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Delaware Court Refuses to Dismiss Aiding and Abetting Claim against Sell-Side M&A Financial Advisor

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DELAWARE CORPORATE LAW BULLETIN

Delaware Court Refuses to Dismiss Aiding and Abetting Claim Against Sell-Side M&A Financial Advisor

*Robert S. Reder**
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Uninformed stockholder vote does not shield financial advisor from potential liability predicated on fiduciary breach by its boardroom client.

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INTRODUCTION

In a recent posting, we discussed the Delaware Supreme Court's affirmance of a $78.5 million damages award against a sell-side financial advisor for aiding and abetting a breach by a target board of directors of its fiduciary duty of care.[1] This decision, commonly referred

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to as *Rural Metro*, is the capstone of the latest trend in stockholder merger litigation: plaintiffs' attorneys targeting deep-pocketed, sell-side financial advisors to obtain monetary damages (and lucrative attorneys' fees) by claiming these advisors aided and abetted alleged fiduciary breaches by their clients, the target company boards.[2] While target company directors generally are shielded from monetary liability for a breach of their duty of care by an exculpatory provision in their corporation's charter (as authorized by Section 102(b)(7) of the Delaware General Corporation Law ("DGCL § 102(b)(7)")), their financial advisors enjoy no similar protection, statutory or otherwise.

By contrast, there are two fairly recent Delaware decisions that offer a potential pathway for dismissal of these aiding and abetting claims.[3] In *Corwin v. KKR Financial Holdings LLC*, the Delaware Supreme Court declared that "the voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review,"[4] rather than the more intrusive enhanced scrutiny standard applicable to merger transactions governed by *Revlon*.[5] In essence, *KKR* provided an ex post vehicle to overcome a board's duty of care breach, thereby potentially undercutting a related aiding and abetting claim against the board's financial advisor.

This is exactly what transpired in *In re Zale Corp. Stockholders Litigation*.[6] In *Zale*, the Chancery Court, applying *KKR*, determined that a fully informed vote of disinterested stockholders required application of the business judgment rule to the conduct of a target company board of directors in connection with a sale transaction. The target board was claimed to have mishandled conflicts of interest on the part of its sell-side financial advisor, to the detriment of the sales process and, ultimately, target company stockholders. The Court determined that plaintiffs failed to demonstrate conduct on the part of the target board so egregious as to overcome the board-friendly presumption of the business judgment rule. Accordingly, the Court

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** Vanderbilt University Law School, J.D. Candidate, May 2016. I would like to thank Professor Reder as well as the *Vanderbilt Law Review* for the ability to participate in the *En Banc* series.

1. For a detailed discussion of the ramifications of this decision, see Robert S. Reder & Margaret Dodson, *Delaware Supreme Court Upholds Multi-Million Dollar Damages Award Against Sell-Side M&A Advisor*, 69 VAND. L. REV. EN BANC 27 (2016).

2. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54 (Del. 2014), *aff'd sub. nom.* RBC Capital Markets, LLC v. Joanna Jervis, No. 140, 2015, opinion (Del. Nov. 30, 2015).

3. For a discussion of these decisions, see Robert S. Reder & Stephanie Stroup Estey, *Sell-Side Financial Advisors in the M&A Crosshairs*, 68 VAND. L. REV. EN BANC 279 (2015).

4. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015).

5. *See* Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

6. *In re* Zale Corp. Stockholders Litig., C.A. No. 9388-VCP (Del. Ch. Oct. 29, 2015).

dismissed a related aiding and abetting claim against the target board's financial advisors that was predicated on that very same fiduciary breach.

