strated.[264] Imposing criminal liability may also give rise to pernicious effects because of the criminal justice system's failure to match the penalty to the social harm caused.[265]

Another possible measure would be public enforcement by regulators. Layering this measure onto a private enforcement regime would add complexity and make more difficult the task of calibrating the regime to effectively deter M&A advisor disloyalty, but may recognize the differing institutional competencies of boards and external regulators. This could be done for particular conflicts that are hard for clients to detect, such as those created by advisors' trading activities.[266]

A further deterrent measure would involve imposing liability on M&A advisors for aiding and abetting directors' policing failures. Such (secondary) liability finds no precedent in deterrence theory, which conceives of private enforcement as involving primary liability and looks to public enforcement by regulators when private enforcement is inadequate.[267] Under traditional aiding and abetting principles, shareholders may sue third parties for aiding and abetting the breach of directors' duties to shareholders, provided those third parties meet a knowledge requirement.[268] The conduct of M&A advisors that amounts to aiding and abetting directors' breaches would not be disloyalty itself, but rather knowing participation by M&A advisors in directorial breaches of duty, and this feature alone raises doubts about the suitability of this mechanism for policing M&A advisor conflicts. Since this measure has been deployed in Delaware recently, it is examined further in Part III.

264. In the wake of the financial crisis beginning in 2007, and in light of the marketing by Goldman Sachs of the ABACUS 2007-AC1 collateralized debt obligation, Congress proposed legislation—not ultimately passed—imposing criminal penalites on broker–dealers for certain willful misconduct. For competing views on the proposed legislation, see *Wall Street Fraud and Fiduciary Duties: Can Jail Time Serve as an Adequate Deterrent for Willful Violations?: Hearing on S.3217 Before the Subcomm. on Crime and Drugs of the S. Comm. On the Judiciary*, 111th Cong. (2010) (statement of John C. Coffee, Jr., Professor of Law, Columbia Univ. Law Sch.), http://www.judiciary.senate.gov/imo/media/doc/10-05-04CoffeesTestimony.pdf [http://perma.cc/4HQR-KHUW]; *id.* (statement of Larry E. Ribstein, Associate Dean, University of Illinois College of Law), http://www.judiciary.senate.gov/imo/media/doc/10-05-04RibsteinsTestimony.pdf [http://perma.cc/2ZFM-KF7M].

265. *See* Fischel & Sykes, *supra* note 260, at 322–23.

266. In some deals, an M&A advisor may stand to benefit from unwinding certain hedging arrangements in its client's stock—earning sums that may "dwarf the potential M&A advisory fee" on the deal and distorting its incentives. *See* Memorandum from Cleary Gottlieb on Selected Issues for Boards of Directors in 2016, at 14–15 (Jan. 26, 2016), https://clients.clearygottlieb.com/rs/alertmemos/2016-10.pdf [https://perma.cc/XJ59-VK44]. These hedging arrangements are complex and may be difficult for clients and their legal counsel to evaluate without outside expertise. *Id.*

267. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 232 (referring to public enforcement by regulatory authorities and to criminal liability as solutions to the inadequacy of private liability rules).

268. Malpiede v. Townson, 780 A.2d 1075, 1096 (Del. 2001).

Yet another line of inquiry concerns how directors should satisfy their duties to shareholders. The challenge here is to operationalize the concept of directorial policing of M&A advisors. If directors reduce or eliminate M&A advisors' fiduciary liability in engagement letters with M&A advisors, should they then be taken to have violated their duties? Should the answer depend on whether the directors used contractual measures to monitor and influence the M&A advisors, despite having relieved M&A advisors of their fiduciary obligations? These questions are also explored in Part III.

One caveat with the proposed regime concerns the potential drawbacks of imposing fault-based liability on directors. Relative to strict liability, a fault-based regime is more susceptible to judicial error, with the result that directors who have taken all cost-effective monitoring and influencing measures may nevertheless fear liability.[269] It also fails to assure that principals internalize the full costs of their agents' wrongdoing.[270] Scholars have suggested various liability regimes incorporating elements of both strict and fault-based liability to address the potential drawbacks of imposing fault-based liability on principals.[271] While innovative, these mixed liability regimes are intended for intentional torts and crimes and do not obviously lend themselves to private liability regimes for conflicts that may or may not be intentional.

Envisioning directors as monitors of M&A advisors might lead some to question M&A advisors' status as fiduciaries. Can M&A principals properly be said to reasonably expect loyalty of their advisors, or to fail to adequately use contract to protect their interests such that fiduciary duties are justified (as argued in Part I), and yet simultaneously be regarded as having the capacity to monitor and influence M&A advisors? They can. To begin, the monitoring capacity of directors required to justify enterprise liability differs in degree and kind from that required to obviate the need for fiduciary duties. Enterprise liability can provide benefits even if the principal cannot actively monitor or completely control the agent.[272] The contractarian approach acknowledges principals' limited capacity to monitor fiduciaries, although it emphasizes not their monitoring incapacity per se but their incapacity to monitor actively enough to solve the agency problem and thereby eliminate the basis under this approach for imposing fiduciary duties.[273] Accordingly,

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269. Fischel & Sykes, *supra* note 260, at 329 ("[Judicial] judgment is inevitably fraught with error. As a result, a corporation that believes itself to have taken all cost-effective monitoring measures may nevertheless fear being found 'negligent' after the fact should a crime occur.").

270. *See* Kraakman, *supra* note 243, at 142–43 (referring to the failure of a negligence rule to assure that principals will fully internalize the costs of their agents' misconduct).

271. *See* Arlen & Kraakman, *supra* note 253, at 718–42 (examining the deterrent effect of novel structures for imposing liability on corporate principals).

272. *See supra* note 258 and accompanying text.

273. Sitkoff, *Economic Structure*, *supra* note 131, at 1041–42 (arguing that "[a]ctive monitoring is not a satisfactory answer to the agency problem," but that the fiduciary obligation is the "preferred regulatory response" to that problem).

while directors cannot actively monitor M&A advisors, they may nevertheless exercise influence sufficient to justify directorial liability, most specifically in how they set (or undermine) the duties that M&A advisors owe their clients.

