Rural Metro Corp and Ensuring Fairness in a Fairness Opinion

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Directors owe fiduciary duties of care and loyalty to shareholders. With respect to the duty of care, courts apply the presumption of the business judgment rule. This presumption assumes directors’ make decisions in good faith, in the best interests of shareholders, and on a fully informed basis. Delaware courts, however, have reduced the duty of care to a simple process standard. Thus, so long as board decisions appear to be informed, courts will uphold them. As a result, courts have rarely found inadequate process and imposed liability for breach of the duty of care.

The Delaware Court of Chancery, however, took an unexpected turn in In re Rural Metro Corp. Stockholders’ Litigation. The case received considerable attention because the court ordered $75.8 million in damages against an investment bank for aiding and abetting a breach of fiduciary duties. Less discussed is the decision’s expansion of directors’ obligations under the duty of care. In Rural, the court found the board of directors owed fiduciary duties of care and ensured fairness in a fairness opinion.

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1. J.D. candidate at the University of Denver Sturm College of Law, May 2015.
3. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (“It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.”) (citations omitted), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000).
5. Horsey, supra note 2, at 978 (“Commentators who surveyed duty of care decisional law through the 1970s identified only a handful of cases outside the context of financial institutions in which directors of business corporations had been found liable for breach of their duty of care.”).
8. In order to invoke the business judgment rule and effectively fulfill their duty of care, directors must: “inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in
directors breached its duty of care by approving the sale of the company without adequately supervising the negotiation process. This failure, in large part, resulted from inadequate oversight of the company’s financial advisor. Specifically, the court found the board did not take actions to mitigate or control the financial advisor’s conflicts of interest—some of which the board was aware.

This paper will discuss the existing case law describing the obligations of directors surrounding the negotiation and approval of a transaction—specifically concerning the oversight of investment banks and the conflicts such relationships create. First, it will detail the pertinent development of the duty of care in Delaware jurisprudence. Then it will discuss the role of investments banks within the process standard of the duty of care. Finally, it will summarize and discuss Rural and the additional obligations Rural has created for directors.

I. THE DEVELOPMENT OF THE DUTY OF CARE IN DELAWARE

Directors were originally liable only for fraudulent actions, willful misconduct, or gross negligence and not for “for mistakes of judgment.” Courts, however, eventually imposed an obligation of care, requiring directors to act in a manner “which ordinarily prudent and diligent men would exercise under similar circumstances.”

Delaware courts adopted a somewhat different standard, requiring the board act with “reckless indifference.” In the absence of a conflict of interest, the courts imposed a strong presumption in favor of the discharge of their duties,” Aronson, 473 A.2d at 812; see also Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) overruled by on other grounds by Gantler v. Stephens, 965 A.2d 695 (2009).

9. Rural, 88 A.3d at 110.
10. Id. at 94.
11. Id.
12. Stephen J. Lubben & Alana Darnell, Delaware's Duty of Care, 31 Del. J. Corp. L. 589, 594–98 (2006) (“By this time, many courts, including the United States Supreme Court, had already held that the standard of care for directors was gross negligence.”).
13. Appeal of Spering, 71 Pa. 11, 24 (1872) (“[Directors] are not liable for mistakes of judgment, even though they may be so gross as to appear to us absurd and ridiculous, provided they are honest and provided they are fairly within the scope of the powers and discretion confided to the managing body.”).
14. Briggs v. Spaulding, 141 U.S. 132, 152 (1891) (finding “the degree of care to which [the directors] were bound is that which ordinarily prudent and diligent men would exercise under similar circumstances”). The Model Business Corporation Act has a similar standard of care: “The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.” Model Bus. Corp. Act § 8.30(b) (2010).
15. See Cole v. Nat'l Cash Credit Ass'n, 156 A. 183, 188 (Del. Ch. 1931) (“The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested.”). Delaware courts, however, have not applied the standard uniformly. See Rabkin v. Philip A. Hunt Chem. Corp., Civil Action No. 7547, 1987 WL 28436, at *1–3 (Del. Ch. Dec. 17, 1987) (finding when directors fail to act “the appropriate standard for determining liability is widely believed to be gross negligence, but a single Delaware case has held that ordinary negligence would be the appropriate standard.”).
board’s action. Courts recognized they are ill equipped to deal with complex corporate decisions and need to protect outside directors, who often serve on a part-time basis, from board decisions that subsequently prove wrong.

