Third parties beware: Claims against advisers may live on after director charges die

By Yosef J. Riemer, Esq., Matthew Solum, Esq. and Allie Samowitz, Esq.
Kirkland & Ellis

Recent decisions in the *Tibco* and *Zale* cases have allowed claims against financial advisers to proceed in the Delaware Chancery Court even where the court has dismissed claims against the target company's directors. *In re Tibco Software Stockholders Litig.,* No. 10319, 2015 WL 6155894 (Del. Ch. Oct. 20, 2015); *In re Zale Corp. Stockholders Litig.,* No. 9388 2015 WL 5853693 (Del. Ch. Oct. 1, 2015).

Shortly after its decision in *Zale*, the court reconsidered its opinion in light of the recent decision from the Delaware Supreme Court in *Corwin*. *Corwin et al. v. KKR Fin. Holdings et al.*, No. 629, 2014, 2015 WL 5772262 (Del. Oct. 2, 2015). The court ultimately dismissed the claim against Zale's financial adviser because the allegations against the Zale board did not rise to the level of gross negligence. Thus, there was no viable breach-of-fiduciary-duty claim to support an aiding-and-abetting claim against the adviser. This decision suggests that the future of aiding-and-abetting claims against financial advisers could turn on the scope of the *Corwin* decision. The outcome of a pending appeal to the Delaware Supreme Court in the *Rural Metro* case should also prove significant in this area of Delaware law. *In re Rural/Metro Corp. Stockholders Litig.*, 102 A.3d 205 (Del. Ch. 2014), (now under consideration by the state Supreme Court), *RBC Capital Mkts. v. Jervis*, No. 140-2015, *oral argument held* (Del. Sept. 11, 2015).

BACKGROUND

Corporate charters typically contain exculpation clauses, which are also known as "102(b)(7) provisions" for the Delaware statute that permits them. These clauses exculpate directors from monetary liability for any breach of the duty of care; instead, directors of corporations whose charters include such a clause can be held liable for damages only if they breach their duties of loyalty or good faith.

> As an example of *Corwin*'s reach, the Chancery Court revisited its decision in *Zale* after this decision by the Delaware Supreme Court.

Breaches of the duties of loyalty and good faith are more difficult to allege (and prove) than breaches of the duty of care. Yet in a handful of recent decisions, the Chancery Court allowed plaintiffs to pursue claims against financial advisers for aiding-and-abetting breaches of the duty care in cases where the directors who were supposedly aided and abetted were no longer defendants.

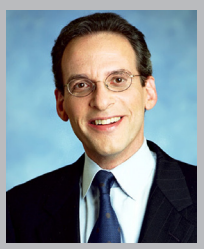
THE BEGINNING: *DEL MONTE* AND *EL PASO*

The Chancery Court began focusing on financial adviser conduct in the *Del Monte* and *El Paso* cases. In *Del Monte*, Vice Chancellor J. Travis Laster granted a preliminary injunction in favor of a putative class of Del Monte stockholders in connection with a proposed transaction whereby Del Monte was to be acquired by KKR, Vestar Capital and Centerview Partners.[1]

Del Monte's financial adviser was not yet a defendant in the action. The court nonetheless held that the plaintiffs showed a likelihood of success on their claim that Del Monte's financial adviser had deceived the Del Monte board by not disclosing that it was seeking to provide buy-side financing to the acquirer and by pairing Vestar and KKR together, allegedly in violation of certain confidentiality agreements. Ultimately, the case settled for almost $90 million, with Del Monte paying $65.7 million and its financial adviser paying $23.7 million.

In *El Paso*, then-Chancellor Leo E. Strine Jr. concluded that plaintiffs — El Paso stockholders — had a reasonable likelihood of success on their claims arising in connection with a proposed merger between El Paso and Kinder Morgan.[2] The court focused on what it viewed as "disturbing behavior" by El Paso's financial adviser in the transaction.

Chancellor Strine found that the plaintiffs had a reasonable probability of success in proving that the financial adviser had a conflict of interest that was not adequately neutralized by El Paso, because they alleged that the adviser owned $4 billion in Kinder Morgan stock and controlled two Kinder Morgan board seats. As with *Del Monte*, the case settled. The payment was $110 million, with the financial adviser agreeing to partially fund the settlement by foregoing its $20 million fee.



(L-R) **Yosef J. Riemer, Matthew Solum** and **Allie Samowitz** are attorneys in the litigation department at **Kirkland & Ellis.** Riemer and Solum are partners with extensive experience litigating in Delaware courts representing a broad group of clients, including acquirers, targets, boards of directors and financial advisers. They represent Vista Equity Partners V LP in the Tibco matter.