More generally, there is no irreconcilable tension in both regarding M&A advisors as fiduciaries of M&A *principals* (their clients) and requiring the *directors* of M&A principals to monitor and influence M&A advisors' conflicts. Nothing in fiduciary doctrine requires those acting for the beneficiary of a fiduciary to blindly trust that fiduciary or even to act passively toward that fiduciary. Similarly, nothing in fiduciary doctrine counsels against those acting for the beneficiary of a fiduciary having a skeptical attitude toward that fiduciary or monitoring and influencing the fiduciary to the extent possible—or suggests that by doing so they (those acting for the beneficiary) undermine that fiduciary's duties toward the beneficiary.[274] To be sure, it may be atypical for some beneficiaries to monitor and influence their fiduciaries, but the focus here is on the conduct of those acting for beneficiaries. The notion of directors as monitors of M&A advisors, rather than as passive actors, reflects directors' status as fiduciaries of M&A principals; it does not undermine the case for characterizing the M&A advisor as a fiduciary itself.

* * *

In sum, a liability regime relying on suits against M&A advisors for disloyalty would face significant practical and doctrinal obstacles, and thus would likely underdeter disloyalty by M&A advisors. Further deterrence would be necessary, and the capacity (albeit limited) of corporate directors to monitor and influence the conduct of M&A advisors suggests that they be enlisted for this purpose. The precise incentive effects of such a regime are uncertain and would require empirical assessments of factors such as the harm imposed by M&A advisor disloyalty and the probability of detection. Nevertheless, theory suggests that imposing fault-based liability, rather than strict liability, on directors may be preferable. It also suggests that any duties be articulated to require directors to engage in both *ex ante* monitoring of M&A advisors and *ex post* investigation and sanctioning of M&A advisors.

If the regime suggested by this analysis ineffectively deterred advisor disloyalty, further deterrence of M&A advisor disloyalty would be required. Holding M&A advisors liable for aiding and abetting directors' fiduciary breaches is a possibility, as is criminal liability for advisors' disloyalty, but each of these deterrent mechanisms presents challenges of its own. A more promising measure is external regulatory oversight of particular hard-to-

274. *Cf.* Bratton & Wachter, *supra* note 13, at 54 ("[I]n arm's-length territory, a proactive stance regarding conflict identification makes sense. In the fiduciary context the beneficiary sits back and waits for the fiduciary to disclose the conflict . . . .").

detect conflicts. The analysis thus raises the prospect of the joint use of methods of legal intervention: liability rules akin to primary and enterprise tort liability as well as public enforcement.[275]

III. valuating Existing Law

This Part evaluates existing law, especially as it is expressed in recent Delaware opinions. It assesses opinions of the Court of Chancery in *Del Monte*,[276] *El Paso*,[277] and *Rural Metro*,[278] as well as that of the Delaware Supreme Court's in *RBC Capital Markets*,[279] which affirms *Rural Metro* and represents the most authoritative judicial guidance on M&A advisor conflicts yet. Until these cases, Delaware had offered little guidance on M&A advisor conflicts.[280]

The Delaware cases involve shareholder claims against directors of target companies alleging fiduciary breaches based on the compromising effect of the conflicts afflicting their M&A advisors. In all cases, the M&A advisors faced conflicts—often real conflicts. In no case did shareholders seek to hold the M&A advisor primarily liable, whether as a fiduciary or otherwise, a phenomenon possibly reflecting concerns that any duties ran to the corporation rather than to shareholders, that a shareholder's derivative suit to enforce wrongs to the corporation would fail, that governing law and forum selection clauses in engagement letters would prevent Delaware courts from hearing the matter, or that M&A advisors were relieved of fiduciary and other liability by terms contractually agreed on by directors.[281] Similarly, in

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275. The intuition is provided by Steven Shavell, who notes that "we would expect that gaps in the effectiveness of one method of intervention would often usefully be filled by other methods of intervention." SHAVELL, FOUNDATIONS, *supra* note 147, at 589. The analysis here suggests only broad prescriptions in an approximate sense because, as Professor Shavell also notes, the "[economic] analysis of the structure of law is at an early stage of development." *Id.* at 592.

276. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813 (Del. Ch. 2011).

277. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012).

278. *Rural II*, 102 A.3d 205 (Del. Ch. 2014); *Rural I*, 88 A.3d 54 (Del. Ch. 2014).

279. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015).

280. In *Toys "R" Us*, 877 A.2d 975 (Del. Ch. 2005), the Court of Chancery sketched the approach it would later follow. Dismissing claims that an M&A advisor's conflicts had compromised its client's sale process, the court described the board's decision to permit its M&A advisor to provide buy-side financing as "unfortunate, in that it tends to raise eyebrows by creating the appearance of impropriety, playing into already heightened suspicions about the ethics of investment banking firms," and cautioned M&A advisors against "creat[ing] the appearance that they desire buy-side work, especially when . . . they are more likely to be selected by some buyers for that lucrative role than by others." *Id.* at 1006 & n.46.

281. As to these potential explanations, see *supra* notes 79, 221 (regarding terms in engagement letters limiting fiduciary duties); 212 (regarding fiduciary duties running to shareholders); and 215 (regarding shareholder derivative suits). As to the final possible explanation, engagement letters typically select New York state law as the governing law and select any state or federal court sitting in New York City as the exclusive forum for any action arising from the agreement. *See* Klinger-Wilensky & Emeritz, *supra* note 232, at 75–84 (providing a template of standard terms and conditions used in engagement letters).

none of these deals did directors themselves seek to hold M&A advisors liable, whether for breach of fiduciary duty or otherwise—a phenomenon underscoring doubts about directors' willingness to hold M&A advisors to account for conflicts.