Courts, therefore, presume the validity of board decisions through the application of the business judgment rule. The Delaware Supreme Court set out the classic formulation of the business judgment rule in Aronson v. Lewis. The rule presumes “that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Boards have a duty “to inform themselves, prior to making a business decision, of all material information reasonably available to them.”

To set aside the presumption plaintiffs must demonstrate gross negligence. Where plaintiffs succeed in doing so, “the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the ‘entire fairness’ of the transaction to the shareholder plaintiff.”

16. Herbert S. Wander & Alain G. LeCoque, Boardroom Jitters: Corporate Control Transactions and Today’s Business Judgment Rule, 42 BUS. LAW. 29, 29–30 (1986) (“The business judgment rule, therefore, provides corporate directors with the broad discretion to formulate dynamic corporate policies without fear of judicial second-guessing and is designed to prevent the judiciary from becoming enmeshed in complex corporate decisionmaking, a task which they are ill-equipped to handle.”) (footnotes omitted).

17. Patricia A. Terian, “It’s Not Polite to Ask Questions” in the Boardroom: Van Gorkom’s Due Care Standard Minimized in Paramount v. QVC, 44 BUFF. L. REV. 887, 892–94 (1996) (“The business judgment rule stems from the judicial recognition of the realities of business decisions. The judiciary realized that it was unable to effectively assess complex corporate decisions in comparison to the corporation’s directors. Consequently, a Delaware court will not ‘substitute its own notions of what is or is not sound business judgment’ in place of the director’s superior judgment.”) (footnotes omitted).


21. Id.

22. Id. “While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence.”

23. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (If a plaintiff is successful in rebutting the business judgment rule, “the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove the trier of fact the ‘entire fairness’ of the transaction to the shareholder plaintiff.”). Entire fairness requires directors to persuade the court the transaction was the product of both “fair dealing and fair price.” Babatunde M. Animashaun, The Business Judgment Rule: Fiduciary Duties and Liabilities of Corporate Directors, 16 S.U. L. REV. 345, 352 (1989).
A. Directors’ obligations under the duty of care: Van Gorkom

The business judgment rule is premised upon an informed board. In *Smith v. Van Gorkom,* the court addressed the requirement. In that case, shareholders challenged the board’s approval of a sale of the company in a cash-out merger. The approval process involved a single two-hour meeting. Notice of the meeting did not include the purpose of the meeting and the directors did not receive the merger agreement or any written valuation of the company.

In asserting the board made an informed decision, the directors pointed to the price paid in the merger (particularly the premium), their experience, and the application of a market test. The court found these sources inadequate to render the board informed as to the value of the company. The directors, the court found, lacked any information on the intrinsic value of the company.

The decision had a direct impact on board behavior. The case emphasized the need for, and role of, financial experts when determining the fairness of the transaction. *Van Gorkom* “tells managers that they can insulate their decisions from subsequent attack, but only if they hire investment bankers and Delaware counsel to structure the appropriate procedural framework for the decisional process.”

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24. “Thus, the business judgment rule is process oriented and informed by a deep respect for all good faith board decisions.” *In re Caremark Int’l Derivative Litig.*, 698 A.2d 959, 967–68 (Del. Ch. 1996).
26. *Id.* at 864.
27. *Id.*
28. *Id.* at 869, 69.
29. *Id.* at 875.
30. The court, however, did not find that market tests, correctly applied, are not sufficient to demonstrate the fairness of a deal. See Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 *Fordham L. Rev.* 1899, 1959 (2003) (“[T]he court spent considerable time analyzing the validity of the market check and finally concluded that the Trans Union/Marmon Group merger agreement never received an adequate market test. Moreover, the court was probably correct in this conclusion.”).
31. *Van Gorkom*, 488 A.2d at 876 (“There was no call by the board . . . for any valuation study or documentation of the $55 price per share as a measure of the fair value of the Company in a cash-out context . . . . [A]t no time did the board call for an evaluation study.”).
33. Macey, *supra* note 27, at 626; see also Elson, *supra* note 27, at 683.
ever, said little about how a board should select or supervise an investment bank or assure the quality of a fairness opinion.  

