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## M&A Advisor Misconduct: A Wrong Without a Remedy?

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## M&A ADVISOR MISCONDUCT: A WRONG WITHOUT A REMEDY?

ANDREW F. TUCH\*

### ABSTRACT

*Merger and acquisition ("M&A") transactions are among the most high profile of corporate transactions. They are also among the most contentious, with around eighty percent of all completed deals litigated in recent years. And yet investment banks—essential advisors on these deals—have generally succeeded spectacularly in avoiding liability, an anomaly considering the routine nature of deal litigation and the frequency with which they face lawsuits in their other activities. This article examines this anomaly, explaining the doctrinal and practical reasons why it arises. In doing so, it puts in context a recently-successful shareholder strategy to bring M&A advisors to heel. The article shows how this litigation strategy—a direct action by shareholders alleging secondary liability against the corporation's M&A advisor based on the underlying wrong of directors—may delicately side-step the traditional obstacles. This strategy has succeeded on occasion, provoking widespread alarm in the investment banking community—but the strategy marks only a modest increase in liability risk for M&A advisors. In fact, the liability framework for M&A advisors remains piecemeal and unlikely to be effective in deterring M&A advisor misconduct. The article concludes by examining reform options, arguing in favor of greater industry self-regulation.*

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## I. INTRODUCTION

Very rarely have banks faced liability for advising on merger and acquisition ("M&A") transactions.<sup>1</sup> At first glance, this is puzzling. M&A deals are ubiquitous. For most transactions, each company engages an M&A advisor, usually an investment bank, and for major M&A transactions clients often engage several such advisors. M&A deals frequently attract lawsuits; in recent years eighty percent or more of all completed deals have been litigated.<sup>2</sup> In their other activities, most notably securities underwriting, banks often face lawsuits, being seen as deep-pocketed defendants.<sup>3</sup> And yet in advising on often-contentious M&A deals, they have succeeded spectacularly by generally avoiding liability altogether.

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<sup>1</sup>Andrew F. Tuch, *Fiduciary Principles in Banking*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 125, 133 (Evan J. Criddle, Paul B. Miller, and Robert H. Sitkoff, eds., 2019) [hereinafter, Tuch, *Fiduciary Principles in Banking*].

<sup>2</sup>See Matthew D. Cain, Jill E. Fisch, Steven Davidoff Solomon & Randall S. Thomas, *Mootness Fees*, 72 VAND. L. REV. 1777, 1787 (2019).

<sup>3</sup>There is longstanding concern that securities litigation frequently targets deep-pocketed defendants, including underwriters. For a brief discussion, see *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006).

This article examines this anomaly, explaining the doctrinal and practical reasons why it arises. In doing so, it puts in context a recently-successful shareholder strategy to bring M&A advisors to heel. The article shows how this litigation strategy—a direct action by shareholders alleging secondary liability against the corporation's M&A advisor based on the underlying wrong of directors—may delicately side-step the traditional obstacles. This strategy has succeeded on occasion, provoking widespread alarm in the investment banking community<sup>4</sup>—but the strategy marks only a modest increase in liability risk for M&A advisors. In fact, the liability framework for M&A advisors remains piecemeal and unlikely effective in deterring M&A advisor misconduct.<sup>5</sup> The article concludes by examining reform options, arguing in favor of greater industry self-regulation.

Parts II, III, and IV consider, respectively, actions against M&A advisors by corporate clients, by clients' shareholders, and by other parties in M&A transactions. The analysis identifies four major obstacles to liability. First, clients' rights and remedies are limited by the parties' engagement letters, which include extensive disclaimers.<sup>6</sup> Clauses purporting to disclaim fiduciary and agency relationships may be insufficient to have fiduciary claims dismissed, but the usual terms of engagement letters typically defeat or significantly constrain clients' other claims against M&A advisors.<sup>7</sup> Second, whatever legal claims may be available to them, clients rarely fight publicly with their M&A advisors, preferring instead to resolve disputes behind closed doors; and, in any case, buyers succeed to the rights of target companies as their owners, significantly reducing the possibility of suits by target companies.<sup>8</sup> Third, while shareholders have shown themselves significantly more willing than client corporations to claim against M&A advisors, in *derivative* claims target shareholders lose standing under the requirement for continuous share ownership.<sup>9</sup> Finally, shareholders have limited prospects in *direct*

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<sup>4</sup>See, e.g., Liz Hoffman, *Delaware Supreme Court Uphold Ruling Against RBC in Rural/Metro Case*, WALL STREET J. (Nov. 30, 2015), <https://www.wsj.com/articles/delaware-supreme-court-upholds-ruling-against-rbc-1448899007> ("[Rural Metro/RBC Capital] has been widely followed by banks. It has spawned at least a dozen [other actions] that seek damages from banks..."); Ron Barusch, *Court Has Lump of Coal for Investment Banks*, WALL STREET J. (Dec. 7, 2015), <https://www.wsj.com/articles/court-has-lump-of-coal-for-investment-banks-1449545442> (describing Rural Metro/RBC Capital as a "long-awaited decision that could have far-ranging impact").

<sup>5</sup>See *infra* Part VI.

<sup>6</sup>See *infra* Part II.

<sup>7</sup>See *infra* Part II.

<sup>8</sup>See *infra* Part II.

<sup>9</sup>See *infra* Part III.A.

claims based on *primary* liability because both the common law and terms in engagement letters virtually assure that an advisor's duties run to the client corporation, rather than to its shareholders.<sup>10</sup> These obstacles do not prevent M&A advisor liability, but they largely explain its infrequency.

Against this backdrop, in Part V the article considers aiding and abetting liability, examining *Rural Metro/RBC Capital*, a Delaware Supreme Court decision affirming a \$76 million damages award against a bank for its role advising a client in an M&A transaction.<sup>11</sup> Brought by the client's shareholders, the action alleged that the advisor aided and abetted fiduciary breaches by the client corporation's directors. While narrowly framed, the Supreme Court in *Rural Metro/RBC Capital* appeared to acknowledge the need for greater guidance and sought, albeit in sometimes-confusing terms, to articulate obligations on M&A advisors and otherwise limit their pursuit of self-interest. Although its statements may provide a basis for finding M&A advisors liable even in the absence of aiding and abetting, this litigation strategy also faces significant obstacles, including the need for predicate breaches committed by directors and limited application to buy-side shareholders. Except in cases with fact patterns suggesting egregious misconduct, even private lawsuits against M&A advisors alleging aiding and abetting liability have limited prospects of success.

Part VI considers other liability options, focusing on public enforcement actions and options for reform. Both the Securities and Exchange Commission ("SEC") and the broker-dealer industry's self-regulatory body, the Financial Industry Regulatory Authority ("FINRA"), have authority to sanction M&A advisors.<sup>12</sup> They rarely do so, instead focusing their enforcement efforts on broker-dealers' conduct toward retail clients.<sup>13</sup> Commentators have suggested reforms to increase the deterrent effect of private lawsuits.<sup>14</sup> This article suggests that self-regulation may offer a more encompassing and durable approach than alternatives to deter wrongdoing by M&A advisors, at least for hard-to-detect misconduct.

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<sup>10</sup>See *infra* Part III.B.

<sup>11</sup>RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 847 (Del. 2015), *aff'd*, 88 A.3d 58 (Del. Ch. 2014), *aff'd* 102 A.3d 205 (Del. Ch. 2014) [hereinafter *Rural Metro/RBC Capital*]. RBC Capital was found liable for \$98 million inclusive of interest. It also settled an enforcement action brought by the SEC, paying \$2.5 million, for causing materially false and misleading disclosures about its valuation analyses in Rural/Metro's merger proxy statement. See In the Matter of RBC Capital Mkts., LLC, Administrative Proceeding File No. 3-17520, Release No. 78735 (2016).

<sup>12</sup>See *infra* Part VI.B.

<sup>13</sup>Andrew F. Tuch, *The Self-Regulation of Investment Bankers*, 83 GEO. WASH. L. REV. 101, 155 (2014) [hereinafter, Tuch, *Self-Regulation of Investment Bankers*].

<sup>14</sup>See *infra* Part VI.

M&A advisors would benefit from principles of conduct tailored to the M&A setting, principles consistent with the reality that M&A advisors are professionals and are understood by clients to be loyal advisors.

## II. ACTIONS BY CLIENTS / M&A PRINCIPALS

A corporation proposing to enter into an M&A transaction seeks assistance from an advisor.<sup>15</sup> At some point, the parties formalize their relationship by executing an engagement letter, signed by representatives of the client and M&A advisor. The engagement letter typically describes the contemplated transaction and the scope of the services to be provided as well as limitations on the advisor's liability in the form of exculpation and indemnification provisions. The M&A advisor gives advice and may act on the client's behalf. The client typically acts as a principal in a transaction involving at least one other principal.

For large transactions, a client may engage multiple M&A advisors, whose roles may be distinct or overlapping. In some transactions, a company's board and management may retain separate advisors. M&A advisors are often broker-dealer subsidiaries of financial conglomerates. M&A advisors may perform multiple roles or functions; the advisor—or, in some cases, the financial conglomerate of which the advisor is part—may also provide a fairness opinion, lend funds, or underwrite an offering of securities.<sup>16</sup> These services provide opportunities and incentives for M&A advisors to engage in misconduct such as the misuse of confidential information for personal benefit.

Corporate clients—as opposed to their shareholders—infrequently bring claims against M&A advisors.<sup>17</sup> First, disputes tend to be resolved privately.<sup>18</sup> It's not entirely clear why this is, although several reasons suggest themselves. Lawsuits may reflect unfavorably on directors' own performance and sour a relationship with a financial institution that otherwise provides valuable services to the company. A proposed deal

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<sup>15</sup>See Andrew Tuch, *Investment Banks as Fiduciaries: Implications for Conflicts of Interest*, 29 MELB. U. L. REV. 478, 486 (2005); see William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEX. L. REV. 1, 8 (2014); see also Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEX. L. REV. 1079, 1080 (2016) [hereinafter, Tuch, *Banker Loyalty*].

<sup>16</sup>For an analysis of how these services may give rise to conflicts, see, e.g., Tuch, *Financial Conglomerates and Information Barriers*, 39 J. CORP. L. 563, 570-78 (2014); see also Andrew F. Tuch, *The Weakening of Fiduciary Law*, in RESEARCH HANDBOOK ON FIDUCIARY LAW 354, 356-61 (D Smith & A Gold, eds, 2018) [hereinafter, Tuch, *The Weakening of Fiduciary Law*].

<sup>17</sup>Tuch, *Banker Loyalty*, *supra* note 15, at 1119-20.

<sup>18</sup>See *id.* at 1122-23.

may be preferred to no deal, even if it is compromised by an M&A advisor's misconduct. M&A advisors are reputation-conscious, wanting to minimize potentially adverse publicity.<sup>19</sup> Major law firms may even discourage their clients from suing M&A advisors—and will almost certainly not represent them if they do so—given the importance to most law firms of maintaining good relations with the major financial institutions that act as M&A advisors.<sup>20</sup>

A second reason for the infrequency of claims by corporate clients against M&A advisors is that buyers succeed to the claims of target companies once a deal closes<sup>21</sup> but have weak incentives to pursue these claims.<sup>22</sup> Accordingly, with very few exceptions, any suits are brought by buyers against buy-side advisors and even then these clients have generally become bankrupt, a condition severe enough to break the reluctance clients would otherwise have to press their claims.

Nevertheless, clients' claims may include breach of contract, commission of a tort, breach of fiduciary duty, and professional malpractice. Broadly speaking, these claims concern an M&A advisor's care or loyalty.

#### A. Care

As to claims alleging lack of care, a client has few fruitful avenues. A common term in an engagement letter insulates M&A advisors from liability "except to the extent that any [liabilities] or expenses incurred by the Board (or any member thereof) or the Company are finally judicially determined to have resulted primarily from the Investment Bank's bad faith, gross negligence or willful misconduct."<sup>23</sup>

For claims framed as a tort alleging negligence by the M&A advisor, courts will apply New York law, the law typically chosen in engagement letters, for reasons discussed below.<sup>24</sup> Courts are likely to frame the inquiry as whether the M&A advisor acted with "gross negligence," per the standard of performance set in the engagement letter.<sup>25</sup>

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<sup>19</sup>*See id.*

<sup>20</sup>*See id.*

<sup>21</sup>8 Del C. § 259(a).

<sup>22</sup>This is most obviously so when a buyer benefited from the target advisor's misconduct. *See* Eric S. Klinger-Wilensky & Nathan P. Emeritz, *Financial Advisor Engagement Letters: Post-Rural/Metro Thoughts and Observations*, 71 BUS. LAW. 53, 56 (2016).

<sup>23</sup>*Id.* at 79.

<sup>24</sup>*See infra* notes 54-69 and accompanying text.

<sup>25</sup>*See* HA2003 Liquidating Trust v. Credit Suisse Securities (USA) LLC, No. 04 C 3162, 2006 WL 6047924 at \*8 (N.D. Ill., Sept. 20, 2006), *aff'd* 517 F.3d 454 (7th Cir. 2008). *See also infra* note 50 and accompanying text (examining why New York law will apply to torts).

New York law generally respects contractual provisions absolving a party from its own negligence. Under New York law, gross negligence differs in kind and degree from ordinary negligence. Gross negligence is conduct that "evinces a reckless disregard for the rights of others or 'smacks' of intentional wrongdoing."<sup>26</sup>

The client might also allege professional malpractice against an M&A advisor.<sup>27</sup> However, under New York law, courts doubt whether M&A advisors are "professionals" that may be sued for professional malpractice,<sup>28</sup> and in any case, the common exculpation provision narrows the scope of liability to "bad faith, gross negligence or willful misconduct."<sup>29</sup> The prospect of such liability against M&A advisors is therefore slim.

Another potential basis of liability is breach of fiduciary duty. However, this claim is most apt when plaintiffs challenge the loyalty that an M&A advisor has shown, or the conflicts of interest it faces, rather than its standard of care.