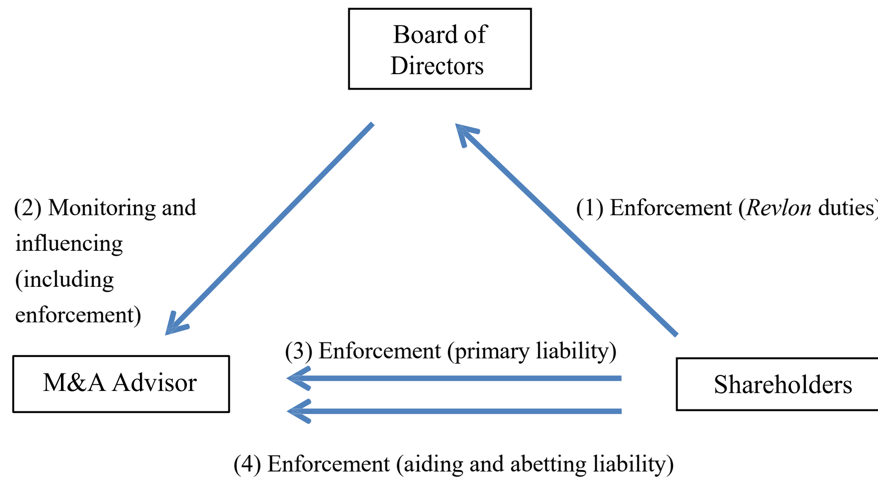
A. *How Delaware Law Conforms*

Figure 3 depicts the enforcement actions available under Delaware law to deter M&A advisor disloyalty. As it suggests, Delaware law conforms in important respects with the analysis in Part II. First, it imposes fault-based liability on directors, requiring them to act reasonably in overseeing or policing M&A advisors' conflicts. The enforcement actions seeking to impose such liability are designated (1) in Figure 3. Second, although Delaware courts have yet to explicitly consider the fiduciary character *vel non* of M&A advisors, their rhetoric and analytical approach in recent opinions support the imposition of fiduciary duties on M&A advisors for the benefit of the corporate client—as considered below.[282] The relevant enforcement actions are designated (2) in Figure 3. Finally, as a matter of principle, shareholders may derivatively enforce any such fiduciary duties owed by M&A advisors to the corporate client;[283] these actions are designated (3) in Figure 3. Under Delaware law, M&A advisors also face aiding and abetting liability; in Figure 3, the relevant actions are designated (4). This Part proceeds by examining the recent Delaware opinions in turn.

282. Limited guidance exists outside the recent decisions discussed in detail in subpart III(A). *See In re* Shoe-Town, Inc. Stockholders Litig., No. 9483, 1990 WL 13475, at *6–7 (Del. Ch. Feb. 12, 1990) (describing an M&A advisor engaged by managers who were attempting a management buyout as "[i]n effect . . . serv[ing] as an agent of *management*" (emphasis added)); Transcript of Oral Argument on Defendant's Motion to Dismiss at 70, *In re* PLX Tech. Inc. Stockholders Litig., No 9880-VCL (Del. Ch. Apr. 15, 2015) (suggesting that "normal agency principles" govern the relationship between an M&A advisor and its client). The claim in this Article is broader: that the M&A advisor should be characterized as a fiduciary in performing both of its (potentially distinct) roles of giving advice (whether as an agent or not) and acting on a client's behalf (as an agent). As to an advisor's dual roles, *see supra* notes 81–96. Courts outside Delaware have considered the potential fiduciary character of the M&A advisor–client relationship. *See supra* note 216. For academic commentary on the potential fiduciary status of M&A advisors, see *supra* note 13 and accompanying text.

283. In determining whether a claim is direct or derivative, the court gives regard to who suffered the alleged harm and who would benefit from any recovery. Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031, 1035 (Del. 2004); *see also* DEL. CT. CH. R. 23.1 (specifying requirements for shareholder derivative actions).

Figure 3: Enforcement actions available under Delaware law to deter M&A advisor disloyalty[284]



In *Del Monte*,[285] the court was "scathing" of the M&A advisor's conduct.[286] After initially considering selling itself, Del Monte Foods changed tack, instructing its M&A advisor, Barclays, "to shut [the sale] process down and let [prospective] buyers know the company is not for sale."[287] Rather than do so, Barclays surreptitiously assisted two potential bidders to formulate a joint bid for the company, conduct that violated "anti-teaming" provisions in the confidentiality agreements each bidder had earlier signed with Del Monte.[288] Barclays actively concealed the bidders' cooperation from Del Monte.[289] When Del Monte began considering a sale months later, Barclays advised it on price negotiations with the same bidders it had surreptitiously assisted without disclosing its involvement with them.[290] Barclays then sought its client Del Monte's consent to provide buy-side financing, after having already discussed that possibility with the

284. Suits to hold M&A advisors primarily liable for disloyalty may be direct or derivative.

285. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813 (Del. Ch. 2011).

286. *See* Joseph Cotterill, *BarCap Criticized over Del Monte Sale*, FIN. TIMES (Feb. 16, 2011, 10:05 AM), http://ftalphaville.ft.com/2011/02/16/489971/barcap-criticised-over-del-monte-sale/ [https://perma.cc/K98P-M642] ("In a scathing preliminary judgment, Judge J. Travis Laster postponed for 20 days Tuesday's planned shareholder vote to approve the deal . . . .").

287. *Del Monte*, 25 A.3d at 822.

288. *Id.* at 817. The court described Barclays' conduct in assisting the potential bidders to team up as "behind-the-scenes efforts . . . to put Del Monte into play." *Id.* At the time the joint bid was facilitated, Barclays was not formally engaged by Del Monte. *Id.* at 833. However, it was "re-engaged" by Del Monte soon after and failed to disclose its role in the joint bid. *Id.*

289. *Id.*

290. *Id.*

prospective buyers—discussions it failed to disclose to its client when seeking consent.[291] After a deal was struck, Barclays conducted the "go-shop" process for Del Monte, despite by then having arranged to provide acquisition financing to the bidders; in consequence, Barclays risked losing lucrative financing fees if either of the bidders walked away[292] or if a higher bid emerged[293]—circumstances that cast doubt on the advisor's incentives to effectively conduct the go-shop. As described by the court, Barclays faced a conflict of interest in teaming the bidders together as well as later in advising on the sale—specifically, in conducting the go-shop while providing buy-side financing. Barclays' conflict in teaming the bidders compromised its client's interests and was therefore a real conflict; in contrast, it was unclear whether Barclays' conflict in conducting the go-shop was real or apparent.

The Court of Chancery issued a preliminary injunction against the directors, postponing target shareholders' vote for twenty days to allow time for another bidder to emerge, based primarily on the compromising effect (on the integrity of the directors' decision-making process) of Barclays' conflicts.[294] In doing so, the court imposed fault-based liability on the directors, applying enhanced judicial review under the *Revlon* standard.[295] It thus focused on the adequacy of the directors' decisionmaking process and the reasonableness of their actions in the circumstances in which they occurred.[296]

Applying the *Revlon* standard, the court ruled that Barclays' conflicts had rendered the directors' decision-making process unreasonable.[297] What "crossed the line" in undermining that process was Barclays' conduct in "secretly and selfishly manipulat[ing] the sale . . . to engineer a transaction

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291. *Id.*

292. *Id.* at 827–28. After permitting Barclays to provide buy-side financing, Del Monte had engaged a second M&A advisor to provide a fairness opinion. It is unclear from the opinion the extent to which that advisor counseled the company on subsequent price negotiations. Although Barclays had obtained the client's consent, it failed to disclose that it had informally arranged to finance the joint bid beforehand. *Id.* at 825–26.