B. Investments banks and boards

Van Gorkom largely imposed a quantitative standard on directors. Subsequent decisions provide little additional insight into the role of the board with respect to the supervision of financial advisors. Some courts acknowledged the importance of “overseeing the outside advice”; however, for the most part, courts did not impose an obligation on directors to pay close attention to the trustworthiness of fairness opinions by investment banks.

The need for, and importance of, board oversight is exacerbated by the potential for conflicts of interest between companies and financial advisors. In some cases, the conflicts arguably create a potential for financial advisers to favor the interests of management over those of shareholders. This occurs because investment banks have an incentive to provide the opinion sought by management out of a “desire to retain and

34. See Steven M. Davidoff, Fairness Opinions, 55 AM. U. L. REV. 1557, 1573 (2006) (discussing the limitations of a fairness opinion including the subjectivity of such an opinion and the conflicts that often arise for investment banks).

35. See William J. Carney, Fairness Opinions: How Fair are They and Why We Should Do Nothing About It, 70 Wash. U. L.Q. 523, 527 (1992) (“The strong message was that boards could protect their decisions only if they met a quantitative standard of information set by the courts. Only if they met this threshold could they be permitted to say they had made an informed business judgment.”) (footnotes omitted). Later Delaware decisions have deemphasized the need for experts in the decision making process. After In re Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006), “[f]or purposes of the duty of care and the business judgment rule, Van Gorkom is dead . . . .” Henry N. Butler, Smith v. Van Gorkom, Jurisdictional Competition, and the Role of Random Mutations in the Evolution of Corporate Law, 45 WASHBURN L.J. 267, 280–81 (2006). This is especially true for the informed prong of the duty of care because even though the Delaware Court of Chancery found that “Disney directors had been taken for a wild ride, and most of it was in the dark,” it still did not find them to have been uninformed. In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 736 (Del. Ch. 2005) aff’d, 906 A.2d 27 (Del. 2006).

36. Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 276 (2d Cir. 1986) (held “[t]he proper exercise of due care by a director in informing himself of material information and in overseeing the outside advice on which he might appropriately rely is, of necessity, a pre-condition to performing his ultimate duty of acting in good faith to protect the best interests of the corporation.”)

37. This was true at least with respect to the firms with “sufficient credentials.” Lucian Arye Bebchuk, Fairness Opinions: How Fair Are They and What Can Be Done About It?, 1989 Duke L.J., 27, 43-44 (1989) (stating the neither the courts nor investment banks concern for professional reputation [leads] investment banks to render unbiased fairness opinions.”) (internal citations omitted).

38. Bankers “face significant conflicts of interest. Bankers are thus likely to use their discretion to render opinions that serve the interests of managers.” Lucian Arye Bebchuk & Marcel Kahan, Fairness Opinions: How Fair Are They and What Can Be Done About It?, 1989 DUKE L.J. 27, 37 (1989) (noting “[s]ince banks are compensated primarily for services other than writing fairness opinions, they have incentives to render pro-management opinions even in situations involving noncontingent fees, because such opinions will typically generate more work than opposition opinions. . . . The difference in incentives between contingent and noncontingent fees is therefore only a matter of degree: investment banks compensated on the basis of work performed will face smaller (but still positive) incentives to generate pro-management opinions than will banks compensated on a contingent basis.”).
attract clients, and psychological and social factors,” which include investment banks’ reputational concerns.  

Other potential conflicts provide for the possible divergence between the company’s interests and those of its financial advisers. In particular, these conflicts arise out of “the fee structure for compensating investment banks and the incentives that structure creates.”

