On October 10, 2014, the trial court issued a second opinion, determining that Rural was worth $21.42 per share at the time of the Warburg transaction, resulting in a total damages figure of $91.3 million. *In re Rural/Metro Corp. Shareholders Litig.* ("*Rural II*"), 102 A.3d 205 (Del. Ch. 2014).

B. Liability for Aiding & Abetting a Breach of Fiduciary Duty

Based upon the Board's failure to properly inform itself and take reasonable steps to maximize Rural's sale price at auction, the trial court concluded that the Board had breached its duty of care under *Revlon*'s enhanced scrutiny standard. It then concluded that RBC – by allegedly creating the unreasonable sale process and informational gaps that led to the Board's breach of duty – had knowingly participated in this breach, rendering it liable for aiding and abetting the Board's predicate breach of fiduciary duty. In *dicta*, the trial court also observed that "[d]irectors are not expected to have the expertise to determine a corporation's value for themselves, or have the time or ability to design and carry out a sale process. Financial advisors provide these expert services. In doing so, they function as gatekeepers." *Rural I*, at 88. The threat of aiding and abetting liability, it continued, would help incentivize gatekeepers to provide sound advice, monitor clients and deter client wrongs.

On appeal, RBC and *amicus curiae* the Securities Industry and Financial Markets Association ("SIFMA") argued that a third party cannot knowingly participate in a Board's breach of the duty of care because such breaches are, by definition, only grossly negligent, and therefore lack the level of intentionality necessary for a third party to "knowingly participate" in them. The Delaware Supreme Court rejected this contention. It explained that "[i]t is the aider and abettor," not the predicate fiduciary, "that must act with *scienter*," and affirmed the trial court's "narrow" holding that "if the third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting." *Rural/Metro*, Op. at 74. Noting that the trial court's findings – which RBC did not directly challenge on appeal – had established the "intentionality of RBC's conduct" and "knowledge of the reality that the Board was proceeding on the basis of fragmentary and misleading information," the Court affirmed RBC's liability for aiding and abetting. *Id.* at 76.

In response to SIFMA's concern that permitting a claim for aiding and abetting a breach of the duty of care could create an imbalance of responsibilities where a non-fiduciary could be held liable for an unintentional violation of a fiduciary duty by a fiduciary, the Court concluded that these concerns were overstated in light of its ruling that the aider and abettor must act with *scienter*, making such a claim "among the most difficult to prove." *Id.* at 80-81. It also emphasized that its "holding is a narrow one that should not be read expansively to suggest that any failure on

the part of a financial advisor to *prevent* directors from breaching their duty of care gives rise to a claim for aiding and abetting a breach of the duty of care." *Id.* at 80 (emphasis in orig.). In a lengthy footnote, the Court then expressly disavowed the trial court's "gatekeeper" designation, which it said would "inappropriately expand" its otherwise narrow holding. *Id.* at 80-81 n.191.

C. Joint Tortfeasor Contribution & Section 102(b)(7) Exculpation

Although RBC would have been liable for the entire $91.3 million damages award under the common law (as an aider and abettor jointly and severally liable for the injury), the Delaware Uniform Contribution Among Tortfeasors Acts ("DUCATA") entitled RBC to "settlement credits," reducing its liability in an amount equal to the *pro rata* share of responsibility for the total damages allocable to any "joint tortfeasors" that had already settled with the plaintiff class. After trial, the parties provided supplemental briefing and argument on the extent and amount of such credits, and RBC bore the burden of establishing which parties were joint tortfeasors. Critically, the trial court held that any Rural directors who qualified for exculpation from financial liability under the company's § 102(b)(7) provision could not be deemed joint tortfeasors under DUCATA. It was thus incumbent upon RBC to establish that the directors would not have qualified for exculpation under § 102(b)(7) and that, but for the settlement, they would have shared a common liability to the plaintiff class. Contrary to RBC's position, the trial court held that RBC would have to make this showing based on the record presented at trial. Because RBC had pursued a "unified front" defense at trial – arguing that it could not have aided and abetted the Board's breach of the duty of care because the Board had committed no such breach – there was little such evidence available. Reviewing the record, the trial court concluded that the interests of three director defendants raised questions about whether they had acted loyally and in good faith. Two of these three directors had testified at trial and, after assessing their testimony, the trial court found that they did not qualify for exculpation. The third director had not testified at trial. The trial court held that RBC had not established this director would not have qualified for exculpation, but noted that if he "had testified . . . and performed poorly or had been impeached on cross examination, then [it] might have concluded that exculpation would have been unavailable." *Rural II*, at 259.* The trial court then determined that the two aforementioned defendants bore a 17% share of the responsibility for the damages suffered by the class, while RBC was responsible for 83% of the damages, an amount equal to $75,798,550.33.

The Delaware Supreme Court affirmed each of the foregoing determinations on appeal.

D. Looking Forward

The *Rural/Metro* decision continues the Delaware Supreme Court's spate of recent decisions closely scrutinizing financial advisor conflicts, and confirms that third-party financial advisors may be held liable for aiding and abetting fiduciaries' breaches of the duty of care owed to their constituents. It must be noted, however, that the Supreme Court described its holding as "narrow," establishing a "difficult to prove" standard of liability that was satisfied here by the "unusual facts" found by the trial court. Moreover, the Court cautioned that it is difficult to establish that a financial advisor acted with *scienter* and explicitly disavowed the lower court's "gatekeeper" *dicta*. Together, this

* The *Rural II* court also determined that Moelis was not a joint tortfeasor because RBC had failed to prove that Moelis had aided and abetted the Board's breaches.

limits the likelihood of success for aiding and abetting claims against financial advisors predicated on anything less than conscious wrongdoing. The *Rural/Metro* decision stands most importantly as reinforcement for the proposition that third-party financial advisors should take pains to fully and accurately disclose actual and potential conflicts to their clients as they arise.

The secondary ramifications of *Rural/Metro* pertain to trial practice and evaluation of liability in multiparty M&A litigation. The possibility that § 102(b)(7) protection will amplify awards against non-exculpated defendants must be taken into account when considering whether defendants should present a united front at trial because if this fails to result in *complete* victory, it could result in exculpation for some defendants and increased liability for others. The latter group, moreover, would have lost the opportunity to introduce evidence that their liability should be reduced by the damages attributable to the former. By the same token, the trial court's stated difficulty in finding non-testifying defendants ineligible for § 102(b)(7) exculpation suggests that non-settling defendants should employ efforts to compel settling defendants to appear at trial to defend their conduct.

CONTACTS

Paula Howell Anderson
New York
+1.212.848.7727
paula.anderson@shearman.com

Steve L. Camahort
San Francisco
+1.415.616.1240
steve.camahort@shearman.com

George A. Casey
New York
+1.212.848.8787
gcasey@shearman.com

Alan S. Goudiss
New York
+1.212.848.4906
agoudiss@shearman.com

Adam S. Hakki
New York
+1.212.848.4924
ahakki@shearman.com

Stephen D. Hibbard
San Francisco
+1.415.616.1174
shibbard@shearman.com

Robert M. Katz
New York
+1.212.848.8008
rkatz@shearman.com

Robert Masella
New York
+1.212.848.5125
robert.masella@shearman.com

John A. Marzulli, Jr.
New York
+1.212.848.8590
jmarzulli@shearman.com

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069