The key element under both *KKR* and *Zale* for obtaining the cleansing effect of a disinterested stockholder vote was full disclosure of whatever errors may have been made by the target board and its financial advisor in connection with the M&A sales process. By contrast, the recent decision of the Delaware Chancery Court in *In re TIBCO Software Inc. Stockholders Litigation* demonstrates the vulnerability of sell-side financial advisors when full disclosure is not provided to target company stockholders.[7]

I. BACKGROUND

Following a sales process for TIBCO Software Inc., a participant in the "enterprise software industry," private equity firm Vista Equity Partners emerged as the winning bidder.[8] The parties entered into a Merger Agreement on September 27, 2014 providing for Vista to purchase all outstanding TIBCO shares for $24 per share in cash. Goldman Sachs ("Goldman") acted as TIBCO's financial advisor during the sales process and opined to the TIBCO Board that the merger price was fair to TIBCO stockholders from a financial point of view.

During the bidding process, Vista consistently sought to assure itself that its ultimate investment in TIBCO would generate an "internal rate of return ('IRR') somewhat higher than its target IRR for its overall fund."[9] Thus, like any private equity buyer, Vista's bidding philosophy was grounded on the proposition that the total purchase price "necessarily comes first, and the per-share price is calculated thereafter."[10] To that end, Vista requested detailed information on the total number of shares of TIBCO stock that it would be required to cash out in the merger. In response, Goldman provided Vista with a TIBCO capitalization table which, it was later determined, double-counted 4,147,144 unvested restricted shares. Vista's investment committee determined that it could support a maximum purchase price of $4.237 billion which, divided by the number of shares it believed (based on the information provided by Goldman) it would have to purchase, resulted in a per share price of $24.25. Vista therefore believed that its ultimate winning bid of $24 per share translated to a total purchase price of

7. *In re* TIBCO Software, Inc. Stockholders Litig., C.A. No. 10319-CB (Del. Ch. Oct. 20, 2015).

8. *In re TIBCO*, C.A. No. 10319-CB, slip op. at 4.

9. *Id.* at 10.

10. *Id.* at 11.

$4.244 billion.[11] Consistent with that understanding, the joint press release issued upon signing announced to the public that the total purchase price was "approximately $4.3 billion."[12]

The aforementioned error came to light on October 5th, when TIBCO's legal counsel circulated a draft proxy statement in preparation for the special meeting of TIBCO stockholders to vote on the transaction. After reviewing the draft, a Goldman employee commented in an email that "'[t]he aggregate value calculation [did]n't look right.' "[13] Following further discussions, the double-count was discovered, thereby "reducing the total implied equity value of the transaction by about $100 million."[14]

The TIBCO Board convened a special meeting to consider the implications of the share-count error on October 11th. Goldman presented a revised analysis which "assumed that the per-share price would remain constant and reduced . . . the equity value [of the transaction] from $4.244 billion to $4.144 billion."[15] Despite this $100 million reduction in the total price to be paid to TIBCO stockholders, Goldman reconfirmed its fairness opinion. The Board concluded that, in light of Goldman's analysis and its concern that Vista might withdraw from the transaction if it were asked to increase the per share price to yield $4.244 billion in equity value, it would not change its recommendation in favor of the transaction.[16]

Vista was advised of the share count error on October 14th, when "TIBCO's counsel told Vista's counsel that the equity value in the Preliminary Proxy should be reduced by $100 million."[17] Unsurprisingly, Vista did not volunteer to increase the per share price agreed to in the Merger Agreement in order to make the TIBCO stockholders whole. One day later, "Vista forwarded to Goldman 'the

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11. As is typical, the merger agreement recited the agreed-upon per share price but made no mention of the total purchase price payable to stockholders. But the merger agreement did accurately represent the total number of shares, as well as the stock options and other stock-based awards, outstanding. Nevertheless, neither party nor any of its advisors discovered the double-count contained in the capitalization table furnished by Goldman to Vista before signing. *Id.* at 1. In addition, two other provisions of the merger agreement—a termination fee and a liability cap—were calculated on the basis of the mistaken total purchase price. *Id.* at 17.

12. *Id.* at 18.

13. *Id.* at 20.

14. *Id.* at 20.

15. *Id.* at 21.

16. To emphasize the importance of the share count to Vista, the merger agreement permitted Vista to terminate the transaction if any inaccuracies in the information concerning TIBCO's capitalization "individually or in the aggregate, would require Vista to pay more than $10 million above the product of $24 per share multiplied by the number of fully diluted shares derived from the Cap Rep." *Id.* at 17.