Often when banks provide a fairness opinion “a significant fraction of the total fee is payable on the condition that the transaction is consummated, and the size of this contingent fee may depend on the company's sale price.” For the most part, contingency fees align the interests of financial advisers and shareholders. The arrangements reward financial advisers for securing the highest price, which in turn guarantees the highest payment for shareholders.

In other circumstances, such a payment structure results in divergent interests. Contingency “fees have been criticized for creating a conflict of interest [for] investment banks because the relative size of the [contingency] fee as compared to the [other] fee[s] may cause a bank to encourage a target to accept a price that does not adequately value the company for the sake of pushing any transaction through.” The degree of such a conflict depends on a number of factors, including the size of the contingency fee.

Conflict may also arise where the financial adviser seeks to participate in both sell-side advising and buy-side financing of a deal. This type of conflict arose in In re Del Monte Foods Co. Shareholders Litigation. There, Del Monte Foods Company (Del Monte) was the target company in an acquisition. During the bidding and sale process, Del Monte’s

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39. Id. at 37.
40. Id.
41. Id. at 38 (“Although banks often receive a fixed fee for fairness opinions, other fees that investment banks receive are frequently contingent.”) (footnotes omitted).
42. See Van de Walle v. Unimation, Inc., Civ. A. No. 7046, 1991 WL 29303, at *3 (Del. Ch. Mar. 7, 1991) (“Nor was [the investment bank’s] contingent fee arrangement viewed as creating a conflict, because that arrangement gave [the investment bank] an incentive to obtain the best available price for all . . . stockholders.”).
43. See Bonnie White, If All Investment Banks are Conflicted, Why Blame Barclays? An Examination of Investment Bank Fee Structures and Del Monte Foods, 162 U. PA. L. Rev. Online 93, 97 (2013) (“The payment of a success fee is contingent on the deal closing and is determined by a percentage of the total value of the deal.”).
44. Id. at 97.
47. Id. at 817.
financial advisor took various actions, which evidenced the conflicts inherent in these types of deals.\textsuperscript{48}

First, the financial advisor, without the knowledge or consent of Del Monte’s board, reduced the “prospect” for competition by bringing two entities together, a private equity firm and a strategic buyer, and convincing them to make a joint rather than separate bid\textsuperscript{49}—something both entities had expressly contracted not to do.\textsuperscript{50} Second, the financial advisor failed to disclose to Del Monte its intention to seek a position as a buy-side financer of the deal.\textsuperscript{51} As a result, “at the same time [the financial advisor] was negotiating [for a higher price per share], [it] had an incentive as a well-compensated lender to ensure that a deal was reached and that [the buyers] did not overpay.”\textsuperscript{52}

The court found that “[d]espite [the special committee’s] independence, the directors failed adequately to oversee the process and permitted the conflicted management team and their financial advisor to exploit the opportunities it presented.”\textsuperscript{53} Thus, “[b]y failing to provide the serious oversight that would have checked Barclays’ misconduct, the directors breached their fiduciary duties. . . .”\textsuperscript{54} Del Monte demonstrated the need for directors to have the prescribed “active and direct role in the sale process.”\textsuperscript{55}

\section*{II. \textit{Rural’s} Addition to the Duty of Care}

\textit{Del Monte} demonstrated the need for greater oversight of financial advisors. In particular, boards needed to be more aware of conflicts arising out of the interest of financial advisors participating in both the sell-side advising and buy-side financing of a deal. The case, however, did not address all conflicts that could arise. In \textit{In re Rural Metro Corp. Stockholders’ Litigation}, the Delaware Chancery Court addressed direc-

\textsuperscript{48} \textit{Id.}

\textsuperscript{49} \textit{Id.} at 823 (“By pairing Vestar with KKR, Barclays put together the two highest bidders from March 2010, thereby reducing the prospect of real competition in any renewed process.”).

\textsuperscript{50} \textit{Id.} at 821 (both companies were subject to a confidentiality agreement that contained a “no teaming provision” and prohibited certain agreements with other potential bidders absent “prior written consent” from Del Monte).