293. *Id.* at 828. Adding further color to Barclays' conduct were its attempts to prevent a rival bank (one untainted by the prospect of receiving financing fees) from securing the go-shop role; to do so Barclays warned the bidders that the rival was "scar[ing] up competition" by seeking to handle the go-shop process, prompting the bidders to offer the rival a financial sweetener ostensibly to cease its solicitation. *Id.* The go-shop proved fruitless, with none of the parties approaching expressing interest in buying Del Monte. *Id.*

294. *Id.* at 818–19.

295. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986).

296. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994). For a detailed description of *Revlon* duties, see generally Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277 (2013).

297. *Del Monte*, 25 A.3d at 835. In fact, because shareholders sought a preliminary injunction, the court held that Barclays' conduct while advising and acting for Del Monte was sufficient to establish a reasonable likelihood of success on the merits of the shareholders' claim that the directors had failed to act reasonably in selling the company. *Id.* at 836.

that would permit [it] to obtain lucrative buy-side financing fees,"[298] along with Barclays' skewed incentives in advising on price negotiations and in conducting the go-shop.[299] More specifically, the directors had failed to act reasonably in exercising "active and direct" oversight over the sale process,[300] and had thus violated their fiduciary duties.

El Paso arose from the landmark $21 billion sale of energy giant El Paso to Kinder Morgan.[301] El Paso's directors relied on advice from their M&A advisor Goldman Sachs in evaluating which of two strategic options to adopt: spinning off one of its business units or merging with Kinder Morgan.[302] Goldman's role was complicated by its nineteen percent ownership interest in Kinder Morgan, the prospective buyer, which compromised its advice to El Paso on the proposed deal with Kinder Morgan.[303] To address concerns about Goldman's incentives, the directors also retained Morgan Stanley for advice and limited Goldman's role to advising only on the first of the two strategic options, the potential spin-off transaction.[304]

Contrary to plan, however, Goldman played an "important role" in advising El Paso's directors on the proposed deal with Kinder Morgan.[305] Goldman bankers advised the El Paso directors to avoid causing Kinder Morgan "to go hostile"; going hostile would have made the proposed merger public knowledge, possibly increasing the competition Kinder Morgan would face in buying El Paso.[306] Goldman bankers also influenced the terms under which El Paso engaged Morgan Stanley; the bank would receive $35 million if it approved the deal, and nothing otherwise, giving it strong incentives to advise El Paso in favor of a merger.[307] Goldman also had sway over the board's decision regarding the proposed merger simply through

298. *Id.* at 817, 833–34.

299. *Id.* at 835.

300. *Id.*

301. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 433 (Del. Ch. 2012).

302. *Id.* at 435–36.

303. *Id.* at 434.

304. *Id.* at 442.

305. *Id.* at 440. Other factors reinforced the view that Goldman was not in fact removed from advising on the merger. The court suggested that Goldman also recommended that the directors "not . . . do any test of the market with other possible buyers of El Paso as a whole." *Id.* at 441. Goldman asked for $20 million for its work on the merger, despite its claim—in legal proceedings—to have performed none. *Id.* at 443. Goldman also sought to be identified as an advisor on the Kinder Morgan merger in the press release announcing the deal. *Id.* at 446. Reportedly, Goldman did not receive the $20 million in fees. *Goldman Sachs Loses $20 Million Fee on El Paso Deal After Conflict of Interest Claims*, HUFFPOST BUSINESS (Sept. 10, 2012, 9:14 PM), http://www.huffingtonpost.com/2012/09/10/goldman-sachs-fee-el-paso_n_1872552.html [https://perma.cc/BCD5-XEZ8].

306. *Id.* at 440.

307. *Id.* at 442.

advising on the only alternative transaction, the potential spin-off.[308] One of Goldman's lead bankers also had an undisclosed $340,000 personal shareholding in Kinder Morgan.[309]

Although ultimately declining to issue a preliminary injunction (reluctantly, because the balance of equities did not favor it), the Court of Chancery again imposed potential fault-based liability on directors for their oversight of M&A advisors.[310] It found shareholders had established a reasonable likelihood of success on the merits of establishing that the directors acted unreasonably in selling the company.[311] In doing so, the court examined Goldman's conduct, pointing to the advisor's conflicts of interest. Goldman's $4 billion stake gave it financial incentives opposed to the best interests of El Paso.[312] The court went further, suggesting that these conflicts were real—that they had compromised Goldman's representation of its client.[313] Influenced by its conflicting incentives, Goldman had made the spin-off transaction appear less favorable relative to the Kinder Morgan deal than it would have otherwise.[314] But it was unclear whether Goldman's conflicts alone were sufficient to compromise the directors' decision-making process, rendering their conduct unreasonable because El Paso's CEO also had a conflict of interest—another factor informing the court's adverse

308. *Id.* at 440; *see also id.* at 441 ("[B]ecause Goldman stayed involved as the lead advisor on the spin-off, it was in a position to continue to exert influence over the Merger.").

309. *Id.* at 442.

310. *Id.* at 434.

311. *Id.*

312. *Id.* (describing Goldman Sachs as having "financial motives adverse to the best interests of El Paso's stockholders"). Goldman's financial calculus would have been to weigh its advisory fees from a spin-off against its potential gain from a Kinder Morgan merger; the court implicitly assumed that the investment bank's expected gain from the merger was the stronger incentive—a reasonable assumption given that El Paso had agreed to pay a $20 million advisory fee despite the spin-off never occurring.

313. *Id.*

314. *Id.* at 441. The court referred to "questionable aspects to Goldman's valuation of the spin-off," suggesting the bank acted on its adverse incentives. *Id.* The court also referred to concern among El Paso's directors that Goldman's advice was tainted by the bank's interest in Kinder. *Id.* at 440.