17. *Id.* at 21.

email that [Vista] used for the calculation of equity value' in connection with its Final Bid: a September 26, 2014 email from Goldman to Vista attaching the Final Cap Table, which included the erroneous share count."[18] Apparently, Goldman neither shared this email with nor told the TIBCO Board that "Vista had admitted relying on the inaccurate capitalization data when preparing its Final Bid."[19]

The final proxy statement disclosed the share count error but said nothing about the fact that Vista had advised Goldman, during the period that the proxy statement was being prepared, that it had relied on the share count in formulating its bid. The final proxy statement was filed with the SEC on October 16th and mailed to TIBCO stockholders shortly thereafter. On December 3rd, TIBCO stockholders approved the transaction by an overwhelming vote. The transaction closed on December 5th.

Soon after the parties announced the transaction, the inevitable stockholder suit challenging the transaction followed. Unlike the typical M&A lawsuit, this one attacked the transaction not on the basis that it did not produce a "good outcome," but rather because the double-count resulted in an underpayment to TIBCO stockholders of $0.57 per share.[20] Specifically, plaintiffs alleged that the TIBCO Board breached its fiduciary duties because "no member of the Board ever asked Goldman (i) how the share count error was made; (ii) whether it was Goldman's fault or not; (iii) whether Goldman had discussed with Vista the overstated share count, or its implication for the Merger's terms; or (iv) whether Vista should or would pay the full $4.244 billion that the Board had thought it had secured for stockholders."[21]

Plaintiffs also claimed that Goldman aided and abetted the Board's breach because it was not forthcoming with all pertinent information. Specifically, although Goldman was aware that Vista had indeed relied on the faulty capitalization table when making its bid and might have, if asked, raised the per share price to yield the total purchase price it thought it was paying, Goldman did not relay this information to the TIBCO Board.[22] In fact, the "Board did not learn that Vista had relied on the erroneous share count . . . until this litigation

18. *Id.* at 21.

19. *Id.* at 21–22.

20. *Id.* at 1 (internal quotation marks omitted).

21. *Id.* at 23.

22. Of course, one cannot assume that Vista would have increased the per share price had it been asked. Vista's COO testified at trial that "once he realized the windfall Vista was about to get as a result of the change in share count—which made the deal cheaper and put Vista's expected returns above its hurdle rate—he felt 'pleasure.' " *Id.* at 22.

was relatively advanced."[23] Such lack of information, as a TIBCO Board member testified, was "a motivating factor for deciding not to challenge Vista on the aggregate purchase price. . . ."[24]

Both the Board and Goldman moved to dismiss plaintiffs' claims. Chancellor Andre G. Bouchard granted the Board's motion, but refused to dismiss the aiding and abetting claim against Goldman.

II. THE COURT'S ANALYSIS

A. Breach of Fiduciary Duties

Plaintiffs alleged that the TIBCO directors breached their fiduciary duties because they (1) "'did not even *attempt* to recover the $100 million in consideration that Vista had agreed to pay TIBCO,' "[25] and (2) failed to "adequately inform themselves in the wake of this discovery."[26] These failings, according to plaintiffs, "violated the Director Defendants' duty under *Revlon* to obtain the highest value reasonably obtainable for the Company in a change of control transaction."[27]

1. Breach of the Duty of Loyalty

First, Chancellor Bouchard considered whether plaintiffs alleged sufficient shortcomings on the part of the TIBCO Board to constitute a breach of their duty of loyalty. In this connection, "[t]he real question . . . is whether the Board's decision not to engage with Vista in an effort to recover some or all of the additional $100 million they believed the transaction would yield was so far beyond the bounds of reasonable judgment as to be inexplicable on any ground other than bad faith."[28] As part of this analysis, the Chancellor noted that the Board was independent and disinterested, met to consider how to deal with the share miscount, received an updated fairness opinion from Goldman and considered the risks of approaching Vista post-signing to seek an increase in the per share price. "Given these practical realities," the Chancellor opined, "the facts pled in the Complaint do not come close in