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RURAL METRO, TIBCO AND ZALE

The *Rural Metro* case went all the way to trial. In that case, Vice Chancellor Laster held that a financial adviser could be liable for aiding-and-abetting a fiduciary duty breach even when the directors only breached their duty of care and were dismissed from the case. Rural Metro stockholders challenged a go-private transaction proposed by Warburg Pincus. Both Rural Metro's directors and one of its financial advisers settled before trial for $6.6 million and $5 million, respectively.

The class of Rural Metro stockholders pressed their remaining claim for aiding-and-abetting against Rural's other financial adviser. After trial, the Chancery Court found that this adviser had misled the board into breaching its duty of care by creating an "informational vacuum." The adviser was found to have provided false information to the Rural board in its valuation materials and found to have not disclosed conflicts of interest, including the adviser's pursuit of providing buy-side staple financing. Rural's financial adviser was ordered to pay $75.8 million in damages.

The case is on appeal, and oral argument was heard by the Delaware Supreme Court on Sept. 30.[3]

In a recent decision in the *Tibco* case, Chancellor Andre G. Bouchard allowed a claim against Tibco's financial adviser to proceed while simultaneously dismissing the breach-of-fiduciary duty claims against Tibco's directors and the claims against the other defendants.[4] Vista and Tibco had signed a merger agreement at $24 per share. The plaintiff alleged that the parties to the transaction believed it was being consummated at an implied equity value of $4.24 billion, which the plaintiff argued represented a $24.57 per share price. Among other things, a spreadsheet provided to the acquirer allegedly had suggested that equity value.

The transaction actually had an equity value of $4.144 billion. After the actual equity value was identified, Tibco's board decided to proceed with the transaction and continue to recommend it to stockholders. The court held that the plaintiff had not adequately alleged that Tibco's board breached its duty of loyalty by failing to recover the supposed $100 million difference or by failing to adequately inform itself about the circumstances of the alleged share-count error.

However, the court allowed the claim against the financial adviser to proceed. It held that it was reasonably conceivable that the financial adviser's alleged failure to disclose certain information to the board created an "informational vacuum" when the board was considering its options after the capitalization error came to light.

The court noted that the financial adviser disputed that assertion, but it found the allegation was reasonably conceivable for purposes of the motion to dismiss. The financial adviser recently filed a motion for summary judgment, and a trial is scheduled for March 2016.

> The *Tibco* court found it reasonably conceivable that the financial adviser "intentionally created an informational vacuum" by failing to provide the board with information.

THE *ZALE* DECISION

In another recent matter, Vice Chancellor Donald F. Parsons held that stockholders stated a claim that Zale's financial adviser had aided and abetted the Zale directors' breach of their duty of care — although he later reconsidered this decision.[5] The court in *Zale* held that the allegations supported a finding that the directors had breached their duty of care but not their duty of loyalty, and so the court dismissed the claims against them. But the claim against the financial adviser was initially allowed to proceed, where the plaintiffs alleged that the financial adviser failed to disclose that one of the members of the team advising Zale had also made a presentation to the acquirer regarding Zale and proposed a per share price of between $17 and $21.

The court found that the financial adviser failed to disclose this alleged conflict of interest until after the merger agreement was signed. Coupling that allegation with the fact that the final per-share price for the transaction was $21, the court found that it was reasonably conceivable that this alleged conflict hampered the ability of the board to seek a higher price. As such, the court allowed the aiding-and-abetting claim against the financial adviser to proceed but dismissed the claims against the other defendants. The court analyzed the breach-of-fiduciary-duty claim pursuant to the *Revlon* standard of review.

One day after this decision in *Zale*, the Delaware Supreme Court in *Corwin* affirmed an opinion by Chancellor Bouchard holding that the business-judgment rule is the appropriate standard of review when a merger has been approved by a fully informed majority of disinterested stockholders.[6] In this case, the Delaware Supreme Court affirmed Chancellor Bouchard's dismissal of the fiduciary duty claim against the directors because the challenged stock-for-stock merger was approved by the majority of shares held by disinterested stockholders in a fully informed vote.

The *Zale* court also interpreted the Delaware Supreme Court's decision in *Corwin* as holding that the appropriate standard of review for breaches of the duty of care is whether the board was grossly negligent. The decision in *Corwin* could limit the circumstances under which the Chancery Court will allow aiding-and-abetting claims against financial advisers.