### B. Loyalty

When the alleged misconduct concerns conflicts of interest, deception, or other forms of disloyalty, the claims against M&A advisors tend to be more promising than in cases of breach of care.<sup>30</sup> Because of the multiple functions that M&A advisors can perform, especially when they are part of a financial conglomerates, potential conflicts of interest are common. Recent examples of alleged misconduct include an M&A advisor agreeing, without its client's consent, to lend funds to a company planning to buy its client;<sup>31</sup> an M&A advisor engineering a sale of its client by having undisclosed negotiations with and providing confidential client

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<sup>26</sup>*HA2003 Liquidating Tr.*, 2006 WL 6047924 at \*15 (citing *Colnaghi, U.S., Ltd. v. Jewelers Prot. Servs. Ltd.*, 611 N.E.2d 282, 283 (N.Y. 1993)).

<sup>27</sup>In determining the governing law for professional malpractice, courts have given regard to choice-of-law rules for torts. *See Shandler v. DLJ Merchant Banking, Inc.*, No. CIV.A. 4797-VCS, 2010 WL 2929654 at \*17, n.149 (Del. Ch. Jul. 26, 2010) (*reprinted in* 36 DEL. J. CORP. L. 725).

<sup>28</sup>Compare *Leather v. U.S. Trust Co. of New York*, 720 N.Y.S. 2d 448, 449-50 (App. Div. 2001) with *EBC I, Inc., v. Goldman Sachs & Co.*, 777 N.Y.S. 2d 440, 443 (App. Div. 2004), *aff'd as modified*, 832 N.E.2d 26 (N.Y. 2005). On appeal in *EBC I*, the New York Court of Appeals left open the question of "whether a financial advisor or underwriter may ever be treated as a professional for purposes of malpractice liability." 832 N.E.2d at 33.

<sup>29</sup>*Klinger-Wilensky & Emeritz, supra* note 22, at 79.

<sup>30</sup>The discussion of fiduciary duties in this subsection draws upon and significantly extends *Tuch, Fiduciary Principles in Banking, supra* note 1, at 133-37.

<sup>31</sup>*See In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).



information to a potential buyer;<sup>32</sup> and an M&A advisor leaking confidential information to a private equity bidder through undisclosed back-channel discussions, to give that bidder an "edge" in the sale process.<sup>33</sup> Consider also an M&A advisor of a bidder that switches course, deciding to buy the client itself through its private equity arm.<sup>34</sup> More generally, conflicts may arise because the M&A advisor has material relationships with either party to the proposed transaction that pre-existed or existed independently of the proposed transaction. The policy concern is that these conflicts may compromise the M&A advisor's loyalty, harming its client.<sup>35</sup> Systematic empirical evidence demonstrates the validity of this concern.<sup>36</sup>

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<sup>32</sup>See *Chester Cty. Emps.' Ret. Fund v. KCG Holdings, Inc.*, No. 2017-0421-KSJM, 2019 WL 2564093 (Del. Ch. June 21, 2019).

<sup>33</sup>See *Morrison v. Berry*, No. CV 12808-VCG, 2020 WL 2843514 (Del. Ch. June 1, 2020).

<sup>34</sup>In the 2006 buyout of HCA Inc., for example, Merrill Lynch advised HCA on its strategic options and introduced its buyout arm to management. Merrill Lynch appears to have retained its advisory role with HCA, advising on the merits of a buyout that would—and eventually did—involve Merrill's buyout arm as a co-investor. Merrill Lynch also helped fund the buyout. See SEC, HCA INC., SCHEDULE 14A PROXY STATEMENT (Oct. 17, 2006), <https://www.sec.gov/Archives/edgar/data/860730/000095014406009545/g02699ddefm14a.htm#125>.

<sup>35</sup>There is also the basic tension created by M&A advisors' contingent fee arrangement, under which advisors receive the bulk of their fees when the contemplated transaction closes, an arrangement creating strong incentives for advisors to support the transaction. See, e.g., *In re TIBCO Software Inc. S'holder Litig.*, 2015 WL 6155894, at \*26 (Del. Ch. Oct. 20, 2015). The tension is not entirely ameliorated for sell-side advisors whose fee increases in proportion to sale price. My thanks to an anonymous reviewer for this insight.

<sup>36</sup>Studies suggest that M&A advisors leak client information for use by securities and options traders and skew their client advice to the detriment of their clients. See Michelle B. Lowry et al., *Informed Trading by Adviser Banks: Evidence from Options Holdings*, REV. FIN. STUD. (forthcoming), available at <https://ssrn.com/abstract=2579463> (finding that options trading by banks advising on M&A is consistent with those traders having an information advantage over banks not so advising, a finding the authors attribute to information leakage from banks' M&A advisors); see Andriy Bodnaruk et al., *Investment Banks as Insiders and the Market for Corporate Control*, 22 REV. FIN. STUD. 4989 (2009) (finding results consistent with M&A advisors exploiting non-public information from M&A clients in their trading activities; further finding that M&A advisers taint their advice to bidder clients, leading to inferior deal outcomes for these clients relative to clients of un-conflicted M&A advisors); see Narasimhan Jegadeesh & Yue Tang, *Institutional Trades Around Takeover Announcements: Skill vs. Inside Information* (Dec. 1, 2010) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1568859](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1568859) (finding that financial conglomerates use non-public information garnered from their M&A clients for the benefit of some brokerage clients). But some studies find little or weak evidence of M&A advisors leaking client information for use by securities traders. See John M. Griffin et al., *Examining the Dark Side of Financial Markets: Do Institutions Trade on Information from Investment Bank Connections?* 25 REV. FIN. STUD. 2155 (2012) (finding "little evidence" of profitable securities trading resulting from information leakage from M&A advisors); see Simi Kedia & Xing Zhou, *Informed Trading Around Acquisitions: Evidence from Corporate Bonds*, 18 J. FIN. MARKETS

Multiple potential causes of action exist. The client could allege breach of contract, although given the usual terms of engagement letters, it would need to establish that the advisor's conduct amounted to "bad faith, gross negligence, or willful misconduct."<sup>37</sup> Professional malpractice is another potential claim but, again, doubt exists under New York law about the merits of such a claim against investment bankers.<sup>38</sup>

A more plausible claim would involve a client alleging breach of fiduciary duty by its M&A advisor. As discussed in Part II, the claim would need to be brought by the client, not its shareholders, to whom fiduciary duties are rarely owed. The fiduciary claim arises because the fiduciary duty of loyalty may require undivided loyalty, subjecting the fiduciary to liability for conflicts of interest to which its client did not give informed consent.

Fiduciary claims against M&A advisors are not easily resolved. They often begin with questions as to whether the advisor in fact has a fiduciary responsibility to the client. Here, I focus on how courts applying New York law have handled these questions. In the following discussion, I turn to Delaware law, which may differ on this issue.

There are several reasons why New York law is especially important in determining questions of M&A advisors' fiduciary responsibility. One is that first-principles analysis suggests that cases will tend to be resolved under New York law. The reasoning is as follows. Because fiduciary duty has been characterized as a tort, we would expect choice-of-law principles *for torts* to resolve fiduciary claims against an M&A advisor.<sup>39</sup> Under these principles, according to the *Restatement (Second) of Conflict of Laws*, the relevant law is that with "the most significant relationship to the occurrence [of the tort] and the parties."<sup>40</sup> When applied to advisors, the test points toward New York law when a majority of the advisor's relevant services were rendered in New York, which is often the case when it comes to M&A activities.<sup>41</sup> This approach

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182 (2014) (finding "weak and suggestive" evidence of information leakage by M&A advisors for use in bond trading).

<sup>37</sup>Klinger-Wilensky & Emeritz, *supra* note 22, at 79.

<sup>38</sup>*See supra* note 28 and accompanying text.

<sup>39</sup>RESTATEMENT (SECOND) OF TORTS, § 874 cmt. A (AM. LAW INST. 1979).

<sup>40</sup>RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 145 (AM. LAW INST. 1971).

<sup>41</sup>*See, e.g., In re Am. Int'l Group, Inc.*, 965 A.2d 763, 817-22 (Del. Ch. 2009) (applying the Restatement (Second) on Conflict of Laws and considering the applicable law for torts and for breach of contract claims); *id.* at 820 ("For both torts like negligence and for breach of contract claims, the Restatement gives substantial weight to the place of performance of the acts that were negligent or that breached the contract. Those factors both favor New York, and so does the related factor of where the relationship between [the client] and [the professional services firm] was centered"); *see also* Shandler v. DLJ Merchant Banking, Inc., 2010 WL 2929654 at \*17 n.149 (Del. Ch. Jul. 26, 2010) (*reprinted in* 36 DEL. J. CORP. L. 725) (applying

"is consistent with the notion that professionals practicing in a certain state should be able to practice in reliance upon the law of that state."<sup>42</sup> Breach of fiduciary duty claims might also be based on the existence of an agency relationship (a fiduciary relationship, by definition<sup>43</sup>), in which case the *Restatement (Second) of Conflict of Laws* would also determine the parties' rights and duties using the "most significant relationship" test.<sup>44</sup>

Instead of applying first-principles analysis to determine the governing law to resolve a fiduciary claim, courts may follow the law specified in a choice-of-law clause in the engagement letter. This is a second reason to focus our analysis on New York law: parties routinely specify New York law as the governing law in their engagement letters. But before taking this approach, courts must determine whether the relevant choice-of-law clause governs non-contractual issues—such as fiduciary breach—arising from a contractual relationship to which the clause applies.<sup>45</sup> Only if it does govern should the approach apply. Courts have taken different positions on whether such clauses govern fiduciary issues.<sup>46</sup> According to a leading treatise, "the most logical inference" from the *Restatement (Second) of Conflict of Laws* is that such clauses apply only to contractual issues,<sup>47</sup> and therefore, not to fiduciary breach. But the legal position is unsettled.<sup>48</sup> Still, because cases often turn on interpretations of the contract in question,<sup>49</sup> clauses should be given their intended effect so that clauses expressed to apply to disputes "whether based on contract, tort, or otherwise"—an increasingly common

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the "most significant relationship" test in § 145 of the Restatement (Second) of Conflict of Laws to a professional malpractice claim against an investment bank and observing that "[t]he balance of these factors points to New York").

<sup>42</sup>*In re Am. Int'l Group, Inc.*, 965 A.2d at 820-21 (citing Greenberg Traurig of New York, P.C. v. Moody, 161 S.W. 3d 56, 74 (Tex.App. 2004)).

<sup>43</sup>See RESTATEMENT (THIRD) OF AGENCY § 1.01 (1) (AM. LAW INST. 2006). As discussed below, M&A advisors may be characterized as fiduciaries by virtue of their role as agents.

<sup>44</sup>RESTATEMENT (SECOND) CONFLICT OF LAWS § 291(f) (AM. LAW INST. 1971); see also RESTATEMENT (SECOND) CONFLICT OF LAWS § 188(1) (AM. LAW INST. 1971) (referring to the "local law of the state which, with respect to that issue, has the most significant relationship to the parties and the transaction ...").

<sup>45</sup>PETER HAY ET AL., CONFLICT OF LAWS 1073 (6th ed. 2018) ("[The relevant question is whether] a choice-of-law clause may, or does, encompass non-contractual issues arising from, or connected to, the same contractual relationship that is the object of the clause[.]").

<sup>46</sup>*Id.* at 1073-76.

<sup>47</sup>*Id.*

<sup>48</sup>*Id.* at 1076 ("The case law on this issue in the United States is still unsettled."); see also *id.* at 1074.

<sup>49</sup>See, e.g., *Thomas v. Fidelity Brokerage Services, Inc.*, 977 F. Supp. 791 (W.D. La. 1998) (rejecting defendant's argument that a choice-of-law provision in a contract extended to a breach of fiduciary duty claim, reasoning that the parties intended the provision to apply to issues of contract construction and enforcement only); HAY ET AL., *supra* note 45, at 1076-78.

formulation—should apply to claims for fiduciary breach. In Delaware, even in the absence of such clear language, courts have been willing to apply the law specified in a choice-of-law clause to tort claims related to the same contract to avoid "uncertainty of precisely the kind that the parties' choice of law provision sought to avoid."<sup>50</sup> When the underlying contractual relationship with an M&A advisor is governed by New York law, some courts have applied New York law to determine fiduciary questions without doing much explicit analysis at all.<sup>51</sup> To the extent courts follow the choice-of-law provision in an M&A advisor's engagement letter—as they may well—they will frequently have regard to New York law.

A typical choice-of-law term includes both a choice-of-law clause and a forum-selection provision. Fiduciary claims against M&A advisors are therefore likely to be resolved in New York courts. A template clause provides:

The Agreement shall be governed by and construed in accordance with the laws of the State of New York without reference to principles of conflicts of law. Each of the Board, the Company and the Investment Bank irrevocably and unconditionally submits to the exclusive jurisdiction and venue of any State or Federal court sitting in New York City over any action, suit or proceeding arising out of or relating to this Agreement. Each of the Board, the Company and the Investment Bank irrevocably and unconditionally waives any objection to the laying of venue of any such action brought in any such court and any claim that any such action has been brought in an inconvenient forum.<sup>52</sup>

In contrast to New York courts, Delaware courts have had little occasion to explicitly consider the fiduciary character *vel non* of M&A advisors. This has not stopped Delaware courts from occasionally opining on the question, as in *Rural Metro/RBC Capital*. In obiter dicta, the court described M&A advisors as arm's-length counterparties of their clients but also specified that M&A advisors have extra-contractual requirements for

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<sup>50</sup>Abry Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032, 1048 (Del. Ch. 2006).