Additionally, the court referred to conduct by Morgan Stanley that was apparently consistent with the exploitation of conflicts of interest; its valuation advice could "be viewed as stretching to make Kinder Morgan's offers more favorable than other available options." *Id.* at 442. The court also referred to Morgan Stanley's tactical advice as "questionable." *Id.* In sum, evidence suggested that the conflicting incentives had not simply skewed Goldman's incentives, but had led to disloyal service. In addition, many tactical decisions made by the company's CEO, who negotiated on behalf of the company, were questionable. *Id.* at 444–45.

The court cited several factors in finding the plaintiffs had a reasonable probability of success on the claim, including "Goldman's continued influence over the Board's assessment of the spin-off." *Id.* at 444. Although the court rejected Goldman's claim that "it was not influenced by its own economic incentives to maximize its $4 billion investment in Kinder Morgan," it seems to acknowledge the fact of conflicts of interest standing alone, and not just their exploitation, may impair directors' decision-making process. *Id.* at 445.

decision against directors.[315] The court's reasoning, however, suggests that Goldman's conduct contributed significantly to the finding against El Paso's directors.

In *Rural Metro* the Court of Chancery again imposed fault-based liability on directors where conflicts of their M&A advisors compromised the sale process.[316] In advising Rural on its potential sale, Rural's M&A advisor used its role to try to secure work on another proposed transaction, in the course of which it distorted Rural's sale process. That transaction involved Rural's competitor, Emergency Medical Services (EMS), which was then exploring strategic alternatives.[317] Believing that private equity firms bidding for EMS might also seek to acquire Rural, the M&A advisor timed Rural's sale process to coincide with that of EMS.[318] By doing so, the advisor created incentives for the firms bidding for EMS to award work to the advisor because doing so might give them an advantage if they bid for Rural.[319] The M&A advisor failed to disclose this strategy to Rural's directors.[320]

While the design of the sale process had the potential to serve Rural's interests, it suffered from undisclosed defects. Bidders for Rural would be required to sign standard confidentiality agreements preventing them from disclosing confidential information to individuals participating in the EMS sale.[321] These provisions would effectively require investors to use separate deal teams to participate in both sales, diminishing the likelihood of bids for Rural and creating an obvious obstacle to the advisor's strategy. In fact, many bidders for EMS declined also to bid for Rural, a factor preventing "the emergence of the type of competitive dynamic among multiple bidders [for Rural] that is necessary for reliable price discovery."[322]

In addition to attempting to leverage its position to gain a role in the EMS sale, the M&A advisor repeatedly lobbied Warburg (the eventual acquirer of Rural) to serve as lender for its acquisition of Rural—without disclosing that lobbying to Rural.[323] The advisor's undisclosed lobbying continued even after it began negotiating the final deal terms with Warburg on Rural's behalf.[324] Though its efforts failed to yield additional work, the

315. The CEO was contemplating buying back a segment of the company after the merger. *Id.* at 447.

316. *Rural I*, 88 A.3d 54, 63 (Del. Ch. 2014). The facts stated here are taken from the Delaware Supreme Court's decision. RBC Capital Mkts. v. Jervis, 129 A.3d 816 (Del. 2015).

317. *RBC Capital Mkts.*, 129 A.3d at 828–29.

318. *Id.* at 835.

319. *Id.* at 828.

320. *Id.* at 854.

321. *Id.* at 855.

322. *Id.* at 856.

323. *Id.* at 839.

324. *Id.*

advisor favored its own interests as a potential lender over those of Rural.[325] Additionally, during the sale process the M&A advisor divulged nonpublic client information to Warburg and manipulated the valuation metrics it provided Rural to increase the appeal of a deal with Warburg—both without disclosure to its client.[326]

In a rare post-trial decision, the Court of Chancery held that the M&A advisor's conduct compromised the integrity of the directors' decision-making process, with the result that the directors' conduct failed *Revlon* scrutiny.[327] It also held the M&A advisor liable to Rural's shareholders for aiding and abetting the directors' fiduciary breaches—an issue explored in subpart III(B).[328]

As in *Del Monte*, Vice Chancellor Laster referred to directors' duty of active and direct oversight over the sale process under the *Revlon* standard of review. That duty required directors to "act reasonably to identify and consider the implications of the investment banker's compensation structure, relationships, and potential conflicts."[329] The board failed to adequately oversee its M&A advisor, failed to act reasonably in the sale process, and breached the fault-based standard.

On appeal, the Delaware Supreme Court in *RBC Capital Markets* affirmed the Court of Chancery's decision, agreeing that the directors' overall conduct failed *Revlon* scrutiny.[330] The directors had failed to effectively oversee the sale process, including by addressing the M&A advisor's conflicts of interest. The directors had also failed to adequately inform themselves as to Rural's value.

As to directors' failure to effectively oversee the sale process, the Delaware Supreme Court pointed particularly to the compromising effect of the dual-track sale process and to its design by a conflicted M&A advisor; it noted that this process served the advisor's own interests in seeking a role in

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325. *Id.* at 838 (observing that the parties' engagement letter failed to "disclose that RBC would favor its interests as a lender over those of the Company").

326. *Id.* at 845.

327. *Rural I*, 88 A.3d 54, 96 (Del. Ch. 2014) ("The combination of RBC's [conduct] . . . caused the Board decision to approve Warburg's offer to fall short under the enhanced scrutiny test. . . . The plaintiffs proved that 'the adequacy of the decisionmaking process employed by the directors . . .' fell outside the range of reasonableness."). Because the directors had settled with the shareholder plaintiffs before trial, the Court of Chancery examined this issue as a predicate question to an aiding and abetting claim against the M&A advisor. Had the directors not settled, they would have enjoyed protection from personal liability under DEL. CODE ANN. tit. 8, § 102(b)(7) (2011). A secondary M&A advisor engaged by Rural had also settled, leaving the (primary) M&A advisor as the sole defendant.

328. *Rural I*, 88 A.3d at 63. The issue of the M&A advisors' liability for aiding and abetting the directors' fiduciary breaches is explored further in subpart III(B).