\textsuperscript{51} \textit{Id.} at 820. (“[Barclays employee] also did not mention that Barclays planned from the outset to seek a role in providing buy-side financing. . . . The Board did not learn that Barclays intended from the outset to have a buy-side role until discovery in this litigation.”).

\textsuperscript{52} \textit{Id.} at 833. Del Monte’s board was later asked to approve both of the financial advisors actions, however, the board was never informed that the financial advisor had intended to take both actions from the outset.

\textsuperscript{53} \textit{Id.} at 836.

\textsuperscript{54} \textit{Id.} at 818. (However, the court also stated “[t]o hold that the Del Monte directors breached their fiduciary duties for purposes of granting injunctive relief does not suggest, much less pre-ordain, that the directors face a meaningful threat of monetary liability.”)

\textsuperscript{55} \textit{Id.} at 835.
tors’ oversight obligations with respect to the structural conflicts of interests of investment banks when there is only one bid in an acquisition.\(^\text{56}\)

**A. The case.**

In *Rural*, shareholders of Rural, a company that provided ambulance and fire protection services in multiple states, filed suit against the board of directors (the Board) for breach of fiduciary duties arising out of the approval of a merger with Warburg Pincus LLC (WP).\(^\text{57}\) Rural Shareholders also made claims against financial advisors, RBC Capital Markets (RBC) and Moelis and Company LLC (Moelis), for aiding and abetting. Prior to trial, the Board and Moelis settled, leaving only RBC as a defendant.\(^\text{58}\)

The matter began when the Board created a special committee to consider acquiring American Medical Response (AMR), a subsidiary of Emergency Medical Services (EMS) and a competitor of Rural. The possible purchase was directly in line with the Rural’s growth strategy of expansion through acquisitions, but the deal never materialized.\(^\text{59}\)

With rumors developing about the sale of EMS, RBC believed Rural might also be subject to an acquisition. The possibility had the potential to benefit RBC. As the court noted, RBC “correctly perceived that the firms [interested in purchasing EMS] would think they would have the inside track on Rural if they included RBC among the banking financing their bids for EMS.”\(^\text{60}\)

On December 8, 2010, the Board reactivated the special committee and charged it with generating a recommendation on an appropriate course of action.\(^\text{61}\) The special committee considered retaining a number of financial firms, including RBC, and held multiple interviews.\(^\text{62}\) During its interview, RBC disclosed an interest in offering staple financing to any potential buyer.\(^\text{63}\) Counsel advised the special committee that any

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57. Id. at 64.

58. Id. at 63. The Board settled for $6.6 million and Moelis settled for $5 million. Stipulation and Agreement of Compromise and Settlement Between Plaintiff, the Rural/Metro Defendants and Moelis & Company LLC, In re Rural Metro Corp. S’holders Litig., 88 A.3d 54 (Del. Ch. 2014) (No. 6350-VCL), 2013 WL 4027958.

59. Rural, 88 A.3d at 65. Nor did an October of 2010 approach from private equity firms that offered to buy Rural. Id. at 64.

60. Id. at 91.

61. Id. at 67.

62. Id. at 67-68.

63. Id. at 66–67. Staple financing is a financing package offered to potential bidders in an acquisition. It is often pre-arranged by the investment bank advising the selling company and includes all details of the lending package, including the principal, fees, and loan covenants. See White, supra note 38, at 96. RBC did not disclose to the board plans to use its position to secure a position in the financing trees of firms bidding for EMS. Rural, 88 A.3d at 68 (“RBC did not disclose that it planned to use its engagement as Rural’s advisor to capture financing work from the bidders for EMS.”).
investment bank seeking to provide staple financing would “present . . . potential conflicts of interest, and potential appearances of conflicts.” 64 Additionally, counsel noted, “if the Committee were to select RBC, [it] would need to be especially active and vigilant in assuring the integrity of the [process] . . . .” 65 The special committee ultimately decided to retain RBC. 66