<sup>51</sup>See, e.g., HA2003 Liquidating Trust v. Credit Suisse Securities (USA) LLC, No. 04 C 3162, 2006 WL 6047924, at \*8 (N.D. III, Sept. 20, 2006), *aff'd* 517 F.3d 454 (7th Cir. 2008); Official Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Securities Corp., No. 00 Civ. 8688(WHP), 2002 WL 362794 (S.D.N.Y. Mar. 6, 2002).

<sup>52</sup>Klinger-Wilensky & Emeritz, *supra* note 22, at 84.

loyalty.<sup>53</sup> These comments were both equivocal and unnecessary for the decision, since the action was framed as a direct suit by target company shareholders alleging aiding and abetting liability against an M&A advisor, an action governed in Delaware under the internal affairs doctrine. Thus, *Rural Metro/RBC Capital* was unable to provide much clarity on Delaware's position concerning fiduciary responsibilities of M&A advisors to their clients.

Courts applying New York law have often regarded M&A advisors as fiduciaries of their clients, or at least been unwilling to dismiss fiduciary claims at the motion-to-dismiss stage. While infrequent, the cases are fairly one-sided: when clients do claim fiduciary breach by their M&A advisors, courts applying New York law have usually rejected attempts by M&A advisors to dismiss the claims. Client relations in the high-stakes M&A world are not easily characterized as arm's length relations in "a workaday world."<sup>54</sup> A few cases illustrate.<sup>55</sup>

In *Frydman & Co. v. Credit Suisse First Boston Corp.*,<sup>56</sup> Frydman & Co. engaged Credit Suisse to advise on its attempt to acquire Starrett Corp., a role in which Credit Suisse would provide Frydman investment banking services and negotiate with Starrett on Frydman's behalf. Ultimately, Starrett rebuffed Frydman, agreeing instead to combine with another company—in a transaction that Credit Suisse agreed to fund. Frydman alleged that Credit Suisse, in agreeing to fund a competing bid, had breached its fiduciary duties to Frydman. Relying on the fiduciary definition in the *Restatement (Second) of Torts* – a fiduciary relationship "exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation"<sup>57</sup> —the court found that Frydman's allegations "raise[d] an issue of fact as to whether the investment bank owed Frydman a fiduciary duty."<sup>58</sup> It was no barrier to this conclusion that the parties had not entered into a written agreement for the bank's services.

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<sup>53</sup>See *supra* notes 39-52 and accompanying text.

<sup>54</sup>*Cf.* *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928).

<sup>55</sup>For a more detailed analysis, see Tuch, *Fiduciary Principles in Banking*, *supra* note 1, at 133-37; see also Tuch, *Investment Banks as Fiduciaries*, *supra* note 15 at 498; Bratton & Wachter, *supra* note 15, at 26, 54; Tuch, *Banker Loyalty*, *supra* note 15, at 1082; Randall S. Thomas & Robert G. Hansen, *A Theoretic Analysis of Corporate Auctioneers' Liability Regimes*, WISC. L. REV. 1147, 1149-51 (1992). *Cf.* Alan D. Morrison & William J. Wilhelm, Jr., *Trust, Reputation, and Law: The Evolution of Commitment in Investment Banking*, 7 J. LEGAL ANALYSIS 363, 407-12 (2015).

<sup>56</sup>*Frydman & Co. v. Credit Suisse First Boston Corp.*, 708 N.Y.S.2d 77 (App. Div. 2000).

<sup>57</sup>RESTATEMENT (SECOND) OF TORTS, § 874 cmt. a (AM. LAW INST. 1979).

<sup>58</sup>*Frydman & Co.*, 708 N.Y.S.2d at 79.

Another case in which a court agreed that an M&A advisor may be a fiduciary under New York law was *American Tissue, Inc. v. Donaldson, Lufkin & Jenrette Securities Corp.*<sup>59</sup> In this instance, a Chapter 11 bankruptcy debtor-in-possession for American Tissue sued the company's former M&A advisor DLJ for breach of fiduciary duty, among other causes of action. American Tissue had sought to acquire Crown Paper and to refinance its debt, and it engaged DLJ as its "investment banker and consultant."<sup>60</sup> DLJ advised American Tissue on acquiring Crown, restructuring its debt, and issuing its bonds to investors. As to the fiduciary breach claim, the court rejected DLJ's argument that an M&A advisor could be a fiduciary only if it were an agent of its client; an M&A advisor could be a fiduciary on an ad hoc basis. A federal district court observed that New York courts had characterized banks as fiduciaries where "there is either 'a confidence reposed which invests the person trusted with an advantage in treating the person so confiding' or an assumption of control and responsibility."<sup>61</sup> American Tissue alleged that it had reposed extraordinary trust in DLJ and relied on DLJ's advice and due diligence with the transactions and that DLJ had been deeply involved in its finances and management.<sup>62</sup> Assuming the truth of the allegations, the district court concluded, "DLJ owed a fiduciary duty to [American Tissue] in its capacities as investment banker and financial advisor."<sup>63</sup>

On similar facts, a federal district court in *Official Committee of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Securities Corp.* found that the plaintiff, acting on behalf of the bankruptcy estate of the M&A advisor's client, had properly pleaded the existence of a fiduciary relationship between the M&A advisor and its client, SmarTalk.<sup>64</sup> The plaintiff pleaded that SmarTalk had placed its trust and confidence in DLJ to advise it on the appropriateness of an acquisition, that DLJ had accepted that trust and confidence, and that DLJ could exert unique influence over SmarTalk because of its superior knowledge.<sup>65</sup>

While courts have often refused to grant M&A advisors' motions to dismiss actions alleging fiduciary breaches, each case requires a fact-specific inquiry. For example, in *Northeast General Corp. v. Wellington*

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<sup>59</sup>*Am. Tissue, Inc. v. Donaldson, Lufkin & Jenrette Securities Corp.*, 351 F. Supp. 2d 79 (S.D.N.Y. 2004).

<sup>60</sup>*Id.* at 83-84.

<sup>61</sup>*Id.* (internal citations omitted).

<sup>62</sup>*Id.*

<sup>63</sup>*Am. Tissue Inc.*, 351 F. Supp. 2d at 83-84.

<sup>64</sup>*Official Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Securities Corp.*, No. 00 Civ. 8688(WHP), 2002 WL 362794, at \*9 (S.D.N.Y. Mar. 6, 2002).

<sup>65</sup>*Id.* at \*8.

*Advertising*, a firm engaged as an "investment banker and consultant" was not a fiduciary of its client because it performed a more limited role than its title suggested—that of a "finder."<sup>66</sup>

Thus, if a fiduciary relationship exists between an M&A advisor and its client, it is likely to arise on a fact-specific, or an ad hoc, basis. The advisor-client relationship is not fiduciary per se (by virtue of its status), unlike relationships between lawyers and clients, unless an agency relationship exists between the advisor and its client. Indeed, in determining whether fiduciary duties arise, courts often apply the definition in the *Restatement (Second) of Torts* and look for familiar indicia, such as whether the client reposes trust and/or confidence in the advisor and receives and relies on the advisor's advice.<sup>67</sup> Given the risk of fiduciary duties, legal advisors to investment banks emphasize the need for fiduciary disclaimers,<sup>68</sup> and they point to New York law for including such terms.<sup>69</sup>

Importantly, under New York law fiduciary disclaimers may not have the effect of preventing fiduciary duties from arising.<sup>70</sup> A common provision asserts that the advisor acts only as an independent contractor and not as an agent or other fiduciary. A sample disclaimer states:

It is understood and agreed that the Investment Bank will act under this Agreement as an independent contractor with obligations solely to the Company and is not being retained hereunder to advise the Company as to the underlying business decision to consummate any Transaction or with respect to any related financing, derivative or other transaction. Nothing in this Agreement or the nature of our services shall be deemed to create a fiduciary or agency relationship between the Investment Bank and the Company or its stockholders, employees or creditors, in connection

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<sup>66</sup>Ne. Gen. Corp. v. Wellington Advert., Inc., 624 N.E.2d 129, 130, 132 (N.Y. 1993).

<sup>67</sup>See Tuch, *Fiduciary Principles in Banking*, *supra* note 1, at 144.

<sup>68</sup>Stephen M. Kotran & Kevin Miller, *M&A Engagement Letters: Strategies for Buyers, Sellers, Investment Banks and Their Counsel*, 18 (Sept. 29, 2016) (available at <http://media.straffordpub.com/products/m-and-a-engagement-letters-strategies-for-buyers-sellers-investment-banks-and-their-counsel-2016-09-29/presentation.pdf>).

<sup>69</sup>The case of *Schneider v. Lazard Freres & Co.*, 552 N.Y.S. 2d 571 (N.Y. App. Div. 1990) is said to have "led to explicit disclaimers of fiduciary and agency relationships in engagement letters and in some investment banks' forms of opinions."; Kotran & Miller, *supra* note 68, at 18.

<sup>70</sup>For a general discussion of the effect of fiduciary disclaimers, see Bratton & Wachter, *supra* note 15 at 36-44; Andrew F. Tuch, *Disclaiming Loyalty: M&A Advisors and Their Engagement Letters*, 93 TEXAS L. REV. 211, 214-224 (2015); see also Tuch, *Fiduciary Principles in Banking*, *supra* note 1, at 139-41.

with the Transaction or otherwise.<sup>71</sup>

But courts may not be bound to accept these clauses. Under the classical position, courts, rather than the parties themselves, determine whether a fiduciary relationship exists.<sup>72</sup> That approach has longstanding scholarly support, although, in recent decades an opposing school has arisen arguing that fiduciary relationships can be entirely eliminated by contract.<sup>73</sup> Applying New York law, courts have taken various approaches, sometimes respecting the effectiveness of fiduciary disclaimers and at other times treating these clauses as non-dispositive of fiduciary questions.<sup>74</sup>

One court did find that "contractual disclaimers of fiduciary duty are enforceable" though only "when sufficiently explicit."<sup>75</sup> By "enforceable," courts mean that these provisions are effective or valid in preventing fiduciary duties from arising and should lead to dismissal of a breach of fiduciary claim.<sup>76</sup> Under this approach, disclaimers must refer explicitly to *fiduciary* liability to be enforceable.<sup>77</sup> In *King County, WA v. IKB Deutsche Industriebank AG*,<sup>78</sup> for example, disclaimers that made no reference to fiduciary duty failed to prevent a fiduciary relationship from arising.<sup>79</sup>

However, courts have also treated fiduciary disclaimers as nonbinding in determining whether fiduciary duties arise. In *Veloron Holdings, B.V. v. Morgan Stanley*, a federal district court applying New York law examined the effectiveness of the following disclaimer:

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<sup>71</sup>Kotran & Miller, *supra* note 68, at 19.

<sup>72</sup>See RESTATEMENT (THIRD) OF AGENCY, §1.02 (AM. LAW INST. 2006).

<sup>73</sup>In truth, scholarly positions fall on a continuum with extreme positions at either end, differing according to the extent that parties to a fiduciary relationship may contractually exclude fiduciary terms; otherwise put, the debate concerns the extent to which fiduciary duties are mandatory. For a summary of the debate, see Daniel Clarry, *Mandatory and Default Rules in Fiduciary Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 435, 442-45 (Evan J. Criddle, Paul B. Miller, and Robert H. Sitkoff, eds., 2019); see also Amir N. Licht, *Motivation, Information, Negotiation: Why Fiduciary Accountability Cannot Be Negotiable*, in RESEARCH HANDBOOK ON FIDUCIARY LAW 159, 174-78 (D. G. SMITH & A.S. GOLD, EDS, 2018).

<sup>74</sup>For a more detailed discussion, see Tuch, *Fiduciary Principles in Banking*, *supra* note 1, at 139-41.

<sup>75</sup>*Valentini v. Citigroup*, 837 F. Supp. 2d 304, 326 (S.D.N.Y. 2011); see also *Seippel v. Jenkens & Gilchrist*, 341 F. Supp. 2d 363 (S.D.N.Y. 2004) (holding no fiduciary duties existed between an investor and a bank because "contractual disclaimers are effective in New York").

<sup>76</sup>See *LBBW Luxemburg, S.A. v. Wells Fargo Sec.*, 10 F. Supp. 3d 504, 523-24 (S.D.N.Y. 2014).

<sup>77</sup>*Id.* at 523 ("Simply put, effective disclaimers must explicitly reference fiduciary duties.").

<sup>78</sup>*King County v. IKB Deutsche Industriebank AG*, 863 F. Supp. 2d 288 (S.D.N.Y. 2012).

<sup>79</sup>*Id.* at 313, n.193.



"[investment bank Morgan Stanley] is acting as an independent contractor and not as a fiduciary and [the counterparty] does not intend Morgan Stanley to act in any capacity other than independent contractor including as a fiduciary or in any other position of higher trust."<sup>80</sup> On a motion for summary judgment, the court rejected the proposition that a disclaimer was dispositive of the character of a relationship between parties, holding:

[W]e must look past the labels that [the parties] placed on their relationship and instead plumb the real character of the services that Morgan Stanley provided . . . because 'Ultimately, the dispositive issue of fiduciary-like duty or no such duty is determined not by the nomenclature [used by the parties] but instead by the services agreed to under the contract between the parties.'<sup>81</sup>

On the facts, the counterparty had "relied on Morgan Stanley's expertise in structuring, pricing and timing[.]" which were "hallmarks of a fiduciary relationship."<sup>82</sup> Though the disclaimer offered "some evidence" to the contrary, the court found a genuine issue of material fact as to whether the contract created a fiduciary relationship.<sup>83</sup>

Moreover, New York law acknowledges that a fiduciary relationship may arise *apart from* a contractual relationship, reducing the likelihood that a fiduciary disclaimer will have effect. In *Baker v. Goldman Sachs & Co.*, the U.S. District Court of Massachusetts, applying New York law, examined the relationship between an M&A advisor and its client's two controlling shareholders, one of whom was a member of the board and both of whom dealt with the M&A advisor in selling the company.<sup>84</sup> While the engagement letter included no fiduciary disclaimer, the courts described fiduciary duties as extra-contractual and required the plaintiff to allege that "the parties created a relationship of higher trust than would arise from [their contracts] alone so as to permit a cause of action for breach of a fiduciary duty independent of the contractual duties."<sup>85</sup> The plaintiffs alleged that they had "put faith, confidence, and trust in [the

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<sup>80</sup>Veleron Holdings, B.V. v. Morgan Stanley, 117 F. Supp. 3d 404 (S.D.N.Y. 2015).