329. *Rural I*, 88 A.3d at 90. The court also explained that active and direct oversight also required that directors "act[] reasonably to learn about actual and potential conflicts faced by . . . their advisors." *Id.*

330. *RBC Capital Mkts.*, 129 A.3d at 854.

the EMS transaction.[331] The process compromised Rural's interests, "imped[ing] interested bidders from presenting potentially higher value alternatives."[332] In finding that the directors breached their *Revlon* duties, the court did not specifically refer to the other conflicts under which the M&A advisor labored, including its lobbying to provide staple financing to Warburg, but nevertheless faulted the directors for "[taking] no steps to address or mitigate RBC's conflicts"[333]—an apparent reference to the multiple conflicts identified by the court, not only the conflict in seeking a role in the EMS deal. The court stated that directors must "be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest [of its advisors]."[334] At the same time, directors need not conduct "searching and ongoing due diligence" of their M&A advisors.[335]

Consonant with the prescriptions of optimal deterrence theory in Part II, these Delaware cases impose fault-based liability on directors, requiring them to act reasonably—a standard of conduct that requires oversight of M&A advisors. The decisions require directors to be alert to conflicts—whether apparent or real—afflicting their M&A advisors and to monitor advisors' incentives and conduct—or to risk acting unreasonably. But oversight of bankers need not be "searching" or require "ongoing due diligence."[336]

The recent Delaware decisions cast M&A advisors in the role of fiduciaries, or at least loyal advisors to their M&A clients, in accord with the analysis in Part I.[337] Although the decisions do not consider the fiduciary character *vel non* of M&A advisors, they support this vision of M&A advisors. First, by characterizing circumstances that give M&A advisors incentives to compromise their representation of clients as conflicts of interest, the decisions conceive of M&A advisors as loyal actors, if not fiduciaries: "Only fiduciaries have an obligation of unselfishness, an obligation which turns self-interest into a conflict of interest."[338]

Second, by regarding advisors' conflicts of interest as compromising directors' decision-making process, the decisions implicitly require loyalty of M&A advisors toward their clients. In none of the decisions did the court examine the M&A advisor's conflicts out of concern for whether the

331. *Id.* at 854–55.

332. *Id.* at 854.

333. *Id.* at 855.

334. *Id.*

335. *Id.*

336. *Id.*

337. Its approach is also consistent with non-Delaware doctrine, which recognizes that M&A advisors may owe fiduciary duties to their corporate clients. *See supra* note 216.

338. Jill E. Fisch, *Fiduciary Duties and the Analyst Scandals*, 58 ALA. L. REV. 1083, 1093 (2007).

advisor's interests were aligned too closely with those of its client (or with those of its client's directors or senior managers)—as it should have had it envisioned the M&A advisor as required to act independently of its client's interests. Rather, the decisions examine each M&A advisor's interests to determine whether they potentially undermined the advisor's loyalty toward its client, reasoning that regards M&A advisors as loyal advisors of their clients.

The Delaware Supreme Court's analysis in *RBC Capital* muddied the waters somewhat, but it nevertheless required M&A advisors to act loyally toward their clients or at least subjected them to robust limits on conflicts with client interests, consonant with fiduciary doctrine.[339] In important dicta, the court disavowed the lower court's description of M&A advisors as gatekeepers and emphasized the "primarily contractual . . . nature" of the advisor–client relationship[340]—but then immediately qualified that description: by imposing on M&A advisors generally (rather than the particular advisor in question) "an obligation not to act in a manner that is contrary to the interests of the board of directors."[341] The court offered other guidance consistent with envisioning M&A advisors as required to act loyally. Even when an advisor acts with its client's consent, it cannot freely pursue its self-interest; rather, 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," the court asserted.[342] Moreover, the court stated that directors "may be free to consent to *certain* conflicts,"[343] suggesting that directors may not consent to others.

The approach in *RBC Capital* toward postengagement relations between M&A advisors and their clients also accords with fiduciary doctrine. As in earlier Delaware decisions, the court evaluated any deviation from loyalty not through the lens of contract, but through the lens of fiduciary doctrine, inquiring whether clients gave "consent" or "permission" for the M&A advisor to engage in conflicted action and considering the scope of information

339. For further discussion, see Andrew F. Tuch, Banker Obligations After RBC Capital (Apr. 19, 2016) (unpublished manuscript) (on file with author). The Delaware Supreme Court's analysis is consistent with guidance of the Court of Chancery in Transcript of Oral Argument on Defendant's Motion to Dismiss, *supra* note 282; see also *supra* note 282.

340. *RBC Capital Mkts.*, 129 A.3d at 865 n.191 ("[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.").

341. *Id.* Similarly, the obligation is expressed absolutely, rather than contingently as it should be expressed if it simply reflects or acknowledges an M&A advisor's potential liability for aiding and abetting director's fiduciary breaches, liability that hinges on the existence of underlying fiduciary breaches.

342. *Id.* at 855.

343. *Id.*

then disclosed.[344] The court suggested that the M&A advisor's exploration of staple financing—one of the conflicts in question—was outside the terms of the consent that directors had given.[345] This analytical approach suggests that the advisor was obliged to be loyal or faced limits on its conflicts with its client's interests. Only when such an obligation exists does consent *to conflicts* become necessary; only then does inquiry into consent to conflicts serve some analytical purpose. Agency law illustrates the point,[346] and indeed the court drew on agency law to support its analysis of client consent.[347]

B. How Delaware Law Fails to Conform

In several other respects, the Delaware approach fails to conform to the liability regime suggested in Part II. Although it imposes fault-based liability on directors, in most cases the Delaware approach relieves them of liability for monetary damages. Nearly all Delaware corporations take advantage of their ability under § 102(b)(7) of the Delaware General Corporate Law to include provisions in their corporate charters exculpating their directors from liability for monetary damages for breaches of fiduciary duty other than for breaches of the duty of loyalty or for bad faith conduct.[348] Unless directors self-deal, the Delaware decisions suggest directors' breaches are likely to be

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344. *See, e.g.*, *RBC Capital Mkts.*, 129 A.3d at 855 n.129 (referring to disclosure of and consent to conflicts); *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 826, 833 (Del. Ch. 2011) (examining the M&A advisor's request to provide buy-side financing and the information it then disclosed to its client); *see also In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1005–06 (Del. Ch. 2005) (examining the M&A advisor's request for permission to provide buy-side financing).

345. *RBC Capital Mkts.*, 129 A.3d at 855 ("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.").