Although not authorized to do so, the special committee put Rural in play by seeking outside offers. 67 Within two months, Rural had received six preliminary bids. Feedback from some private equity firms suggested that Rural’s price could increase if its growth strategy had more time to develop. 68 Additionally, the concurrent sales of Rural and EMS had the potential to limit the likelihood for offers from firms bidding on EMS; however, the special committee continued the sale process. 69

With the deadline for final bids only a few days away, the Board met for the first time since empowering the special committee. 70 It retroactively granted the special committee the authority to move forward with a deal and declined to extend the deadline for final bids. 71

Ultimately, Rural received only a single final offer. WP offered $17.00 per share, a premium over the prior day’s closing price of $12.38. 72 At the same time, CD & R, the firm that purchased EMS, expressed interest in making an offer but indicated a need for more time. 73 The special committee decided not to wait for CD & R and directed RBC to pursue final negotiations with WP. 74

During the pendency of the negotiations, RBC engaged in “last minute efforts to solicit a buy-side financing role from [WP]” 75 and offered WP a $65 million revolving line of credit for one of its portfolio companies. 76 Additionally, RBC lowered its fairness range, thereby making the

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64. Id. at 68.
65. Id.
66. Id. at 69 (“On December 26, 2010, Shackelton sent an update to the Board reporting that the Special Committee had hired ‘RBC (as primary) and Moelis (as secondary) [advisors.]’.”).
67. Id.
68. Id. at 70. Not all members of the special committee received this information.
69. Id. (“It should have been clear from the outset, . . . that financial sponsors who participated in the EMS process would be limited in their ability to consider Rural simultaneously because they would be constrained by confidentiality agreements they signed as part of the EMS process and because EMS would fear that any participants in both processes would share EMS’s confidential information with its closest competitor.”).
70. Id. at 72–73.
71. Id. at 73–74.
72. Id. at 74.
73. Id.
74. Id. at 72–73.
75. Id. at 94.
76. Id. at 76–77.
price offered by WP more attractive to the Board.77 Ultimately, WP did not include RBC in its financing tree but did increase the purchase price to $17.25.78

The Board, in a joint meeting with the special committee, met at approximately 11:00 pm on March 27, 2011.79 At the meeting, the Board, for the first time in the entire process, received RBC’s valuation analysis of the deal.80 After convening for 78 minutes, it approved the transaction.81

B. The court’s holding

The subsequent litigation centered on the aiding and abetting claims against RBC. To establish a claim for aiding and abetting, shareholders must identify a breach of fiduciary duty by the board.82 The court focused on the Board’s supervision of the sale process while determining if there was a breach.83

The court emphasized that boards are required to take an active role in the oversight process.84 Directors 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.”85 Instead, the task often falls to financial advisors who serve as “gatekeepers.”86 Nonetheless, directors cannot be “passive instrumentalities” and instead are required to provide “active and direct oversight” of a merger process.87

In applying these duties, the court analyzed the directors’ decision to hire RBC. The court discussed the directors’ failure to take action after learning of RBC’s intention to pursue buy-side financing.88 Directors, in this context, have an obligation “to learn about actual and potential conflicts faced by directors, management, and their advisors.”89 The court stressed, “directors must act reasonably to identify and consider the im-

77. Id. at 78 (The day before the Board approved the merger RBC worked to make the deal look more attractive. “The combined effect of [RBC] lowering ‘consensus’ adjusted EBITDA by $6.7 million and lowering the low-end multiple from 7.5x to 6.3x was dramatic. On Saturday morning, the ‘consensus’ precedent transaction range was $13.31 to $19.15. On Saturday afternoon, it was $8.19 to $16.71, entirely below the deal price.”).
78. Id. at 76.
79. Id. at 78-79.
80. Id. at 79.
81. Id. at 95-96.
82. Id. at 80.
83. Id. at 103-06.
84. Id. at 89.
85. Id. at 88.
86. Id.
87. Id. at 89-90.
88. Id. at 90.
89. Id. at 90 (stating the role of independent directors is especially important in making sure management, and professionals like investment bankers, are impartial).
plications of the investment banker's compensation structure, relationships, and potential conflicts.\footnote{90}