<sup>81</sup>*Id.* at 453 (citing *Ne. Gen. Corp. v. Wellington Adver., Inc.*, 82 N.Y.2d 158, 163 (N.Y. 1993)).

<sup>82</sup>*Id.*

<sup>83</sup>*Id.* at 455.

<sup>84</sup>*Baker v. Goldman Sachs & Co.*, 656 F.Supp.2d 226, 229-33 (D. Mass, 2009).

<sup>85</sup>*Id.* at 236 (citing *Brooks v. Key Trust Co. Nat'l Ass'n*, 809 N.Y.S.2d 270, 272-73 (N.Y. App. Div. 2006)).

M&A advisor's] specialized judgment and advice."<sup>86</sup> They alleged that "special circumstances existed to create a fiduciary relationship apart from the terms of the contract," sufficiently so that the court dismissed the M&A advisor's motion to dismiss the claim.<sup>87</sup> Along similar lines, in *EBC I, Inc., v. Goldman Sachs*, the New York Court of Appeals refused to grant an underwriter's motion to dismiss a claim for fiduciary breach.<sup>88</sup> Although no fiduciary relationship arose from the contract between Goldman and its underwriting client (an issuer of securities), the parties may nevertheless have a relationship *independent of their contract*. Indeed, "to the extent that underwriters function, among other things, as expert advisors to their clients on market conditions, a fiduciary duty may exist."<sup>89</sup>

In sum, under New York law, a claim of fiduciary breach by a client against its M&A advisor stands some prospect of surviving a motion to dismiss even when the parties' engagement letter includes a disclaimer purporting to prevent fiduciary duties from arising between the parties. Although corporate boards tend to resolve disputes with their M&A advisors behind closed doors, rather than in adversarial proceedings, parties need to be attentive to New York law in order to understand the rights and responsibilities that may follow from their agreements. Courts' analysis is necessarily fact-specific, so the parties must also attend to the particulars of their cases, not just the law in general.

Nonetheless, M&A advisors need not be alarmed about the potential imposition of fiduciary duties. Fiduciary doctrine rarely creates blanket prohibitions on conduct. Indeed, fiduciaries routinely obtain their beneficiaries' informed consent to conduct that would otherwise amount to fiduciary breach. Even commentators who appear to take a different view of fiduciary disclaimers, regarding them as effective in extinguishing fiduciary liability, say that the relevant cases "teach" bankers, among other things, to "[d]isclose all material conflicts, existing and potential"<sup>90</sup> and to "promptly advise[]" the client if a conflict of interest arises during a sale process.<sup>91</sup> This guidance is consistent with basic precepts of fiduciary law. Interestingly, these commentators qualify their guidance by observing that it is an "unresolved question. . . whether *all* conflicts can be

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<sup>86</sup>*Id.* at 237.

<sup>87</sup>*Id.* at 237.

<sup>88</sup>*EBCI, Inc. v. Goldman Sachs*, 832 N.E.2d 26, 33-34 (N.Y. 2005).

<sup>89</sup>*Id.*

<sup>90</sup>ARTHUR FLEISCHER, JR. ET AL, TAKEOVER DEFENSE: MERGERS AND ACQUISITIONS (8<sup>th</sup> ed. 2018) §18.01[C].

<sup>91</sup>*Id.*

cured by disclosure and informed consent."<sup>92</sup> They refer to remarks by Vice Chancellor Laster in the transcript opinion in *In re PLX Tech. Inc.*:

I think it is important to note that all conflicts are not equal. They run the gamut from minor issues, where directors can readily understand them after disclosure and where the board can easily waive them or authorize the bank to proceed. But at the other end of the spectrum are major problems that may be so pervasively impairing that the directors could not reasonably consent.<sup>93</sup>

This judicial guidance is consistent with the Supreme Court's later guidance in *Rural Metro/RBC Capital*, examined below.<sup>94</sup> Courts do not specify which "conflicts" or "problems" informed consent may not cure. However, it is plausible to interpret Vice Chancellor Laster's remarks as suggesting that directors risk violating their own duties by consenting to certain advisor conflicts or problems, rather than that advisors who get such consent do not get the benefit of that consent in protecting themselves from liability in actions brought by clients. In other words, these judicial remarks may mean that getting informed client consent will protect an M&A advisor from liability for fiduciary breach in an action by its client even if giving such consent might have breached directors' own duties.

These principles apply to M&A clients, whether acquirers or targets. But what about shareholders? They, too, face obstacles to successfully claiming against M&A advisors.

### III. ACTIONS BY SHAREHOLDERS OF A CLIENT

Relative to their corporations, shareholders (and their counsel) have stronger incentives to bring claims against M&A advisors and are more likely to do so. This Part considers derivative claims and direct claims alleging primary liability; Part V considers direct claims based on secondary liability.

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<sup>92</sup>*Id.*

<sup>93</sup>*In re PLX Tech. Inc.* Transcript Ruling, C.A. 9880-VCL (Del. Ch. Sept. 3, 2015), slip op. at 36-37.

<sup>94</sup>*RBC Capital Mkts. v. Jervis*, 129 A.3d 816, 855 (Del. 2015) (finding that directors "may be free to consent to *certain* conflicts") (emphasis added); *see also* *Morrison v. Berry*, No. CV 12808-VCG, 2020 WL 2843514, at \*1 (Del. Ch. June 1, 2020).

### A. *Derivative Claims*

Shareholders may sue derivatively on their corporation's behalf, asserting claims that belong to the corporation. Such claims against an M&A advisor might include breach of contract, negligence, professional malpractice, and breach of fiduciary duty. As explained in Part II, however, the corporation's rights and remedies are governed or limited by the parties' engagement letters, which include extensive disclaimers. Moreover, shareholders are limited in their ability to pursue derivative claims because they must adequately plead demand futility and because a board of directors, even one tainted by self-interest, can legally delegate its authority to a committee of disinterested directors to "move to dismiss derivative litigation that is believed to be detrimental to the corporation's best interest," even if that litigation was validly initiated.<sup>95</sup> These limits affect derivative suits brought by the shareholders of buyers and targets alike. Other limits depend on whether shareholders hold stock in the buyer or target.

For shareholders of target companies, procedural rules require them to continuously own the target company's stock in order to maintain derivative suits. So, while sell-side shareholders might want to commence a suit against an M&A advisor to assert the company's rights, the continuous share ownership requirement is no longer satisfied once a merger closes.<sup>96</sup> This procedural obstacle effectively prevents target shareholders bringing derivative suits against M&A advisors. The procedural obstacle explains why suits against M&A advisors alleging breach of contract or fiduciary duty based on the advisor-client relationship, when they are brought, are brought by corporations rather than derivatively by shareholders (although, as explained in Part I, there are impediments to these corporate suits too).

In addition to the claims mentioned above, buy-side shareholders may assert derivative claims against an M&A advisor for aiding and abetting fiduciary breaches of their directors, but these claims stand little chance of succeeding. Aiding and abetting claims require an underlying

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<sup>95</sup>Zapata Corp. v. Maldonado, 430 A.2d 779, 783, 786 (Del. 1981). Courts nevertheless have discretion to second-guess the committee's decision. *Id.* at 788–89. Moreover, a board may decline to pursue any "demand" for suit by shareholders, a decision courts will respect provided the board's decision was not wrongful.

<sup>96</sup>See Lewis v. Anderson, 477 A.2d 1040, 1049 (Del. 1984) ("A plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit."). In the context of actions against M&A advisors, see John Jenkins, *Rural/Metro One Year Later: Ongoing Doctrinal Concerns*, DEALLAWYERS.COM BLOG (Dec. 8, 2016), <http://www.deallawyers.com/blog/2016/12/ruralmetro-one-year-later-ongoing-doctrinal-concerns.html> (interview with Kevin Miller, Alston & Bird LLP).

claim of primary wrongdoing, which will typically be a claim of breach of fiduciary duties by the buyer's directors. Buyer shareholders will generally allege injury to the company and will therefore need to assert these claims derivatively,<sup>97</sup> both the underlying claim of fiduciary breach and the aiding and abetting claim.<sup>98</sup> Shareholders will face the well-known impediments to pursuing derivative claims.<sup>99</sup> Moreover, fiduciary breach is significantly less likely for buy-side directors than for sell-side directors. Unlike target boards that may face the standard of review known as enhanced scrutiny, boards on the buy-side have yet to face exacting review under this standard and instead face review under the deferential business-judgment standard.<sup>100</sup> This differential treatment may warrant reassessment,<sup>101</sup> but for now it produces a regime that largely protects buy-side directors from liability for fiduciary breach, creating "extremely limited opportunit[ies] . . . to pursue fiduciary litigation in connection with acquisition transactions."<sup>102</sup> In turn, imposing aiding and abetting liability on buy-side M&A advisors based on fiduciary breaches by buy-side directors is unlikely. In contrast, because target directors face significantly greater risk of liability for fiduciary breach, target shareholders may more plausibly allege aiding and abetting against their M&A advisors, although these will be direct claims, rather than derivative claims, and are considered below.<sup>103</sup>

### B. Direct Claims—Primary Liability

Direct claims allege an injury to shareholders rather than to the company. Shareholders bringing a direct action against an M&A advisor alleging *primary* liability under either New York or Delaware law are unlikely to succeed. Such an action would take the form of shareholders claiming that their company's M&A advisor injured shareholders directly.

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<sup>97</sup>See *El Paso Pipeline GP Co., LLC v. Brinckerhoff*, 152 A.3d 1248, 1260-61 (Del. 2016) ("[C]laims of corporate overpayment are normally treated as causing harm solely to the corporation and, thus, are regarded as derivative."); see also *Gentile v. Rossette*, 906 A.2d 91, 99-100 (Del. 2006) (finding the same, but noting an exception for transactions with controlling shareholders).

<sup>98</sup>As an example of such a derivative action, see *Tilden v. Cunningham*, C.A. 2017-0837-JRS, 2018 WL 5307706 (Del. Ch. Oct. 26, 2018).

<sup>99</sup>See *supra* note 95 and accompanying text.

<sup>100</sup>See Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Overpayment Problem*, 96 MINN. L. REV. 1018, 1052-56 (2012).

<sup>101</sup>See Afra Afsharipour & J. Travis Laster, *Enhanced Scrutiny on the Buy-Side*, 53 GA. L. REV. 443, 472 (2019).

<sup>102</sup>Afsharipour, *supra* note 100, at 1056. See also Lawrence A. Hamermesh, *Premiums in Stock-for-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties*, 152 U. PA. L. REV. 881, 909 (2003).

<sup>103</sup>See *infra* Part V.

The claim would not derive from the company's rights against the advisor as in a derivative action.

M&A advisors tend not to have direct relationships with shareholders that may provide a basis for primary liability. M&A advisors' contractual duties run to their clients. M&A advisors are unlikely to owe a duty of care to the shareholders of their clients, except in exceptional circumstances.<sup>104</sup> Nor will M&A advisors owe fiduciary duties to their clients' shareholders.<sup>105</sup> An unusual fact pattern arose in *Baker v. Goldman Sachs & Co.*, in which the U.S. District Court of Massachusetts, applying New York law, found facts sufficient to support the existence of a fiduciary relationship between an M&A advisor and a controlling shareholder that also served as a board member.<sup>106</sup> However, the engagement letter was drafted widely enough to allow that construction, and shareholders "were the central players in the transaction, not mere bystanders as in the typical shareholder case."<sup>107</sup> Moreover, shareholders are unlikely to be third-party beneficiaries under M&A engagement letters because engagement letters suggest no intent by the parties to benefit or protect shareholders.<sup>108</sup>

Engagement letters help to ensure that advisors avoid direct primary liability to their clients' shareholders. One template provides that "[a] financial advisor is engaged solely to provide financial advice to its client company and/or its board of directors (or a special committee thereof) and not to provide advice to any other person."<sup>109</sup> Another template provides that "[a]ll advice provided is intended solely for the use and benefit of the

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<sup>104</sup>See *Stuchen v. Duty Free Intern., Inc.*, No. CIV.A. 94C-12-194, 1996 WL 33167249, at \*10-12 (Del. Super. Ct. Apr. 4, 1996).

<sup>105</sup>See *Joyce v. Morgan Stanley & Co.*, 538 F.3d 797, 801-02 (7th Cir. 2008) (rejecting a claim that an M&A advisor owed a fiduciary duty to shareholders of its corporate client where the engagement letter stated that the M&A advisor was working only for the client); see also *In re Shoe-Town, Inc. Stockholders Litig.*, C.A. No. 9483, 1990 WL 13475, at \*6-7 (Del. Ch. Feb. 12, 1990) (reprinted in 16 DEL. J. CORP. L. 440) (finding that an M&A advisor engaged by management to provide a fairness opinion for the challenged transaction owed no fiduciary duty to shareholders); see also *Young v. Goldman Sachs & Co.*, No. 08 CH 28542, 2009 WL 247626, at \*8 (Ill. Cir. Ct. Jan. 13, 2009) (finding that an M&A advisor owed no fiduciary duties to the shareholders of its corporate client).

<sup>106</sup>*Baker v. Goldman Sachs & Co.*, 656 F. Supp.2d 226, 236-37 (D. Mass. 2009).

<sup>107</sup>*Id.* at 237.

<sup>108</sup>See *Stuchen*, 1996 WL 33167249, at \*8-10 (Del. Super. Ct. 1996). But see *Baker*, 656 F. Supp.2d at 234-35 (applying New York law to deny a motion to dismiss a claim that a shareholder, in her capacity as a member of the board of directors, was a third-party beneficiary under an engagement letter between an M&A advisor and its client).

