

Delaware Supreme Court upholds *Rural/Metro* rulings

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Introduction Decision

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In March 2014 the Delaware Court of Chancery issued its opinion in *In Re Rural/Metro Corporation Stockholders Litigation*, in which the court held that Rural/Metro's financial adviser RBC was liable to a class of Rural/Metro stockholders for aiding and abetting a breach of fiduciary duty by Rural/Metro's board of directors in connection with the acquisition of Rural/Metro by Warburg Pincus (for further details please see "[Financial adviser liable for aiding and abetting board breach of fiduciary duties](#)"). In addition, the court awarded \$75.8 million in damages to the class (for further details please see "[Rural Metro decision results in significant liability for financial adviser](#)").

RBC appealed these rulings to the Delaware Supreme Court, and on November 30 2015 the Supreme Court issued its ruling upholding the Delaware Court of Chancery's decisions.⁽¹⁾

Decision

The Supreme Court found that the Delaware Court of Chancery's factual findings were adequately supported by the trial record. Specifically, the lower court had found that Rural/Metro had commenced a sales process without authorisation from the full board of directors and that the sales process was shaped by RBC in a manner designed to benefit RBC by creating potential opportunities for RBC both to participate in the financing of a contemporaneous acquisition of EMS, a Rural/Metro competitor, and to provide financing to Warburg Pincus, the ultimate acquirer of Rural/Metro.

The Supreme Court also upheld several key legal rulings made by the Delaware Court of Chancery.

Application of Revlon scrutiny

RBC argued that the lower court had erred in applying *Revlon's* enhanced scrutiny test to the entire Rural/Metro sale process (including the unauthorised commencement of the sale process). RBC argued that such scrutiny should apply only to the board's decision to select Warburg Pincus as the winning bidder. The Supreme Court rejected this argument, finding that a special committee had initiated an active bidding process to sell the company months before the final board approval, and the board subsequently ratified the special committee's actions. Moreover, the Supreme Court noted that delaying the application of *Revlon* to the endpoint of a sale process – when the final decision was made to sell the company – would potentially incentivise boards to avoid active engagement in a transaction until the end of a sale process. Finally, the Supreme Court noted that the key flaws in the sale process occurred during the period between the initiation of that process by the special committee and board approval of the transaction, and to find that *Revlon* was not applicable during this period would undermine the *Revlon* inquiry, which required the court to "examine whether a board's overall course of action was reasonable".

Reasonableness of board conduct

Applying the *Revlon* standard, the Supreme Court affirmed the Court of Chancery's finding that the board's conduct fell outside of the range of reasonableness required by *Revlon* in the context of a sale

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of the company. The Supreme Court found that a conflict of interest arose when RBC designed the sale process to enable it to seek to finance the acquisition of EMS, and later Warburg Pincus, the ultimate acquirer of Rural/Metro, which the lower court found were not fully disclosed to the board. The Supreme Court noted that, although a board can consent to such conflicts "directors need to be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest". The board's failure to manage such conflicts, combined with its failure to be adequately informed as to the company's value (having received a valuation report from RBC less than two hours before the meeting at which the transaction was approved) led the Supreme Court to affirm the Delaware Court of Chancery's finding that the board had breached its fiduciary duties.

Disclosure failures

The Supreme Court also upheld the lower court's findings that the Rural/Metro board failed to satisfy its duty of disclosure to the company's stockholders. Of particular note was the court's finding that the proxy statement failed to fully disclose how RBC intended to use the Rural/Metro sale process to obtain fees for financing activities (both in connection with a contemporaneous transaction involving a competitor of the company and by providing financing to Warburg Pincus). The court dismissed as inadequate a generic disclosure in the proxy statement that RBC had the right to offer staple financing in light of, among other things, RBC's efforts to obtain a financing role for Warburg Pincus, especially towards the end of the sale process.

Aider and abettor liability

The Supreme Court also affirmed the lower court's holding that RBC was liable as an aider and abettor of the board's fiduciary breaches, emphasising in particular RBC's role in intentionally misleading the board and in creating an "informational vacuum" that caused the board to breach its fiduciary duties. In so finding, the court rejected arguments that attaching aider and abettor liability to a board's unintentional breach of duty would create an imbalance of responsibilities to the detriment of the non-fiduciary, noting that aider and abettor liability requires scienter of the aider and abettor, which makes such liability difficult to prove.

Impact for financial advisers

Importantly for financial advisers, the Supreme Court rejected the lower court's view that financial advisers function as 'gatekeepers' in M&A transactions. Instead, the Supreme Court noted that the services provided by a financial adviser are primarily contractual in nature and can vary from one transaction to another, and that it is for a board to determine, in negotiation with the financial adviser, the scope and terms of the financial adviser's engagement. According to the Supreme Court, "[t]he 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 decision making processes". As a result, it is not the case that any failure by a financial adviser to prevent directors from breaching their duty of care gives rise to an aiding and abetting claim against the adviser.

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Endnotes

(1) *RBC Capital Markets, LLC v Jervis*, No 140, 2015 (Del 2015).

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