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M&A Bankers Amp Up Disclosures Amid Chancery Crackdown

By **Matt Chiappardi**

Law360, Wilmington (July 3, 2017, 10:32 AM EDT) -- Once largely invisible from a deal litigation perspective, financial advisers are facing more scrutiny in the Delaware Chancery Court, and while a recent raft of decisions comes short of creating a full panic on Wall Street, the court climate has created unique pressures and significantly affected bankers' behavior.

When the Delaware Supreme Court affirmed a nearly $76 million judgment against RBC Capital Markets in 2015 for its role in Rural/Metro Corp.'s sale to Warburg Pincus LLC, experts say it sent a shiver through Wall Street that it would be open season on financial advisers being tagged with major deal liability for aiding and abetting an alleged breach of fiduciary duty.

A year and a half later, some of that anxiety has been eased by subsequent moves in the Chancery Court, but the deal litigation landscape is in a place where bankers are a tempting, albeit still challenging, target for plaintiffs, and the financial adviser community has made some wholesale changes in response.

"It's more clear now that bankers have to be as careful as directors," said Lawrence Hamermesh, professor of corporate and business law at Widener University Delaware Law School. "This wasn't just a minor adjustment."

Full and transparent disclosure of potential conflicts has not just become more important than ever, it's practically mandatory as far as the Chancery Court is concerned.

Whereas once a one-sentence disclosure was enough, now the information has to be much more robust, to the point that one can tell when a particular financial adviser worked with a buyer and seller and the projections they used so that shareholders can run their own calculations, said William M. Regan, a partner in Hogan Lovells' global financial services litigation practice group.

The disclosure habit has extended to when financial advisers do business with boards, and the message from the Chancery Court has been heard: "Be transparent or you're at risk," Regan said.

"The Chancery Court has recognized the very substantial role financial advisers play, and misconduct gets their attention," he said. "I don't think the level of concern is going to rise to the level of turning down a transaction, but the level of concern with disclosure is heightened."

Two key and coupled decisions since Rural/Metro have dulled its sharp impact in Wall Street circles. The

Chancery Court's application of the state Supreme Court's Corwin v. KKR Financial Holdings standard, which allowed many breach of fiduciary duty claims to be "cleansed" by a fully informed shareholder vote**,** to aiding-and-abetting claims against financial advisers allowed many bankers to wipe some sweat from their brows.

The case, challenging Zale Corp.'s nearly $700 million merger with Signet Jewelers Ltd., originally left Merrill Lynch on the hook for aiding and abetting claims, even though Vice Chancellor Donald F. Parsons Jr. dismissed the breach of fiduciary duty allegations against the companies' directors.

Later, after Corwin was affirmed, Vice Chancellor Parsons also tossed the claims against Merrill Lynch, finding that since the predicate breach of fiduciary duty claims were no more, there couldn't be any aiding and abetting issues, logic that was affirmed by the state Supreme Court in 2016.

"Zale should give folks some comfort, but it's not 100 percent," Regan said. "If you have that full disclosure, then you and your financial adviser have the benefit of Corwin, so long as you don't rise to the level of intentional misconduct or egregious neglect."

But it isn't exactly smooth seas for financial advisers in the new climate. Pressures on plaintiffs firms from Corwin's high standard and a decision in the case over Trulia Inc. and Zillow Inc.'s $2.5 billion merger all but wiped out so-called disclosures-only settlements that could generate six-figure attorneys' fees in exchange for broad releases.

Plaintiffs attorneys have said they worry this situation makes a path to a successful claim much harder in the Chancery Court — at the expense, they say, of shareholder rights — and sharpens the incentive to go after bankers that are in the court's crosshairs for the possibility of a rich settlement or judgment.

"With the difficulty of getting disclosure-only settlements, you see more and more challenges" to a financial adviser's role in a merger, said Linda C. Goldstein, a partner and securities fraud trial attorney at Dechert LLP. "When you're squeezing the balloon, everything is going to shift to the area of least resistance."