<sup>109</sup>See Kevin Miller, *The Obligations of Financial Advisors – New Decision Upholds Contractual and Other Limitations*, *Deal Lawyers* 10 (Apr. 2008).

[Committee of the] Board of the Company and may not be relied upon by any other person or used for any other purpose.<sup>110</sup>

The presumption that M&A advisors' primary obligations run to the client rather than to its shareholders—and therefore that obligations run to shareholders only in rare cases—is sensible. M&A advisors deal in fact with their corporate client and its authorized representatives rather than with the client's shareholders, which are often widely dispersed and not authorized to act on the corporation's behalf. In most public companies, shareholders owed fiduciary duties would lack any real-time mechanism for giving consent to advisor conflicts—another reason that putting shareholders in a fiduciary relationship with M&A advisors would make little sense.

#### IV. ACTIONS BROUGHT BY ANOTHER M&A PRINCIPAL (OTHER THAN THE CLIENT)

An M&A principal may sue the M&A advisor of another deal participant, although these suits are rare. Deal participants will rarely succeed against another actor's M&A advisor since the M&A advisor's duties of care or loyalty typically run to its own client. The relationship between an M&A advisor and another deal participant is often adversarial, since deal participants usually operate at arm's length, having opposing interests from one another. For example, in *Walton v. Morgan Stanley & Co. Inc.* an M&A advisor owed (unspecified) duties to its own client, but no fiduciary duty to Olinkraft, the corporation its client had sought to buy, even though Olinkraft had revealed confidential information to that M&A advisor to facilitate a deal with the M&A advisor's client.<sup>111</sup> Allegedly, the M&A advisor not only traded on that information for its own profit, but also disclosed it to another client to induce that client to buy Olinkraft, which it did, increasing the value of the stock the M&A advisor had bought in Olinkraft.<sup>112</sup> By majority, the Second Circuit concluded that the M&A advisor dealt at arm's length with Olinkraft and that its receipt of Olinkraft's confidential information did not make it Olinkraft's fiduciary or otherwise create liability.<sup>113</sup>

M&A advisors face potential liability for misrepresentations and related claims, although proof may be difficult. For instance, in a high-profile private-equity deal for the sale of a record label, the buyer alleged

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<sup>110</sup>Kotran & Miller, *supra* note 68, at 13.

<sup>111</sup>*Walton v. Morgan Stanley*, 623 F.2d 796, 799 (2d Cir. 1980).

<sup>112</sup>*Id.*

<sup>113</sup>*Id.*

fraudulent misrepresentation, negligent misrepresentation, fraudulent concealment, and tortious interference against the seller's M&A advisor.<sup>114</sup> Ultimately, the claims resulted in no liability.<sup>115</sup>

#### V. ACTIONS BROUGHT BY SHAREHOLDERS BASED ON AIDING AND ABETTING LIABILITY

In recent years, target shareholders bringing claims against M&A advisors have tended to pursue claims of secondary liability, whereby liability is imposed on "parties who, although not the primary authors or beneficiaries of misconduct,"<sup>116</sup> are related in some way to the parties who are, such as because they have participated in the misconduct or even failed to prevent it.<sup>117</sup> The form of secondary liability claimed is aiding and abetting, an intentional tort. (As discussed in Part III, buy-side shareholders are unlikely to bring aiding and abetting claims against buy-side M&A advisors and any such claims would generally need to be brought derivatively). For Delaware corporations, aiding and abetting actions are likely to be governed by Delaware law because of Delaware's interest in the internal affairs of its corporations.<sup>118</sup>

Where the alleged primary wrongdoing is fiduciary breach, aiding and abetting requires the existence of a fiduciary relationship, a breach of the fiduciary's duty, knowing participation in that breach by the defendant, and damages proximately caused by the breach.<sup>119</sup> This cause of action holds promise for shareholders because it sidesteps many of the obstacles faced by other actions. An action by shareholders, it avoids client reluctance to sue and the effect of liability-limiting provisions in engagement letters. A direct action, it avoids the requirement for continuous share ownership for derivative actions. An action based on *secondary liability*, it overcomes the problem (from shareholders' perspective) that M&A advisor duties rarely run directly to shareholders.

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<sup>114</sup>For further discussion, see *Terra Firma Invs. (GP) 2 Ltd. v. Citigroup Inc.*, 716 F.3d 296, 301 (2d Cir. 2013).

<sup>115</sup>*Id.*

<sup>116</sup>Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 53 (1986).

<sup>117</sup>See *id.*; see also Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 80, n.4 (1981).

<sup>118</sup>See, e.g., *Shandler v. DLJ Merchant Banking, Inc.*, 2010 WL 2929654 at \*17, n.149 (Del. Ch. Jul. 26, 2010) (*reprinted in* 36 DEL. J. CORP. L. 725) ("When a claim against a third-party is that it was knowingly complicitous in a breach of fiduciary duty against a Delaware entity, Delaware's interest is paramount.").

<sup>119</sup> *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001).



An aiding and abetting claim was at the center of *Rural Metro/ RBC Capital*,<sup>120</sup> the leading Delaware authority for M&A advisor liability. In this case, shareholders claimed that an M&A advisor to target company Rural/Metro had aided and abetted a fiduciary breach by the company's directors. As to fiduciary breach, the Supreme Court found that the M&A advisor RBC had undermined the reliability and competitiveness of the sale process, resulting in a faulty sale process. Directors had not effectively overseen the process, failing *Revlon* scrutiny.

The M&A advisor undermined Rural/Metro's sale process in several ways. First, it timed and structured the process to coincide with the sale of a competing business with the aim of gaining additional work for itself from bidders participating in that sale. This strategy in fact impeded higher-priced bids being made for its client, Rural/Metro, because confidentiality and other concerns made it infeasible for those bidders to participate in both planned sales.<sup>121</sup> Second, the M&A advisor repeatedly pitched its funding services to Rural/Metro's eventual buyer, Warburg, without disclosing these activities to Rural/Metro.<sup>122</sup> The advisor continued lobbying Warburg even as it began negotiating with Warburg on Rural/Metro's behalf regarding the final deal terms.<sup>123</sup> Such conduct cast doubt on the force with which the advisor advanced Rural/Metro's position in negotiations, since it was also trying to curry favor with Warburg. Even though the advisor's efforts failed to yield work from Warburg, the court observed that the advisor had favored its own interests over those of Rural/Metro.<sup>124</sup> Third, the M&A advisor divulged non-public information to Warburg and manipulated the valuation metrics it provided Rural/Metro, aiming to increase the likelihood of a deal with Warburg—again without having informed its client, Rural/Metro.<sup>125</sup>

Multiple advisor conflicts therefore impaired the sale process. Unaware of them, directors took no steps to mitigate them.<sup>126</sup> Even the presence of a second M&A advisor retained by Rural/Metro failed to bring directors' conduct within a range of reasonableness because the board had treated the second advisor's role as secondary to RBC's role and skewed that advisor's incentives by agreeing to compensate it on a contingent basis.<sup>127</sup>

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<sup>120</sup> *RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 861 (Del. 2015).

<sup>121</sup> *Id.* at 854-56.

<sup>122</sup> *Id.* at 839.

<sup>123</sup> *Id.*

<sup>124</sup> *RBC Capital Markets*, 129 A.3d at 838.

<sup>125</sup> *Id.* at 845.

<sup>126</sup> *Id.* at 855.

<sup>127</sup> *Id.* at 857.

As to board conduct that would have survived *Revlon* scrutiny, the Supreme Court explained:<sup>128</sup>

[D]irectors need to be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest. But, at the same time, a board is not required to perform searching and ongoing due diligence on its retained advisors in order to ensure that the advisors are not acting in contravention of the company's interests, thereby undermining the very process for which they have been retained. . . . Because the conflicted advisor may, alone, possess information relating to a conflict, the board should require disclosure of, on an ongoing basis, material information that might impact the board's process.<sup>129</sup>

The first two elements for aiding and abetting liability—a fiduciary relationship and a breach of the fiduciary's duty—were satisfied. The fact that directors had already settled with the M&A advisor—and would have enjoyed immunity under a standard charter exculpation provision had they not—did not prevent this finding. The third element—knowing participation—"requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach."<sup>130</sup> The Supreme Court explained, "[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 the informational vacuum, then the third party can be liable for aiding and abetting liability."<sup>131</sup> The court referred to this statement as a "narrow holding" and found that the M&A advisor had acted with the necessary degree of scienter.<sup>132</sup> With the final element for aiding and abetting liability—damages proximately caused by the breach—also satisfied, the court affirmed a damages award against the M&A advisor for \$76 million.<sup>133</sup>

Despite avoiding many of the obstacles facing other causes of actions against M&A advisors, aiding and abetting is a limited cause of action. First, the requirement for a predicate breach of fiduciary duty narrows the range of conduct within the reach of aiding and abetting liability. This is so even though the predicate breach need not in fact give

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<sup>128</sup> *RBC Capital Markets*, 129 A.3d at 855-56 (footnotes omitted).

<sup>129</sup>*Id.*

<sup>130</sup>*Id.* at 861-61.

<sup>131</sup>*Id.* at 862 (citing language from the Court of Chancery).

<sup>132</sup>*RBC Capital Markets*, 129 A.3d at 862.

<sup>133</sup>*Id.* at 823.

rise to personal liability; recall that Rural/Metro's directors were protected from personal liability by a charter exculpation provision. Nevertheless, in the absence of a predicate breach, "[a]s a matter of law and logic, there cannot be secondary liability for aiding and abetting an alleged harm."<sup>134</sup> Accordingly, aiding and abetting liability is tied to directorial conduct and is defeated if directors have satisfied their duties.<sup>135</sup> In the M&A setting, buy-side directors are unlikely to commit fiduciary breach because they will generally be reviewed under the business judgment standard.<sup>136</sup> Directors on the sell-side may face enhanced scrutiny—a standard of review more likely to result in fiduciary breach—but recent case law offers potential relief to these directors. Under *Corwin v. KKR Fin. Holdings LLC*, in post-closing suits for monetary damages involving third-party mergers, directors' conduct will be reviewed under the business-judgment standard if the transaction was approved by a fully informed, uncoerced vote of shareholders.<sup>137</sup> Testing directors' conduct under the more deferential business judgment rule diminishes the prospect of primary liability for directors, typically resulting in dismissal of a claim for fiduciary breach.<sup>138</sup> Aiding and abetting liability is correspondingly less likely, since it will not arise in the absence of a primary violation, no matter how culpable an M&A advisor's conduct.<sup>139</sup> Even an M&A advisor that concealed material information from target directors would avoid liability for aiding and abetting if those directors nevertheless satisfied their fiduciary duties. A culpable M&A advisor may therefore lie beyond the reach of liability.

The second significant limitation of aiding and abetting liability is the requirement for scienter. The Delaware Supreme Court in *Rural Metro/RBC Capital* referred to the aiding and abetting claim as "among the most difficult to prove" because of this knowledge requirement.<sup>140</sup>

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<sup>134</sup>In re Alloy, Inc., No. 5626-VCP, 2011 WL 4863716, at \*14 (Del. Ch. Oct. 13, 2011).

<sup>135</sup>Tuch, *Banker Loyalty*, *supra* note 15, at 1146.

<sup>136</sup>See Afsharipour, *supra* note 100, at 1053-54. Moreover, buy-side claims are likely to be brought derivatively, as to which see Part II.

<sup>137</sup>Corwin v. KKR Financial Holdings LLC, 125 A.3d 304, 309 (Del. 2015).

<sup>138</sup>Singh v. Attenborough, 137 A.3d 141, 151-52 (Del. 2016); *see also* Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161, 167 (2019) (applying the business-judgment rule "is outcome-determinative for a fiduciary duty lawsuit against the target board of directors in an M&A transaction") (citing *Morrison v. Berry*, 191 A.3d 268, 273-74 (Del. 2018)).

<sup>139</sup>City of Miami General Employees v. Comstock, 2016 WL 4464156, at \*23 (Del. Ch. Aug. 24, 2016); *aff'd on other grounds*, 158 A.3d 885 (Del. 2017) ("A claim for aiding and abetting a breach of fiduciary duty cannot survive if the underlying fiduciary duty claims do not.").

<sup>140</sup>RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 866 (Del. 2015); *see also* Lyman Johnson, *The Reconfiguring of Revlon*, in RESEARCH HANDBOOK ON MERGERS AND

Recently, in *Singh v. Attenborough*, the Delaware Supreme Court stressed that the requirement for knowing participation in aiding and abetting liability gives M&A advisors "a high degree of insulation from liability."<sup>141</sup> An M&A advisor had been late in disclosing a potential conflict of interest to its client but the court was "skeptical that [this] supposed instance of knowing wrongdoing ... produced a rational basis to infer scienter."<sup>142</sup> Knowing participation requires that the M&A advisor give "substantial assistance" to the primary violators; the inquiry is necessarily fact-intensive.<sup>143</sup>

Still, an extreme set of facts may amount to aiding and abetting by an M&A advisor, or at least survive a motion to dismiss, as in *Morrison v. Berry*.<sup>144</sup> In litigation over the buyout by private equity firm Apollo of grocery chain Fresh Market, Vice Chancellor Glasscock considered claims of aiding and abetting breaches of fiduciary duty. In an earlier decision, the Chancery Court had dismissed shareholder claims against Fresh Market's board for failure to state a non-exculpated claim for fiduciary breach.<sup>145</sup> In its decision considering aiding and abetting, however, the court found, relevantly, that a shareholder had adequately pleaded that the target board failed to satisfy its *Revlon* duties.<sup>146</sup> (Fresh Market shareholders had approved Apollo's tender offer, but the proxy was misleading, with the result that *Corwin v. KKR* offered no protection to the target's board.) JP Morgan, Fresh Market's M&A advisor, had provided a conflict disclosure memorandum to the board without fully disclosing its communications with Apollo, including communications by a JP Morgan representative responsible for managing the bank's relationship with Apollo.<sup>147</sup> At the time the bank provided its memorandum, Apollo was the only bidder for Fresh Market.<sup>148</sup> The relationship banker allegedly acted as an informational intermediary between Apollo and the bank's senior advisor to Fresh Market, disclosing confidential information to Apollo to

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ACQUISITIONS (forthcoming) (manuscript at 18-19) (U. of St. Thomas Legal Studies Research Paper No. 20-22) (describing aiding and abetting liability for M&A advisors as "rare" because of the requirement for "knowing participation").