346. According to the *Restatement (Third) of Agency*, "[c]onduct by an agent *that would otherwise constitute a breach of duty* . . . does not constitute a breach of duty if the principal consents to the conduct." *See* RESTATEMENT (THIRD) OF AGENCY § 8.06(1) (AM. LAW INST. 2005) (emphasis added). More specifically, the conduct is treated as not constituting a breach of duty. Thus, when a fiduciary obtains its client's informed consent, the consent shelters the fiduciary from liability *that would otherwise arise* for that conduct. The law governing lawyers is similar. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 122 cmt. b (AM. LAW INST. 1998) ("The conflict rules are subject to waiver through informed consent by a client who elects less than the full measure of protection *that the law otherwise provides*." (emphasis added)).

347. In its discussion of disclosure and consent, the court cites an article by Professors William Bratton and Michael Wachter that explicitly draws its own references to disclosure and consent from agency law. *RBC Capital Mkts.*, 129 A.3d at 865 n.191.

348. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2011) (forbidding charter provisions from eliminating or limiting personal liability of directors for, among other things, breaches of directors' duty of loyalty and "for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law"); Houseman v. Sagerman, No. 8897-VCG, 2014 WL 1600724, at *8 (Del. Ch. Apr. 16, 2014) ("Nearly all corporations take advantage of [§ 102(b)(7)], presumably because doing so returns value to stockholders.").

duty of care breaches and thus within the scope of these charter provisions.[349] Directors' liability for monetary damages for fiduciary breaches is correspondingly limited, diminishing the deterrent effect of directorial liability.

In consequence, the only realistic remedy available to plaintiffs for violations of directors' fiduciary duties—leaving aside aiding and abetting liability—is the injunction.[350] However, this remedy arguably imposes weak deterrent force on directors. Before obtaining a preliminary injunction, shareholders must demonstrate a reasonable probability of success on the merits, the occurrence of immediate and irreparable harm if an injunction is refused, and that the balance of equities weighs in favor of an injunction.[351] A preliminary injunction may therefore be denied—as it was in *El Paso*—when only the final factor (the balance of equities) favors that result. In refusing to grant a preliminary injunction in *El Paso*, then-Chancellor Strine cited the risks to El Paso shareholders that Kinder Morgan would refuse under the merger agreement to close the deal if an injunction were granted. He expressed "frustration" with the injunction as failing to "provide the kind of fine instrument that enables optimal protection of stockholders in this context."[352] The reason was that shareholders would be faced with the prospect of no deal or accepting a deal that was "good" but not "as good" as it would be if the directors had discharged their fiduciary duties.[353] Not wanting to deprive shareholders of the chance to accept the deal, compromised though the directors' decision-making process was, then-Chancellor Strine refused to issue the injunction. The directors therefore escaped sanction, despite acting unreasonably in overseeing the sale process. Although directors continue to face reputational sanctions for fiduciary breaches, they may escape personal liability entirely, weakening their incentives to police M&A advisors' activities.

The fault-based standard imposed on directors in Delaware may also fail to conform fully with the analysis in Parts I and II. Directors must act reasonably in overseeing the conduct of their M&A advisors, but there is no suggestion that they need to hold their M&A advisors accountable for their disloyalty. Delaware law clearly provides incentives for boards to oversee their M&A advisors during the sale process to avoid violating their fiduciary duties. But the board of directors that later learns of advisor disloyalty may lack incentives under Delaware law to enforce its rights against its advisor,

349. *See In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 448 (Del. Ch. 2012) (finding that the exculpatory charter provision likely protects independent directors); *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 818 (Del. Ch. 2011) (finding that the exculpation under Section 102(b)(7) makes chances of a monetary damage judgment "vanishingly small").

350. *Id.* (citing Police & Fire Ret. Sys. of the City of Detroit v. Bernal, No. 4663-CC, 2009 WL 1873144, at *3 (Del. Ch. June 26, 2009)).

351. *E.g.*, Cantor Fitzgerald, L.P. v. Cantor, 724 A.2d 571, 579 (Del. Ch. 1998).

352. *El Paso*, 41 A.3d at 450.

353. *Id.* at 450–51.

especially if the advisor's conduct is otherwise unlikely to come to light. Put otherwise, the duty in Delaware requires *ex ante* policing but does not require *ex post* policing if directors learn of advisor disloyalty after the sale process has concluded.

Another point of distinction concerns the scope of Delaware's regime. Because it applies most forcefully when *Revlon* duties arise, many advisor conflicts would fall beyond its reach.[354] When *Revlon* duties do not arise, Delaware courts typically apply the highly deferential business judgment rule (BJR) to assess directors' conduct.[355] The regime is unlikely to constrain buy-side advisor conflicts because the buyer's directors will not owe *Revlon* duties; it will not apply to sell-side advisor conflicts in deals that do not trigger *Revlon* duties. Accordingly, the buy-side M&A advisor that buys a stake (as principal) in the seller during a deal, putting upward pressure on the sale price, would escape sanction under the constraints articulated in these decisions,[356] as would the buy-side advisor simultaneously acting for a competing bidder or even competing with its client to acquire the target company itself.

Finally, Delaware courts' imposition of aiding and abetting liability is not clearly supported by the analytical framework in Part II. In *RBC Capital*, the Delaware Supreme Court found that the M&A advisor had aided and abetted the fiduciary breaches by directors because it had "knowingly participated" in them by exploiting its own conflicts of interest and creating an informational vacuum.[357] However, if we regard M&A advisor disloyalty as the wrong to be deterred, then directorial liability represents a form of secondary liability, and M&A advisors' liability for aiding and abetting directorial breaches may represent tertiary liability. While the deterrent effects of such liability are uncertain, two observations deserve emphasis. First, absent aiding and abetting liability, private enforcement fails to effectively deter M&A advisor disloyalty in M&A transactions: advisors face little risk of primary liability; directors face little threat of personal liability for

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354. Enhanced judicial scrutiny under *Revlon* does not apply in the case of stock-for-stock mergers of widely held corporations. *See In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 989 (Del. Ch. 2014) ("Enhanced judicial scrutiny under *Revlon* is not implicated in this action because the stock-for-stock merger involved widely-held, publicly traded companies.").