Financial advisers were not always front and center on the Chancery Court's radar, until a bombshell of a ruling in 2011 in the case over Del Monte Foods Co.'s $4 billion sale to a private-equity led group that said Barclays PLC had "secretly and selfishly manipulated" the transaction.

The court delayed the sale in what at the time was a polarizing decision, and the case eventually settled with Barclays agreeing to pay investors a sum north of $20 million.

Experts say the decision was a bit of a wake-up call on the role bankers were playing in mergers and acquisitions, and the litigation landscape has significantly changed since.

"Bankers themselves are creating deals to make money," said Peter B. Andrews, co-founding partner of Andrews & Springer LLC, which specializes in securities class actions. "We are always looking at the conduct of the financial advisers. They are probably the most incentivized parties in getting a deal done."

Andrews and other plaintiffs attorneys have said that financial advisers make for a natural target in a legal paradigm that they contend makes it more difficult to bring claims against independent directors. Indemnification provisions in corporate charters can't cleanse bankers' behavior under Delaware law, and if real misconduct is uncovered the liability can be steep, even if they settle.

Financial advisers have taken notice.

“There’s enormous pressure on banks to settle, regardless of the merits,” said Kevin Miller, a partner at Alston & Bird LLP who represents financial advisers, “for fear of being the last defendant standing and the risk of significant damages à la Rural/Metro.”

Miller said that a common plaintiffs’ tactic that can leave bankers in the lurch is to leave them out of settlement talks until the very end, forcing financial advisers either to capitulate or to go ahead with a case already a ways along where they’d have to rely only on directors’ defense theories instead of their own.

The calculation becomes something similar to the one made in traffic court. Motorists may believe they are innocent of a traffic violation but in court plead to a lower offense anyway to avoid the risk of a poor driving record or higher insurance premiums, Miller said.

But what stops bankers from reaching for antacid is that there is still a high bar to prove wrongdoing, and a lot of pitfalls and obstacles for plaintiffs along the way.

“Delaware law requires scienter, actual knowledge you assisted a breach, and it’s a defendant-friendly standard,” said James J. Beha II, a partner in Morrison & Foerster LLP’s litigation department. “The law is protective of financial advisers who are doing their jobs.”

Andrews said a key difficulty is getting discovery early enough in a case to really examine bankers’ behavior, a challenge nowadays in the face of the Corwin and Zale decisions’ power to nip claims in the bud.

“The difficulty lies in getting the proper documents,” he said. “It’s not until you get past motions to dismiss that more particularized discovery is obtained.”

There’s also the notion that the facts surrounding Rural/Metro, in which the court found RBC engaged in major behind-the-scenes maneuvering, were so egregious that it was the exception and not the Chancery rule.

Peter N. Flocos, a partner at K&L Gates LLP and an adjunct M&A law instructor at the University of Pennsylvania Law School, notes that beyond Rural/Metro and Del Monte, the big banker claims are still comparatively uncommon.

“Look at the four-year length of time between Del Monte and Rural/Metro,” Flocos said. “It’s hardly every day that there is a successful claim against a financial adviser.”

“The potential for liability was always overstated,” Hamermesh said. “The standard of proof is enormously high: knowing participation in a breach. The facts have to be pretty awful, and they were in Rural/Metro.”

Whether Rural/Metro was an anomaly or not, Hamermesh said that the “most sober” financial advisers said “we did need to clean up some of our acts,” and that has translated into a real bump in robust disclosures about the shadow they cast over deals.

“It’s more than just not hiding information,” the professor said. “It takes affirmative work.”

James D. Gassenheimer, a partner at Berger Singerman LLP, suggests that financial advisers are taking this seriously, even over-disclosing just to be safe.

“They’re looking for complete transparency,” Gassenheimer said. “The message: Be overly careful. Go overboard.”

--Editing by Brian Baresch and Mark Lebetkin.

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