23. *Id.* at 24.
24. *Id.* at 23.
25. *Id.* at 49.
26. *Id.* at 47.
27. *Id.* at 47.
28. *Id.* at 50.

my view to demonstrating that the members of the Board intentionally disregarded their duties by failing to renegotiate with Vista."[29]

2. Breach of the Duty of Care

On the other hand, Chancellor Bouchard did consider plaintiffs' allegations "troubling,"[30] and it indeed was "reasonably conceivable" that there could be a duty of care claim "for which the Director Defendants would be exculpated but that could form the predicate breach for an aiding and abetting claim."[31] According to the Chancellor, at least for purposes of the motion to dismiss before him, there was a "sufficiently wide gulf between what was done and what one rationally would expect a board to do after discovering a fundamental flaw in a sale process."[32] Specifically, the Chancellor indicated that the Board needed to perform a more thorough investigation and "press Goldman . . . for a complete explanation concerning the circumstances of the share count error (*e.g.*, what caused it, who was responsible, etc.)."[33] If the Board had done this, the directors would have had a "more complete picture of the situation," and would have been better able to determine the best course of action for TIBCO's stockholders.[34]

Despite finding a potential breach by the TIBCO directors of their duty of care, Chancellor Bouchard was compelled to dismiss the damages claim against the directors. TIBCO's certificate of incorporation contained a provision pursuant to DGCL § 102(b)(7) shielding the directors from personal liability for a breach of their duty of care. As a result, plaintiffs were not entitled to an award of monetary damages from the TIBCO directors.

B. Aiding and Abetting

Unlike target company directors, sell-side financial advisors such as Goldman do not enjoy the protection of a DGCL § 102(b)(7) provision in their clients' charter documents. Therefore, the dismissal of the claim against the TIBCO directors did not necessarily relieve Goldman of potential liability for the related aiding and abetting claim.

Chancellor Bouchard explained that "'[t]o succeed on a claim for aiding and abetting a breach of fiduciary duty, Plaintiff must prove: (1)

29. *Id.* at 51–52.
30. *Id.* at 52.
31. *Id.* at 50.
32. *Id.* at 53.
33. *Id.* at 53–54.
34. *Id.* at 54.

the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, and (3) knowing participation in that breach by the non-fiduciary.' "[35] The first factor was satisfied by the obvious fact that the TIBCO directors indeed have a fiduciary relationship with the company's stockholders, and the second by the Chancellor's determination that the directors conceivably breached their duty of care. Therefore, the decision whether to dismiss the claim against Goldman hinged "on whether the Complaint sufficiently alleges that Goldman knowingly participated in the Director Defendants' alleged breach."[36]

Chancellor Bouchard further explained that "'[t]o demonstrate the knowing participation element of an aiding and abetting claim, it must be reasonably conceivable from the well-pled allegations that the third party act[ed] with the knowledge that the conduct advocated or assisted constitute[d] . . . a breach [of fiduciary duty].' "[37] "The requirement of 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.' "[38]

Against this backdrop, the Chancellor considered whether plaintiffs had sufficiently alleged "knowing participation" on Goldman's part. Plaintiffs' key allegation in this regard was that Goldman failed to provide the TIBCO Board with the email in which Vista confirmed that it had indeed relied on the faulty share count in formulating its bid. Not only was Goldman "a highly sophisticated investment bank," likely aware that the Board was not asking all the pertinent questions or investigating to the extent its duties required upon learning of the double-count but, plaintiffs alleged, Goldman actively "concealed" a "critical piece of information," thereby creating an "informational vacuum at a critical juncture when the Board was still assessing its options vis-à-vis Vista or Goldman to secure some or part of the $100 million equity value shortfall."[39]

For purposes of Goldman's motion to dismiss, Chancellor Bouchard found plaintiffs' allegations of "knowing participation" sufficient to support the aiding and abetting claim predicated on the

35. *Id.* at 55 (quoting Zimmerman v. Crothall, 62 A.2d 676, 711 (Del. Ch. 2013)).