As an example of *Corwin*'s reach, the Chancery Court revisited its decision in *Zale* after this decision by the Delaware Supreme Court. The *Zale* court held that plaintiffs had to allege gross negligence by the board in order to state a claim for breach of the duty of care.[7] The court determined that the allegations against the Zale directors did not rise to the level of gross negligence, and therefore there was no breach of the duty of care. Having found no underlying breach, the court also dismissed the aiding-and-abetting claim against the financial adviser.

TAKEAWAYS

Pending a decision on the *Rural Metro* appeal and further clarification on *Corwin*'s reach, the factor that has created the greatest risk for financial advisers is an allegation that a financial adviser withheld information from the board. In *Del Monte*, the court expressed concern over plaintiffs' allegations that the financial adviser concealed its pursuit of providing buy-side financing and paired KKR with Vestar. In *El Paso*, a banker from El Paso's financial adviser allegedly did not disclose that he personally owned what

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the court saw as a considerable amount of Kinder Morgan stock.

The *Rural Metro* and *Zale* courts viewed the financial advisers in those cases as neglecting to disclose conflicts of interest that these courts found significant. In *Rural Metro*, the conflict was that the financial adviser sought buy-side fees, and in *Zale* it was that the financial adviser had allegedly already made a presentation to the acquirer. The *Tibco* court found it reasonably conceivable that the financial adviser had "intentionally created an informational vacuum" by failing to provide the board with information regarding the use of erroneous capitalization information.

FINAL THOUGHTS

Expanding aiding-and-abetting liability against financial advisers raises costs and creates uncertainty. The Securities and Financial Markets Association has explained that holding financial advisers liable for aiding-and-abetting duty-of-care breaches creates uncertainty and potentially encourages litigation that will increase costs for advisers, companies, and ultimately, shareholders.[8] Others have questioned whether it makes sense from economic and fairness perspectives to hold financial advisers liable while exculpating directors.[9]

The Delaware Supreme Court may have provided a means to address this issue in *Corwin* by clarifying two aspects of Delaware law. First, as indicated in the discussion of *Zale* above, the *Corwin* decision could be read as suggesting that gross negligence must be alleged to assert a breach-of-the-duty-of care claim. Second, and not yet addressed by any of the decisions discussed above, the Delaware Supreme Court held in *Corwin* that the business judgment standard applies to breach-of-fiduciary-duty claims where the transaction was subject to a fully informed, uncoerced shareholder vote. The effect of that decision may be resolved in the *Tibco* case, where the financial adviser recently submitted a motion for summary judgment, or on the *Rural Metro* appeal to the Delaware Supreme Court. WJ

NOTES

[1] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

[2] *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432 (Del. Ch. 2012).

[3] *In re Rural Metro Corp.*, 88 A.3d 54 (Del. Ch. 2014).

[4] *In re Tibco Software Stockholders Litig.*, No. 10319-CB (Del. Ch. Oct. 20, 2015).

[5] *In re Zale Corp. Stockholders Litig.*, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015).

[6] *Corwin v. KKR Fin. Holdings*, 2015 WL 5772262 (Del. Oct. 2, 2015).

[7] *In re Zale Corp. Stockholders Litig.*, No. 9388-VCP (Del. Ch. Oct. 29, 2015).

[8] *See* Brief for the Securities Industry & Financial Markets Ass'n as Amicus Curiae Supporting Appellant, RBC Capital Mkts. v. Jervis, No. 140, 2015 (Del. May 28, 2015); *see also Desimone v. Barrows*, 924 A.2d 908, 928 (Del. Ch. 2007) "([T]he realities of modern complex litigation make proceeding past the pleading stage and into discovery exceedingly expensive").

[9] *See, e.g.*, A. Thompson Bayliss & Sarah E. Hickie, *Buck-Passing Under 102(b)(7): The (Unanticipated?) Liability-Shifting Impact of Director Exculpation*, 28 INSIGHTS: THE CORP. & SEC. L. ADVISER 11 (2014) (asserting that the *Rural Metro* decision may result in inappropriate liability shifting); Steven Davidoff Solomon, *Ruling Highlights Unequal Treatment in Penalizing Corporate Wrongdoers*, N.Y. TIMES (Mar. 18, 2014), *available at* http://dealbook.nytimes.com/2014/03/18/ruling-highlights-unequal-treatment-in-penalizing-corporate-wrongdoers/ (questioning whether it makes sense to hold investment banks but not directors liable, especially where it is director misconduct that the bank's liability is based on).

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