<sup>141</sup>*Singh v. Attenborough*, 137 A.3d 151, 152 (Del. 2016).

<sup>142</sup>*Id.*

<sup>143</sup>*In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at \*41-42 (Del. Ch. Aug. 27, 2015).

<sup>144</sup>*Morrison v. Berry*, No. CV 12808-VCG, 2020 WL 2843514, at \*1 (Del. Ch. June 1, 2020).

<sup>145</sup>*Morrison v. Berry*, No. CV 12808-VCG, 2019 WL 7369431, at \*15 (Del. Ch. Dec. 31, 2019).

<sup>146</sup>*Morrison*, 2020 WL 2843514, at \*10.

<sup>147</sup>*Id.* at \*9.

<sup>148</sup>*Id.* at \*5.

give it "an edge in the bid process."<sup>149</sup> The court accepted the inference that "the Board's failure to comprehend its financial advisor's conflict of interest with the sole bidder conceivably breached duties imposed in the *Revlon* context."<sup>150</sup> The Board had received the disclosure memorandum but "did not probe further to ask whether any of the Apollo coverage team were acting as go-between for Apollo and the [M&A advisor's] Fresh Market deal team."<sup>151</sup> As to the requirement of knowing participation, the M&A advisor had "intentionally disguised its communications with Apollo and thus knowingly deceived the Board about its ongoing conflicts."<sup>152</sup> The court denied JP Morgan's motion to dismiss, finding it conceivable that the advisor had aided and abetted the target board's breach of *Revlon* duties. It also found it conceivable that the M&A advisor had aided and abetted directors' breaches of their disclosure obligations.<sup>153</sup>

Problematic advisor conduct was also alleged to have occurred in *Chester County Employees' Retirement Fund v. KCG Holdings, Inc.*, leading the Chancery Court to deny the M&A advisor's motion to dismiss an aiding and abetting claim.<sup>154</sup> The allegations supported an inference that KCG's board committed fiduciary breach by failing to use a reasonable process to manage its M&A advisor's influence.<sup>155</sup> Jefferies was KCG's long-time M&A advisor and largest shareholder. Around the time it was advising KCG on a restructuring plan,<sup>156</sup> Jefferies was engineering a sale of the company by negotiating with Virtu, the high-frequency-trading firm.<sup>157</sup> A longtime Jefferies' investment banker participated in discussions with Virtu, even disclosing confidential information he had acquired from KCG.<sup>158</sup> Jefferies disclosed some of these dealings to KCG, but when KCG's board asked for full disclosure, Jefferies disclosed what the court described as a "sanitized" record,<sup>159</sup> allegedly omitting details such as

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<sup>149</sup>*Id.* at \*9.

<sup>150</sup>*Morrison*, 2020 WL 2843514, at \*10.

<sup>151</sup>*Id.* at \*9.

<sup>152</sup>*Id.* at \*10.

<sup>153</sup>*Id.*

<sup>154</sup>*Chester Cty. Emps.' Ret. Fund v. KCG Holdings, Inc.*, No. 2017-0421-KSJM, 2019 WL 2564093 (Del. Ch. June 21, 2019).

<sup>155</sup>*Id.* at \*18.

<sup>156</sup>Although Jefferies is described as KCG's long-time advisor, it is not clear whether KCG had engaged Jefferies at the time of Jefferies' discussions with Virtu. After Virtu's bid, KCG's CEO "did not know the full extent of Jefferies' discussions with Virtu and he engaged Jefferies, and specifically [Jefferies' banker] Yavorsky, to help formulate the Restructuring Plan." *Id.* at \*5. But whether Jefferies was engaged by KDG on another matter at the time of the Virtu discussions is uncertain.

<sup>157</sup>*Id.* at \*1-4.

<sup>158</sup>*Chester Cty. Emps.' Ret. Fund*, 2019 WL 2564093 at \*4.

<sup>159</sup>*Id.* at \*19.

Jefferies' assistance to Virtu in drafting its initial bid letter and Jefferies' disclosure of KCG's confidential information.<sup>160</sup> The court regarded the facts as "sufficiently analogous to those at issue [in] *RBC* and give rise to an inference of knowing participation at the pleadings stage."<sup>161</sup>

An M&A advisor was also alleged to have engaged in highly culpable conduct in *In Re Tibco Software Inc. Stockholders Litigation*, another rare case in which the Chancery Court denied the advisor's motion to dismiss an aiding and abetting claim.<sup>162</sup> After signing its merger agreement, the target board was informed by its advisors that, due to an error in counting the company's shares (but not the per share merger price), the total merger price would be \$100 million less than the board had understood. The board met to consider its options but allegedly failed to ask its M&A advisor about the cause of the error, the M&A advisor's role in making it, the advisor's discussions with the buyer about the error, and whether the buyer should nevertheless pay any or all of the full stated amount.<sup>163</sup> As the board deliberated, the M&A advisor knew but failed to disclose "a critical piece of information"—that the buyer had admitted to the M&A advisor "that it had, in fact, relied on the erroneous share count in making its...[per share] offer."<sup>164</sup> "The Board did not learn that [the buyer] had relied on the erroneous share count, and that Goldman knew that [the buyer] had relied on the erroneous share count, until this litigation was relatively advanced."<sup>165</sup> In failing to adequately investigate the circumstances of the error or its options for recovery, the board conceivably breached its duty of care (a predicate breach, even though the directors were exculpated from liability).<sup>166</sup> The M&A advisor's alleged failure to disclose a vital piece of information "created an informational vacuum at a critical juncture when the Board was still assessing its options" against the buyer and M&A advisor.<sup>167</sup> Other allegations, including the contingent structure of the advisor's compensation and its desire to curry favor with the buyer, were sufficient to allow the court to infer that the advisor's conduct was knowing and intentional.<sup>168</sup>

As these cases illustrate, aiding and abetting actions face significant hurdles, and successful fact patterns show high culpability by an M&A

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<sup>160</sup>*Id.* at \*6.

<sup>161</sup>*Id.* at \*19.

<sup>162</sup>*In re TIBCO Software Inc. S'holders Litig.*, No. 10319-CB, 2015 WL 6155894 (Del. Ch. Oct. 20, 2015).

<sup>163</sup>*Id.* at \*10.

<sup>164</sup>*Id.* at \*2.

<sup>165</sup>*Id.* at \*11.

<sup>166</sup>*In re TIBCO Software Inc.*, 2015 WL 6155894 at \*22-24.

<sup>167</sup>*Id.* at \*25.

<sup>168</sup>*Id.* at \*25-26.

advisor. In particular, the requirement for knowing participation in a predicate breach has required the advisor to know that the board is breaching its duties and to "participate[] in the breach by misleading the board or creating the informational vacuum."<sup>169</sup> It is not enough if the advisor knows that the board is breaching its duties; the advisor must participate in the breach, giving substantial assistance to the primary violators. In *Morrison v. Berry*, the Chancery Court characterized *Rural Metro/RBC Capital* as finding that liability attached "if the advisor, with the requisite scienter, caused the board to act in a way that [breached its *Revlon* duties]."<sup>170</sup> Similarly, according to the Chancery Court, aiding and abetting liability can arise "where a conflicted advisor has prevented the board from conducting a reasonable sales process, in violation of [*Revlon* duties]."<sup>171</sup> These formulations emphasize the extent of participation that M&A advisors will usually need to give to satisfy the requirement for knowing participation. It is insufficient that the advisor simply take part in underlying breach, even knowingly; the cases suggest that the board's breach will arise from, if not be caused by, the M&A advisor's conduct.<sup>172</sup> The most obvious example of such participation occurs when a board's breach arises from the board's own information deficit, a deficit that results from the advisor's intentional failure to fully disclose its dealings to the board.

Another obstacle is the requirement for predicate breach, such as a board failing to satisfy its *Revlon* duties or breaching its disclosure obligations. In *Morrison v. Berry*, the Chancery Court observed that because of the difficulty of satisfying this element, a "faithless advisor" may escape liability; there is a risk of "a wrong without a remedy."<sup>173</sup> The court suggested in obiter that this element may be satisfied in the absence of board culpability: "where a conflicted advisor has prevented the board from conducting a reasonable sales process, in violation of [*Revlon* duties], the advisor can be liable for aiding and abetting that breach without reference to the culpability of the individual directors."<sup>174</sup> However, this suggestion is difficult to reconcile with courts' analysis which has established predicate breach by reference to a board's own failings. For

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<sup>169</sup>*RBC Capital Markets*, 129 A.3d at 861.

<sup>170</sup>*Morrison*, 2020 WL 2843514, at \*9 (emphasis added).

<sup>171</sup>*Id.* (emphasis added).

<sup>172</sup>*Cf. In re TIBCO Software Inc.*, 2015 WL 6155894, at \*24 ("The requirement for participation can be established if the alleged aider and abettor 'participated in the board's decisions, conspired with [the] board, or otherwise caused the board to make the decisions at issue.'") (citing *Malpiede v. Townson*, 780 A.2d 1075, 1098 (Del. 2001)).

<sup>173</sup>*Morrison*, 2020 WL 2843514, at \*8; see also Joel Edan Friedlander, *Confronting the Problem of Fraud on the Board*, 75 BUS. LAW. 1441, 1445 (2019).

<sup>174</sup>*Id.* at \*9.

example, in *Morrison v. Berry*, Fresh Market's board had received the M&A advisor's disclosure memorandum but "did not probe further to ask whether any of the Apollo coverage team were acting as go-between for Apollo and the [M&A advisor's] Fresh Market deal team."<sup>175</sup> In *Rural Metro/RBC Capital*, the target board took no steps to address or mitigate the advisor's conflicts and was not sufficiently active and informed in overseeing the sale process.<sup>176</sup> In *In re Tibco*, the board had allegedly failed to ask its M&A advisor basic questions about the share-count error, including how it how occurred, the advisor's role in making it, and the remedial options available.<sup>177</sup> Aiding and abetting liability therefore requires not only M&A advisor misconduct, such as deceiving the board, but also board fiduciary breach, based on the board's own failings.

In addition, an aiding and abetting action practically requires the board to misinform shareholders in proxy materials. Without this, the board would benefit from the protections offered by *Corwin*. However, this practical requirement would usually be met when an M&A advisor withheld material information from or otherwise misled the board because the company would then lack the information required to fully inform shareholders.

Importantly, in its discussion of aiding and abetting liability, the Supreme Court in *Rural Metro/RBC Capital* appeared to acknowledge the need for greater guidance on M&A advisor liability more generally. It sought, albeit in sometimes-confusing terms, to articulate obligations on M&A advisors and otherwise limit their pursuit of self-interest. The Supreme Court failed to clearly identify the source for these limits, but its statements suggest a basis for finding M&A advisors liable even in the absence of aiding and abetting and may strengthen direct claims by clients against M&A advisors.

That the court exposed M&A advisors to additional potential liability may not be obvious at first. In one sense, the court seemed to eliminate a possible source of liability, when it disavowed the Court of Chancery's description of M&A advisors as "gatekeepers." Controversially, the Chancery Court had described M&A advisors using this term, which is used both loosely to describe market participants with public-regarding functions and specifically in scholarly literature to

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<sup>175</sup>*Morrison*, 2020 WL 2843514, at \*9.

<sup>176</sup>*RBC Capital Markets*, 129 A.3d at 865-66.

<sup>177</sup>*In re TIBCO Software Inc.*, 2015 WL 6155894, at \* 10.



describe market participants with duties to deter wrongdoing by other actors.<sup>178</sup>

The Delaware Supreme Court seemed to further ward off liability when it described M&A advisors in terms suggesting they are arm's-length counterparties whose obligations are determined by parties' agreements. In footnote 191, the court explained:

"[T]he 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. Rational 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 engagement letter typically defines the parameters of a financial advisor's relationship and responsibilities with its client."<sup>179</sup>

Taking comfort in these sentences, commentators have claimed that "contractual arrangements between companies and their M&A advisors will generally be respected [by courts]."<sup>180</sup> But the same footnote continues in strikingly different terms:

Here, the Engagement Letter expressly permitted [the M&A advisor] to explore staple financing. But, this permissive language was general in nature and disclosed none of the conflicts that ultimately emerged. As became evident in the instant matter, the conflicted banker has an informational advantage when it comes to knowledge of its real or potential conflicts. See William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 *Tex. L. Rev.* 1, 36 (2014). ("The basic requirements of disclosure and consent make eminent sense in the bank-client context. The conflicted banker has an informational advantage. Contracting between the bank and

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<sup>178</sup>See JOHN C. COFFEE, JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* 2 (2006); Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 *YALE L.J.* 857, 890 (1984); Andrew F. Tuch, *Multiple Gatekeepers*, 96 *V.A. L. REV.* 1583, 1589-96 (2010).

<sup>179</sup>*RBC Capital Mkts. v. Jervis*, 129 A.3d 816, 865-66 n.191 (Del. 2015).