36. *Id.* at 55–56.

37. *Id.* at 56 (quoting Lee v. Pincus, 2014 WL 6066108, at *13 (Del. Ch. Nov. 14, 2014) (internal quotation marks omitted)).

38. *Id.* at 56 (quoting Malpiede v. Towson, 780 A.2d 1075, 1098 (Del. 2001)).

39. *Id.* at 57–58.

Board's alleged breach of its duty of care.[40] Consequently, the Chancellor denied Goldman's motion.

CONCLUSION

In *TIBCO*, Chancellor Bouchard dismissed a breach of fiduciary duty claim against the TIBCO directors, yet refused to dismiss a claim that the Board's sell-side financial advisor aided and abetted that alleged fiduciary breach. Both claims arose from the same set of circumstances: a double-counting of potentially outstanding shares of TIBCO stock that arguably cost TIBCO stockholders $100 million in value. The real problem was not the innocent double-counting of outstanding shares, but rather the Board's apparent failure to attempt to rectify that mistake before allowing the transaction to close, as well as Goldman's apparent failure to inform the Board that the winning bidder relied on the inflated share count in calculating its final bid. Although the TIBCO directors were shielded from personal liability for the potential breach of their duty of care, that potential breach served as a predicate for Chancellor Bouchard's refusal to dismiss the related aiding and abetting claim against Goldman.

So what makes the result in *TIBCO*, as far as sell-side financial advisors are concerned, different from that in *Zale*? In both cases, the target company stockholders voted in favor of the transaction in question, which under *KKR* would seem to be sufficient to cleanse the fiduciary breaches that served as predicates for the aiding and abetting claims. However, in *Zale*, the Court determined that the disclosure to stockholders was adequate and their vote fully informed. On the other hand, Chancellor Bouchard did not even mention the possibility that the stockholder vote in *TIBCO* would relieve Goldman of potential liability. The reason for this difference seems readily apparent.

In the words of the Chancellor, had the TIBCO Board been "[a]rmed with a more complete picture of the situation, the Board would have been better equipped to consider, among other things, . . . whether to change its recommendation to stockholders *before the Merger vote*."[41] Because the Board did not know all the important information, its recommendation could not possibly have been one that was adequately

40. Chancellor Bouchard also noted that Goldman's desire to secure its fee for acting as financial advisor, 99% of which was contingent on a completed transaction, helped support "a reasonable inference at this stage of the proceedings that Goldman was motivated to create an informational vacuum" to make sure that the deal would go forward. *Id.* at 59.

41. *Id* at 54 (emphasis added).

informed.[42] Therefore, the resulting stockholder vote did not merit the deferential business judgment presumption that the fully informed stockholder vote was provided in both *KKR* and *Zale*.

As in *Zale*, *TIBCO* emphasizes the importance of sell-side financial advisors being upfront with their target company clients, both before *and* during the sale process. In *Zale*, the potential financial advisor conflict of interest was fully disclosed to the stockholders before their vote. In *TIBCO*, by contrast, the key information was not provided to stockholders because it apparently was withheld from the Board by its financial advisor. The message to sell-side financial advisors cannot be clearer: the directors you represent are shielded from liability in ways that you are not, so timely and full disclosure of all material aspects of your representation is paramount. Only a stockholder vote that is fully-informed will rectify a breach of fiduciary duty on the part of the target board. In cases such as this, the financial advisors have the same, or perhaps an even greater, interest in providing material information to stockholders as do the directors themselves.

42. It should be noted that in *Zale*, Vice Chancellor Parsons stated, in relation to *TIBCO*, that there was no "indication that the merger was not approved by a majority of disinterested stockholders in a fully informed vote." *In re* Zale Corp. Stockholders Litig., C.A. No. 9388-VCP, slip op. at 9 (Del. Ch. Oct. 29, 2015). While Chancellor Bouchard was not explicit in *TIBCO* as to whether he found the stockholder vote to be fully informed or not, the quoted sections above illustrate that the Board did not have all the relevant information and therefore could not make an informed recommendation.