Here, the Board was unaware of the RBC's efforts to provide financing in the EMS acquisition.\footnote{91} The Board was aware, however, of RBC's desire to provide staple financing to any purchaser and the contingent nature of the compensation paid to the financial advisor.\footnote{92} The compensation raised concerns in circumstances involving only a single offer. As a result, the court suggested the Board had particularly meaningful oversight obligations in the "final stages of the negotiations."\footnote{93} Directors had a fiduciary obligation to consider whether any offer was appropriate, even if doing so resulted in the failure to trigger the contingent compensation otherwise paid to the financial advisor.

### III. Rural's Effect

"Rural" mostly focused on the role of financial advisors in the sale of the company. The court viewed the process as tainted by the financial advisor's conflict of interest. The Board knew of some of the conflicts, such as RBC's desire to provide staple financing,\footnote{94} others, such as the payment of a contingency fee, were structural.\footnote{95} These factors had the potential to cause the interests of the company and the adviser to diverge.\footnote{96}

Recognizing this potential for divergence, the court emphasized at least two sets of responsibilities. First, boards must take greater steps to uncover actual conflicts of interest by financial advisors. In particular, the court in "Rural" was concerned with potential conflicts arising from the desire to provide financing to the purchaser and to use the role as sell-side advisor to gain access to the financing tree in another acquisition.\footnote{97}

\footnote{90. \textit{Id.}}
\footnote{91. \textit{Id.} at 107 ("Only RBC knew the full extent of its conflicts, including its successful plan to use the Rural sale process to gain a place on the financing trees of the bidders for EMS and its late-stage push for a buy-side financing role from Warburg, including feverish discussions with Warburg on March 26, 2011, the day before the merger was approved and the same day that RBC was finalizing its valuation work.").}
\footnote{92. \textit{Id.} at 68.}
\footnote{93. \textit{Id.} at 94.}
\footnote{94. See White, supra note 38, at 96 ("Staple financing has been criticized for creating a conflict of interest for bankers who, on the one hand, seek as sell-side advisors to maximize the price paid to the target's stockholders, and on the other, want as a creditor to ensure that an acquirer will be able to repay its financing obligations.").}
\footnote{95. \textit{Id.} at 97. ("Success fees have been criticized for creating a conflict of interest on the part of investment banks because the relative size of the success fee as compared to the transaction fee may cause a bank to encourage a target to accept a price that does not adequately value the company for the sake of pushing any transaction through.").}
\footnote{96. \textit{Id.} ("The potential for conflicts has caused some commentators to argue that 'the investment banker will have an economic incentive to persuade the seller to sell the business even if the price is low or the non-price terms are unfair to the seller . . . .'").}
\footnote{97. \textit{Rural}, 88 A.3d at 91 ("Setting aside this fundamental problem, the decision to initiate a sale process fails the enhanced scrutiny test 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 . . . .")}
Second, the court recognized a boards’ obligation to take into account structural conflicts that can cause interests to diverge. In particular, boards must be mindful of the conflicts that arise when “a bank is asked to opine and advise on a transaction that it stands to benefit from only if the transaction transpires.” This conflict is most likely to occur when the board receives only a single bid. In order to fulfill this obligation, boards will have to take an even more “active and direct role in the sale process.”

After Rural, a board’s hiring process of a financial adviser will require increased due diligence. Now, a board must inquire about these types of actual and potential conflicts. In addition, the process may require a more thorough awareness of a firm’s business, including the disclosure of any current and potential clients.

In addition, boards must seek to reduce the risk of such conflicts. They should require financial advisors, at the time of retention, to represent that no conflicting relationships exist. To the extent a conflict arises, the agreement should further mandate notice to the board or special EMS... Although a well-informed board might have considered these issues and reasonably decided to pursue a near term sale process, neither the Board nor the Special Committee made such a decision. Shackelton and RBC unilaterally put Rural into play, and RBC was motivated by a desire to secure its place in the financing trees of the bidders in the EMS auction. Based on the totality of the evidence, the initiation of a sale process in December 2010 fell outside the range of reasonableness.