<sup>180</sup>See Memorandum from Wachtell, Lipton, Rosen & Katz, *The Delaware Supreme Court Speaks to Boards and the Investment Banks*, Dev. 3, 2015.

the client respecting the bank's conflict cannot be expected to succeed until the informational asymmetry has been ameliorated. Disclosure evens the field: the client board has choices in the matter... and needs to make a considered decision regarding the seriousness of the conflict."). 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 deliberative 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.<sup>181</sup>

This additional language qualifies the court's description of the advisor-client relationship as "primarily contractual," suggesting that non-contractual terms may also govern the parties' relationship. First, it faults the M&A advisor for not more fully disclosing conflicts of interest in its engagement letter—as if in the absence of detailed disclosure and consent those conflicts would be impermissible. Second, the advisor is obliged "not to act in a manner that is contrary to the interests of the board of directors."<sup>182</sup> The court thus suggests extra-contractual limits on M&A advisors' ability to pursue its self-interest. Other parts of the opinion also make much of the possibility that directors might "consent" to an M&A advisor's "conflicts."<sup>183</sup> The court fails to explain the source of these apparent extra-contractual constraints on advisor conflicts, although on the issues of disclosure and consent the court does cite a passage by William Bratton and Michael Wachter that discusses agency law principles.<sup>184</sup>

It is unclear what analytical template the court applies to M&A advisors. The court sends mixed messages. It refers to their role as "primarily contractual" and yet also imposes on them an obligation "not to

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<sup>181</sup>*RBC Capital Mkts.*, 129 A.3d at 865, n.191.

<sup>182</sup>*Id.*

<sup>183</sup>In articulating directors' duties under the *Revlon* standard, the court says that directors "may be free to consent to *certain* conflicts." *Id.* at 855 (emphasis added). The Court requires directors to continue overseeing M&A advisors even when directors have given consent. *See id.* at 855 n.129 ("A board's reasonable reliance on an advisor presupposes that it has undertaken to manage conflicts as part of its oversight of the process. 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.").

<sup>184</sup>*RBC Capital Mkts.*, 129 A.3d at 865-66 n.191. *See* Bratton & Wachter, *supra* note 15, at 36.

act in a manner that is contrary to the interests of the board of directors."<sup>185</sup> The court suggests that M&A advisors need informed consent from their clients for conflicts and yet observes, "[a] board's consent to a conflict does not give the advisor a 'free pass' to act in its own self-interest and to the detriment of its client."<sup>186</sup> The court even suggests—as do later decisions<sup>187</sup>—that directors may not consent to some M&A advisor conflicts,<sup>188</sup> although these limits may be imposed on directors by their fiduciary duties rather than be direct limits on advisors.<sup>189</sup>

At a minimum, the court's statements and analytical approach conceive of M&A advisors as loyal advisors. They suggest that advisors face extra-contractual limits on conflicts of interest, limits that are consistent with—and to the extent they cannot be waived by informed client consent, stricter than—those imposed under fiduciary law.

## VI. COMPLETENESS OF LIABILITY REGIME AND SUGGESTED REFORMS

Having considered the significant obstacles to M&A advisor liability in private enforcement actions, this Part considers the completeness of the liability regime.

### A. Private Enforcement

The liability regime for M&A advisors creates obstacles to clients and especially their shareholders in attempting to hold M&A advisors liable for wrongdoing. Client corporations may claim against M&A advisors. Although clients' rights and remedies are typically limited by the parties' engagement letters, clauses purporting to disclaim fiduciary and agency relationships may be insufficient to have fiduciary claims dismissed. Other claims may also be brought.<sup>190</sup> Whatever legal claims may be available, buyers succeed to the rights of targets, making suits

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<sup>185</sup>*RBC Capital Mkts.*, 129 A.3d at 865-66, n.191.

<sup>186</sup>*Id.* at 855.

<sup>187</sup>In re PLX Tech. Inc. Transcript Ruling, C.A. 9880-VCL (Del. Ch. Sept. 3, 2015), slip op. at 36-37 ("[A]ll conflicts are not equal . . . Major problems . . . may be so pervasively impairing that the directors could not reasonably consent."); see *supra* note 131 and accompanying text; see also In re Zale Corp. S'holder Litig., C.A. 9388-VCP, slip. op. at 52 (Del. Ch. Oct. 1, 2015) ("[S]ome of a board's financial advisor's conflicts arguably cannot be consented to in the proper discharge of a director's fiduciary duties.").

<sup>188</sup>*RBC Capital Mkts.*, 129 A.3d at 865 (stating that directors "may be free to consent to certain [M&A advisor] conflicts").

<sup>189</sup>For further discussion, see *supra* notes 90-94 and accompanying text.

<sup>190</sup>See *supra* Part II.

against sell-side M&A advisors extremely rare.<sup>191</sup> Even suits by clients against buy-side advisors are rare because of board reluctance to sue, and those few suits that are brought tend to occur only for clients whose deals have left them bankrupt.<sup>192</sup>

Shareholders are significantly more willing to claim against M&A advisors but have even weaker prospects.<sup>193</sup> In derivative claims, target shareholders will lose standing under the requirement for continuous share ownership. In direct claims based on primary liability, shareholders have succeeded on rare occasion but have limited prospects today since both the common law and terms in engagement letters virtually assure that an advisor's duties will run to the client rather than to its shareholders.

Recent cases such as *Rural Metro/RBC Capital* demonstrate that M&A advisors face some risk of liability for direct claims based on secondary liability, but these are circuitous forms of action necessitating predicate breaches committed by directors.<sup>194</sup> Aiding and abetting liability arises not specifically for M&A advisor wrongdoing but for the conceptually distinct conduct of knowingly participating in a primary violation, namely directors' oversight and other failures. Directors on the sell-side will benefit from the business-judgment rule if their transactions are approved by a fully informed, uncoerced vote of shareholders.<sup>195</sup> Directors may also comply with their duties even if an M&A advisor commits wrongdoing, which will defeat the case for aiding and abetting liability. And even if directors' conduct constitutes a predicate breach, they will usually be exculpated from liability by charter provisions for duty of care breaches, which reduces their incentives to monitor and oversee their M&A advisors in the first place. Aiding and abetting is thus a narrow and highly attenuated mechanism for deterring misconduct by M&A advisors.

In short, clients have few avenues for holding M&A advisors liable for wrongdoing and probably will not take the chance even if they have a realistic option to do so; and shareholders usually cannot feasibly hold

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<sup>191</sup>See *supra* note 22 and accompanying text.

<sup>192</sup>See *HA2003 Liquidating Trust v. Credit Suisse Securities (USA) LLC*, No. 04 C 3162, 2006 WL 6047924 at \*17 (N.D. Ill., Sept. 20, 2006), *aff'd*, 517 F.3d 454 (7th Cir. 2008); see *Am. Tissue, Inc. v. Donaldson, Lufkin & Jenrette Securities Corp.*, 351 F. Supp. 2d 79 (S.D.N.Y. 2004); see also *Official Comm. Of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Sec. Corp.*, No. 00 Civ. 8688(WHP), 2002 WL 362794 (S.D.N.Y. Mar. 6, 2002).

<sup>193</sup>See *supra* Part III.

<sup>194</sup>See *supra* Part V.

<sup>195</sup>So too will directors on the buy-side benefit from the business-judgment scrutiny (because enhanced scrutiny will usually not apply), although suits against them for aiding and abetting would be expected to be derivative. See *supra* Part III.A.

M&A advisors liable. There is reason to think that this piecemeal liability regime fails to effectively deter M&A advisor misconduct.<sup>196</sup>

### B. Public Enforcement

M&A advisors may also face liability in public enforcement actions. Major M&A advisors are broker-dealers.<sup>197</sup> They must register with the Financial Industry Regulatory Authority ("FINRA"), the self-regulatory body for broker-dealers, as either member firms or associated persons and are thereby subject to its rules.<sup>198</sup> FINRA enjoys what the SEC regards as "primary responsibility for the regulatory oversight of a broker-dealer's activity."<sup>199</sup> It is functionally equivalent to self-regulatory bodies that govern other professionals, such as lawyers and accountants.

Both generally applicable FINRA rules and FINRA rules specific to investment banking govern M&A advisors' conduct.<sup>200</sup> The general rule, FINRA Rule 2010, requires members and associated persons "in the conduct of ... business, [to] observe high standards of commercial honor and just and equitable principles of trade."<sup>201</sup> This "just and equitable" requirement is FINRA's most commonly-invoked rule.<sup>202</sup> Other FINRA rules, scattered through the FINRA rulebook, govern the use of "manipulative, deceptive or other fraudulent device[s]";<sup>203</sup> the suitability

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<sup>196</sup>For more detailed analysis of why M&A advisors are likely to be under-deterred, see Tuch, *Banker Loyalty*, *supra* note 15, at 1105-11; 1121-23; 1145-51.

<sup>197</sup>This subsection draws on Tuch, *Self-Regulation of Investment Bankers*, *supra* note 13, at 116-22.

<sup>198</sup>*See id.* at 118.

<sup>199</sup>*See* U.S. SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS: AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT A-7 (2011) [hereinafter SEC BROKER-DEALER STUDY].

<sup>200</sup>The generally applicable FINRA rules for broker-dealers relate to qualifications, business conduct, market manipulation, and financial soundness. Firms that engage in a limited range of activities, such as advising on M&A and offerings of securities, may choose to be regulated by FINRA as capital acquisition brokers under a more tailored regulatory regime. *See* FINRA, REGULATORY NOTICE 16-37, SEC APPROVAL CAPITAL ACQUISITION BROKER (CAB) RULES 2 (2017), <https://www.finra.org/rules-guidance/notices/16-37>.

<sup>201</sup>FINRA, RULE 2010: STANDARDS OF COMMERCIAL HONOR AND PRINCIPLES OF TRADE (2008), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2010>. On December 15, 2008, as a result FINRA consolidating its rules following its formation, FINRA Rule 2010 replaced NASD Rule 2110. Although expressed as a member obligation, FINRA Rule 2010 also applies to associated persons; *see also* FINRA, RULE 0140: APPLICABILITY § (a) (2008), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/0140> ("Persons associated with a member shall have the same duties and obligations as a member under the Rules.").

<sup>202</sup>*See, e.g.*, Dep't of Enforcement v. Golonka, No. 009017439601 FINRA Disciplinary Proceeding 1, 8 (FINRA 2012).

<sup>203</sup>*See* FINRA, RULE 2020: USE OF MANIPULATIVE, DECEPTIVE OR OTHER FRAUDULENT DEVICES (2008), <https://www.finra.org/rules-guidance/rulebooks/finra->

of advice provided to customers;<sup>204</sup> "the improper use of... [customers'] securities or funds";<sup>205</sup> the conduct of outside business activities;<sup>206</sup> underwriting terms and arrangements;<sup>207</sup> conflicts of interest in underwriting;<sup>208</sup> restrictions on the purchase and sale of securities in initial public offerings;<sup>209</sup> the provision of fairness opinions in M&A;<sup>210</sup> and compliance with information barriers.<sup>211</sup> These rules govern aspects of investment bankers' conduct.

Except for the guidance on fairness opinions, FINRA's rules are not tailored toward M&A advisors, offering little to guide advisors through the thorny conflicts of interest or other issues they often face. The bulk of FINRA's rules are directed toward traditional broker-dealer activities, such as accepting customer orders to trade securities and apply only incidentally to M&A advising.<sup>212</sup> However, M&A advisors are indeed broker-dealers; they must register with FINRA as members, and their investment banking employees must register with FINRA as associated persons. The catch-all "just and equitable" rule applies broadly, giving FINRA capacity to punish M&A advisors' conduct that falls short of its expectations.<sup>213</sup>

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rules/2020; *see also* FINRA, RULE 2210: COMMUNICATIONS WITH THE PUBLIC §§ (d)(1)(A)-(B) (2010), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210> (essentially banning false or misleading statements in communications with the public).

<sup>204</sup>*See* FINRA, RULE 2111: SUSTAINABILITY §§ (b), .01 (2020), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111>.

<sup>205</sup>*See* FINRA, RULE 2150: IMPROPER USE OF CUSTOMERS' SECURITIES OR FUNDS; PROHIBITION AGAINST GUARANTEES AND SHARING IN ACCOUNTS § (a) (2017), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2150>.

<sup>206</sup>*See* FINRA, RULE 3270: OUTSIDE BUSINESS ACTIVITIES OF REGISTERED PERSONS (2015), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/3270>.

<sup>207</sup>*See* FINRA, RULE 5110: CORPORATE FINANCING RULE-UNDERWRITING TERMS AND ARRANGEMENTS §§ (a)(1)(B), (b)(1) (2020), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5110>.

<sup>208</sup>*See* FINRA, RULE 5121: PUBLIC OFFERINGS OF SECURITIES WITH CONFLICTS OF INTEREST § (f)(12)(A) (2020), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5121>.

<sup>209</sup>*See* FINRA, RULE 5130: RESTRICTIONS ON THE PURCHASE AND SALE OF INITIAL EQUITY PUBLIC OFFERINGS §§ (a)(2), (a)(4)(A)-(C) (2020), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5130>; *see also* FINRA, RULE 6130: TRANSACTIONS RELATED TO INITIAL PUBLIC OFFERINGS § (a) (2011), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/6130>.

<sup>210</sup>*See* FINRA, RULE 5150: FAIRNESS OPINIONS §§ (a)-(b) (2020), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5150>.

<sup>211</sup>*See generally* NAT'L ASS'N SEC. DEALERS, JOINT MEMORANDUM ON CHINESE WALL POLICIES AND PROCEDURES, NOTICE TO MEMBERS NO. 91-45 (1991) (providing FINRA guidance and explaining the "minimum elements" for "adequate" Chinese walls).

<sup>212</sup>For instance, the suitability obligation is almost invariably applied to traditional broker-dealer activities, and scholarly and judicial materials consider it in that context.

<sup>213</sup>*See* FINRA, RULE 2010: STANDARDS OF COMMERCIAL HONOR AND PRINCIPLES OF TRADE (2008), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2010>.

Nevertheless, FINRA seems to focus its enforcement efforts much more on protecting retail investors than on looking out for M&A advisors' clients. Examining the period 2008 to 2013, one study shows that FINRA sanctions remarkably few M&A advisors their conduct toward their M&A clients: no investment banker faced sanction for conduct in advising on a public M&A deal; nor did any firm face sanction for the conduct of its bankers in such a deal.<sup>214</sup>

There is good reason to question whether the SEC is any more vigilant in disciplining M&A advisors. Despite possessing the power to enforce FINRA's rules,<sup>215</sup> the SEC regards FINRA as having "primary responsibility" for regulating broker-dealers' activity.<sup>216</sup> As a self-regulatory organization, FINRA serves as "the first line of defense" in regulating the conduct of market participants.<sup>217</sup> Additionally, FINRA may have direct market knowledge and expertise, giving it greater potential effectiveness in regulating the ethics of broker-dealers than the SEC.<sup>218</sup> FINRA, not the SEC, conducts routine examinations of broker-dealers.<sup>219</sup> Because of these institutional differences, the SEC remains "mainly focused on antifraud enforcement"<sup>220</sup> and rarely becomes involved in enforcing FINRA's "just and equitable" rule,<sup>221</sup> despite having jurisdiction to do so. Ultimately, however, an assessment of the SEC's deterrence force

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<sup>214</sup>See Tuch, *Self-Regulation of Investment Bankers*, *supra* note 13, at 134-45.

<sup>215</sup>See 15 U.S.C. § 78u(d)(1) (2018). The SEC also exercises oversight over FINRA's rulemaking and disciplinary powers. *See id.* § 78s(b)(1). It also supervises FINRA for compliance with federal securities laws and FINRA's own rules. *See id.* § 78(s)(g)(1).

<sup>216</sup>See SEC BROKER-DEALER STUDY, *supra* note 199, at iv ("FINRA has primary responsibility for examining broker-dealers. The [SEC] also examines broker-dealers, . . . but generally does not examine broker-dealers on a routine basis."); *id.* at A-7 ("FINRA . . . has primary responsibility for the regulatory oversight of a broker-dealer's activity.").

<sup>217</sup>See DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 122 (2008) ("Self-regulation in financial markets and services is often characterized as the first line of defense in preserving market integrity and protecting against fraud and abuse.").

<sup>218</sup>See SEC. & EXCH. COMM'N, REPORT PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934 REGARDING THE NASD AND THE NASDAQ MARKET 7 (1996). The SEC regards self-regulators "as having certain advantages over direct government regulation," including the ability "to bring to bear expertise and intimate knowledge of the complexities of the securities industry and thereby . . . to respond quickly to regulatory problems," and the ability to "adopt and enforce compliance with ethical standards beyond those required by law." *Id.*

<sup>219</sup>See *supra* note 216 and accompanying text.

<sup>220</sup>See DEP'T OF THE TREASURY, *supra* note 217, at 122 ("Whereas government regulators are mainly focused on antifraud enforcement, [self-regulatory organizations] can adopt and amend industry rules that address a wider range of activity and professional conduct.").

<sup>221</sup>See JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1028 (6th ed. 2009) (observing that "for the most part, these [FINRA] 'just and equitable' conduct rules] in and of themselves are outside the ambit of direct SEC regulation").

requires detailed study of SEC enforcement activity, which is outside the scope of this article.<sup>222</sup>

### C. Reform Proposals

The M&A liability regime has provoked a range of responses from commentators. Professors Bratton and Wachter examine alternatives to the analytical framework in *Rural Metro/RBC Capital*—most notably, a safe harbor requiring both full disclosure of conflicts and the engagement of a second, unconflicted advisor—and conclude that "there is no clearly superior alternative to *Revlon* scrutiny despite the attendant risks and uncertainties."<sup>223</sup> Deborah DeMott acknowledges the indirect nature of aiding and abetting liability but regards it as "fit[ting] within established categories of intentional tort,"<sup>224</sup> as a "significan[t] ... potential source of liability,"<sup>225</sup> and as capable of "fill[ing] in gaps left by other sources of law and regulation."<sup>226</sup> As to suggested reform, Kevin Miller, a prominent lawyer who frequently advises investment banks, regards aiding and abetting liability's need for proof of a predicate breach as "creat[ing] significant tension in the legal architecture for aiding and abetting claims" and potentially "prevent[ing] a finding of liability against a culpable bad actor."<sup>227</sup> Mr. Miller has suggested a reform to allow a target's shareholders to bring post-closing derivative claims against M&A advisors "where the claims relate to conduct inextricably linked to the transaction whose closing would otherwise extinguish stockholder standing," overcoming the continuous share ownership requirement.<sup>228</sup> This reform would change procedural rules but would not upset existing substantive rights.

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<sup>222</sup>Enforcement by state regulators would appear to have little deterrent force in this setting. To avoid duplication of regulatory authority by state and federal regulators, the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, preempted many state securities laws, narrowing states' regulatory authority to, among other things, enforce state antifraud legislation. See DEP'T OF THE TREASURY, *supra* note 217, at 55. The role of state agencies in regulating broker-dealers is subsidiary to that performed by FINRA and the SEC. See DEP'T OF THE TREASURY, *supra* note 217, at 55. ("Though states could still require broker-dealer registration [after the 1996 reforms], the SEC and the [NASD] . . . would carry out most broker-dealer regulation."). Nevertheless, the question whether state action adequately deters M&A advisors' misconduct cannot be ruled out without a detailed assessment.

<sup>223</sup>Bratton & Wachter, *supra* note 15, at 82.

<sup>224</sup>Deborah A. DeMott, *Fiduciary Breach, Once Removed*, 94 TEXAS L. REV. 238, 249 (2016).

<sup>225</sup>*Id.* at 239.

<sup>226</sup>*Id.*

<sup>227</sup>See Jenkins, *supra* note 96.

<sup>228</sup>*Id.*



More provocatively, Joel Friedlander, a lawyer who frequently represents shareholders in Delaware actions, including *Rural Metro/RBC Capital*, has proposed recognizing a new tort for "fraud on the board."<sup>229</sup> The tort would apply to "knowing misconduct that corrupts board decision-making[.]" meaning that "[a] financial advisor that defrauds a board into making a value-destroying choice would be answerable in tort to any proper plaintiff (i.e., the corporation or its stockholders) who suffers an injury proximately caused by the fraud."<sup>230</sup> By not requiring proof of predicate liability, this proposed tort would close the "gap" that could allow a culpable M&A advisor to escape liability when directors have themselves committed no fiduciary breach.<sup>231</sup>

In earlier work, I tentatively supported enhancing shareholders' private rights of action against M&A advisors to plug liability gaps.<sup>232</sup> Such a proposal holds promise in overcoming the obstacles standing in the way of holding M&A advisors to account but would encourage unmeritorious suits and, in any case, would probably stand little chance of judicial recognition. A more encompassing and durable approach to effectively deter wrongdoing by M&A advisors, at least for hard-to-detect conflicts, is industry self-regulation. Self-regulation finds justification in the advantages it offers over direct government regulation.<sup>233</sup> As an early Chair of the SEC explained, self-regulation has the ability regulate conduct and activity "too minute for satisfactory control; some of it lying beyond the periphery of the law in the realm of ethics and morality."<sup>234</sup> He further explained that "[i]nto these large areas self-government, and self-government alone, can effectively reach."<sup>235</sup> Self-regulatory efforts to shape conduct may be better received by the market professionals, and thus more effective, than impositions from outside.<sup>236</sup> Self-regulatory

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<sup>229</sup>Friedlander, *supra* note 173, at 1443 (using "fraud on the board" as a shorthand descriptor).

<sup>230</sup>*Id.* at 1488, 1491.

<sup>231</sup>*Id.* at 1445, 1476-77.

<sup>232</sup>See Tuch, *Banker Loyalty*, *supra* note 15, at 1149, 1154.

<sup>233</sup>See generally JOHN C. COFFEE, JR. & HILLARY A. SALE, *SECURITIES REGULATION: CASES AND MATERIALS* 629 (12th ed 2012) (discussing the enforcement advantages of securities self-regulatory organizations).

<sup>234</sup>See JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 185-86* (Aspen 3d ed. 2003) (quoting William O. Douglas, then Chairman of the SEC, discussing the "unquestioned advantages" of self-regulation over direct SEC enforcement).

<sup>235</sup>*Id.*

<sup>236</sup>See ANNELEISE RILES, *COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS* 227 (Univ. of Chi. Press, 2011) (discussing the "empirical reality" of market participants seeking to circumvent new financial regulatory measures and the factors affecting an actor's compliance with regulation).

initiatives are also likely to be better tailored to specific industry needs than other mechanisms given self-regulators' close industry ties.<sup>237</sup> Self-regulators may enjoy cost advantages in formulating and interpreting rules, since they typically have greater degrees of expertise and technical knowledge than government regulators.<sup>238</sup> They may thus shape conduct beyond the reach of law and regulation.

M&A advisors may benefit from principles of conduct tailored to the M&A setting—cannons of professional responsibility—provided they are enforced. These principles could cover matters including client engagement and communications, standards of competence and loyalty, the content of engagement letters, the protection of confidential information, and the structure of remuneration, although at a minimum, considering the focus of this article, I would envisage them covering the specific matter of conflicts of interest (the counterpart of self-regulatory rules governing underwriters' conflicts).<sup>239</sup> These principles would not create private rights of action for clients or their shareholders, but they would establish rules applied by the regulator, a dedicated body housed either within the self-regulatory body FINRA or independently of it. The body may need investigative and enforcement capacity or alternatively, could operate on a more informal basis along the lines of the U.K. Panel of Takeovers and Mergers, which administers the City Code on Takeovers and Mergers.<sup>240</sup> The body could also keep a public register of complaints against M&A advisors, along the lines of the consumer complaint database maintained by the Consumer Financial Protection Bureau. In this way the regulator could leverage M&A advisors' sensitivity to reputational harm to improve standards of conduct.<sup>241</sup> M&A advisors would be given the chance to respond to complaints; information identifying the complainant would be withheld.

Such a self-regulatory body and accompanying rules may be more likely to instill in M&A advisors the values expected of them by many clients and to promote public trust in them. Such rules would be consistent with calls by banking regulators, domestically and internationally, for

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<sup>237</sup>See William A. Birdthistle & Todd M. Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1, 55 (2013) ("Perhaps the greatest single benefit that self-regulation possesses over other forms of regulation is its access to direct industry expertise.").

<sup>238</sup>See Anthony Ogus, *Self-Regulation*, in 5 ENCYCLOPEDIA OF LAW AND ECONOMICS, 587, 591 (Bouckaert & De Geest, eds., 2000). There are nevertheless risks of self-regulation, as to which see Benjamin P. Edwards, *The Dark-Side of Self-Regulation*, 85 U. CIN. L. REV. 573, 604-12 (2017).

<sup>239</sup>See FINRA, RULE 5121: PUBLIC OFFERINGS OF SECURITIES WITH CONFLICTS OF INTEREST § (f)(12)(A) (2020), <https://www.finra.org/rules-guidance/rulebooks/finra-rules/5121>.

<sup>240</sup>City Code on Takeovers and Mergers (2016) (UK).

<sup>241</sup>My thanks to Howell Jackson for suggesting the possibility of a complaints database.

improved ethical conduct by bankers.<sup>242</sup> Because they would be intended to instill ethical conduct, these rules might be viewed by some as impractical or un-operationalizable.<sup>243</sup> However, ethical concepts should be capable of definitional precision in the specific setting of mergers and acquisitions; indeed, FINRA has already stated rules regarding fairness opinions.<sup>244</sup> The rules would not be intended to limit innovation; they would need to be updated as technology advances. M&A advisors have an established role in the M&A ecosystem, and such a regime would offer potentially important benefits in filling liability gaps, buttressing deterrence, and promoting high standards of conduct. More concretely, and as a starting point, the proposed self-regulator could provide guidance about the handling of M&A advisors' conflicts. Should all material conflicts be disclosed to clients? Are any conflicts disabling? And to what extent may advisors disclaim responsibility for their conflicts?<sup>245</sup>

## VII. CONCLUSION

For now, though, the liability regime for M&A advisors is piecemeal. Both clients and their shareholders generally lack feasible options to pursue claims against M&A advisors. The prospect of liability, already slim, diminished in the wake of *Corwin v KKR*.<sup>246</sup> In *Rural Metro/RBC Capital*, the Delaware Supreme Court acknowledged the need for greater guidance and sought, albeit in sometimes-confusing terms, to articulate obligations on M&A advisors and otherwise limit their pursuit of self-interest. These obligations and limits could be made clearer and more enforceable through self-regulatory rules—rules consistent with the reality that M&A advisors are professionals and are understood by clients to be loyal advisors.

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<sup>242</sup>See David Zaring, *The International Campaign to Create Ethical Bankers*, 3 J. FIN. REG. 187, 187–190 (2017).

<sup>243</sup>See Dan Awrey et al., *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?*, 38 DEL. J. CORP. L. 191, 205 (2013) ("Framing policy debates around seemingly inchoate concepts like culture and ethics is thus often, and understandably, viewed as somewhat impractical."); David Zaring, *Regulating Banking Ethics: A Toolkit*, 43 SEATTLE U. L. REV. 555, 577 (2020) ("regulators have made ethics a priority such that they have turned to a number of different strategies to operationalize a concept that has always risked being amorphous and un-operationalizable."). See also Alan D. Morrison & William J. Wilhelm, Jr., *Opacity, Complexity, and Self-Regulation in Investment Banking*, 83 GEO. WASH. L. REV. ARGUENDO 1, 21 (2015) ("Ethics are complex and disputed. Any policy framework built upon a general desire to instill more ethical behavior stands upon very uncertain foundations.").

<sup>244</sup>See *supra* note 210 and accompanying text.

<sup>245</sup>For other considerations, see Tuch, *Self-Regulation of Investment Bankers*, *supra* note 13, at 170–73.

<sup>246</sup>*Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304, 309 (Del. 2015).