98. Davidoff, supra note 29, at 1587 (stating general contingency fee structures do not pay investment banks unless they find a deal to be fair and that the problem is not solved by simply keeping the fairness opinion fee separate from the success fee because the success often dwarfs the fairness opinion fee).

99. Delaware law has historically required a board to take an active and direct role in the sale process. See In re Del Monte Foods Co. S’holders Litig., 25 A.3d 813, 835 (Del. Ch. 2011) (“Delaware law requires that a board take an ‘active and direct role in the sale process.’ ”).

100. Id. at 832. (“Because of the central role played by investment banks in the evaluation, exploration, selection, and implementation of strategic alternatives, this Court has required full disclosure of investment banker compensation and potential conflicts. This Court has not stopped at disclosure, but rather has examined banker conflicts closely to determine whether they tainted the directors’ process.”) (citing In re John Q. Hammons Hotels Inc. S’holder Litig., Civil Action No. 758-CC, 2009 WL 3165613, at *16 (Del.Ch. Oct. 2, 2009) (emphasizing importance of disclosure of potential banker conflict of interest and explaining that “[t]here is no rule ... that conflicts of interest must be disclosed only where there is evidence that the financial advisor’s opinion was actually affected by the conflict”); Simonetti Rollover IRA v. Margolis, C.A. No. 3694–VCN, 2008 WL 5048692, at *8 (Del.Ch. June 27, 2008) (“[I]t is imperative for the stockholders to be able to understand what factors might influence the financial advisor’s analytical efforts.... For that reason, the ... benefits of the Merger to [the investment bankers,] beyond its expected fee, must also be disclosed to ... stockholders.”); see also In re Lear Corp. S’holder Litig., 926 A.2d 94, 114 (Del.Ch.2007) (requiring disclosure of CEO conflict of interest where CEO acted as negotiator; “Put simply, a reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders, when that motivation could rationally lead that negotiator to favor a deal at a less than optimal price, because the process of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price.”); see also, Lessons of Del Monte Foods for Companies Running (or Considering) a Sale Process, CLEARY GOTTLEIB STEEN & HAMILTON LLP (Feb 16, 2011), http://www.cgsh.com/files/News/83ddeb78-b4a1-4fa4-abde-53ddc5a28fcb/Presentation/NewsAttachment9fc1f89f-f120-468a-b625-55951665584/CGSH%20Alert%20-%20DelMonte%20Foods.pdf.
committee. Finally, the agreement should specifically prohibit the firm from participating in certain types of transactions such as the financing syndicate of any purchaser or competitor.

Boards must also take into account the inherent conflict that arises out of the system of compensation.\(^{101}\) This is especially true where—as was the case in Rural—only one bid surfaces.\(^{102}\) In such cases, directors must seriously consider the option of taking no offer at all, something that will negatively affect financial advisors paid on a contingency basis.\(^{103}\)

*Rural* adds to the lessons from *Del Monte*. Directors should pause when dealing with the structural conflicts that exist in financial advisor agreements. Additionally, this is one step closer to what many argue is the only way to extinguish such conflicts which is to “require a fundamentally different fee structure for investment bankers working on such a sale, and ultimately [eliminate] success fees and staple financing.”\(^{104}\)

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101. In re Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1023 n.46 (Del. Ch. 2005) ("In general, however, it is advisable that investment banks representing sellers not create the appearance that they desire buy-side work, especially when it might be that they are more likely to be selected by some buyers for that lucrative role than by others.").

102. Davidoff, supra note 29, at 1586–87 ("The investment bank therefore has a hefty incentive to ensure that the contemplated transaction for which it will issue a fairness opinion progresses to completion. But, conflict arises where a bank is asked to opine and advise on a transaction that it stands to benefit from only if the transaction transpires.")

103. *Del Monte*, 25 A.3d at 835–36 ("The role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management [and here I add other contingently compensated professionals like investment banks] may not necessarily be impartial.") (citations omitted).

104. White, supra note 38, at 94.