355. The BJR involves a highly deferential standard of judicial scrutiny, under which courts will not second-guess the judgments of properly functioning boards of directors. *E.g.*, Orman v. Cullman, 794 A.2d 5, 20 (Del. Ch. 2002). The rule can be rebutted in the M&A context, such as by showing that a controlling stockholder stands on both sides of a transaction. *KKR Fin. Holdings*, 101 A.3d at 990. But "[i]f the plaintiff rebuts the business judgment presumption, the Court applies the entire fairness standard of review to the challenged action and places the burden on the directors to prove that the action was entirely fair." eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 36–37 (Del. Ch. 2010).

356. For similar facts, see *Australian Sec & Invs Comm'n v Citigroup Glob Mkts Austl Pty Ltd [No. 4]* (2007) 160 FCR 35 (Austl.).

357. The court subsequently awarded nearly $76 million to shareholders. *Rural II*, 102 A.3d 205, 224 (Del. Ch. 2014).

failing to reasonably police advisors' disloyalty; and in neither case does the threatened magnitude of sanction compensate for the low probability of sanction. Further deterrence of M&A advisors' conflicts is desirable.

Second, aiding and abetting liability is poorly suited to the task of deterring M&A advisors' conflicts. As a form of secondary liability, it is tied to directorial conduct and is thus defeated where directors discharge their own duties, even where M&A advisors have acted disloyally.[358] In an extreme case, an M&A advisor would avoid aiding and abetting liability where it effectively concealed its disloyalty from directors who, despite being misled, acted reasonably. Aiding and abetting liability arises not for M&A advisor disloyalty, but for the conceptually distinct conduct of knowingly participating in directors' failure to reasonably police M&A advisors' conduct. Even where directors do breach their fiduciary duties, it is easy to conceive of circumstances where a disloyal M&A advisor harms its client without knowingly participating in directors' oversight lapses and therefore avoids liability. For example, a brazenly disloyal M&A advisor may cause real harm without either misleading the board or creating an informational vacuum, and so arguably fall beyond the reach of aiding and abetting liability. Indeed, the Delaware Supreme Court in *RBC Capital* referred to the aiding and abetting claim as "among the most difficult to prove" because of this knowledge requirement.[359]

C. *How Delaware Law Should Develop*

Delaware law likely leaves M&A advisors underdeterred from acting disloyally toward their clients. Though directors must police advisor conflicts, they will rarely face personal liability for failing to comply with their duty to do so, absent self-dealing of their own. Directors are risk averse and reputation conscious, making them potentially vulnerable to adverse judgments, especially if the deals are high profile and most especially if directors are "shamed" by harsh judicial rhetoric.[360] The potential for directorial

358. If a merger has been approved by a fully informed, uncoerced majority of the disinterested shareholders, then in a suit for damages, directors' conduct will be reviewed under the deferential business judgment rule rather than under stricter standards. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015). Applying this standard of review makes it considerably more likely that directors will satisfy their fiduciary duties—and lead to dismissal of aiding and abetting claims against M&A advisors. *See In re* Zale Corp. Stockholders Litig., No. 9388-VCP, 2015 WL 6551418, at *1 (Del. Ch. Oct. 29, 2015).

359. 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 ACQUISITIONS 18–19 (S. Davidoff Solomon & C. Hill eds., forthcoming), http://ssrn.com/abstract=2654008 [https://perma.cc/8WAF-YAEZ] (describing aiding and abetting liability for M&A advisors as "rare" because of the requirement for "knowing participation").

360. *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1103–04 (1997) (suggesting that the possibility of "public shaming" by Delaware judicial opinions constrains managers' conduct).

liability is thus not without force, but it may fail to counteract the potentially powerful incentives in M&A deals for conduct contrary to shareholder interests and, ultimately, may not force directors to bear the costs of M&A advisor disloyalty. For their part, M&A advisors rarely face primary liability for disloyalty, although—in narrow circumstances—they may face liability for the conceptually distinct conduct of aiding and abetting directors' breaches.

The question is how, if at all, Delaware should respond: first, to any general underdeterrence of M&A advisor disloyalty and second, to any evident gaps in liability (and thus deterrence). As for general underdeterrence, Delaware law—like all private law—has limited capacity to respond. It cannot compensate for a low probability of sanction by employing the widely suggested options of increasing the magnitude of sanctions or by imposing criminal liability.[361] Though courts might limit the force of § 102(b)(7) charter provisions by interpreting directors' oversight lapses as breaches of the duties of loyalty or good faith—and thus outside the scope of the charter provisions—to do so risks both undermining the coherence of doctrine and increasing the liability of directors in contexts unrelated to M&A advisors' conflicts (if the narrower interpretation of § 102(b)(7) is applied to other contexts)—consequences not justified by the analysis in this Article.

With limited options, Delaware has seized upon the doctrine of aiding and abetting liability to bolster deterrence. As discussed, however, aiding and abetting liability is a narrow and highly attenuated mechanism for deterring advisor disloyalty.[362] Courts could expand it by, for example, presuming scienter when investment bankers "knowingly or recklessly" participate in directors' breaches, a change that would mirror Dodd-Frank Act reforms to aiding and abetting liability under Rule 10b-5 in actions brought by the SEC.[363] However, such a doctrinal shift would have uncertain deterrent effects and do nothing about the contingent nature of the liability, under which disloyal advisors avoid liability when directors act reasonably, discharging their fiduciary duties. Aiding and abetting liability should remain narrow, provided Delaware courts use other mechanisms of deterrence.

Several doctrinal improvements suggest themselves. First, courts should provide greater guidance on directors' responsibilities for overseeing M&A advisors and articulate specifically the conduct directors must require of M&A advisors. In *RBC Capital*, the Delaware Supreme Court faulted directors for failing to "*address or mitigate* . . . conflicts";[364] states that their

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361. *See supra* notes 237–39, 262–65 and accompanying text.

362. *See supra* note 267–68 and accompanying text.

363. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929O, 124 Stat. 1376, 1862 (2010) (amending 15 U.S.C. § 78t(e) (2008)).

364. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 855 (Del. 2015) (emphasis added).

oversight role includes "*identifying and responding to* actual or potential conflicts of interest";[365] and observes that directors' reliance on § 141(e) presupposes that they have "undertaken to *manage* conflicts as part of [their] oversight of the process."[366] The precise conduct required remains vague. It is also unclear under this guidance when directors must enforce an M&A advisor's apparent obligation "not to act in a manner that is contrary to the interests of the board of directors."[367]

Courts should also provide guidance on the terms on which directors should engage M&A advisors and the conditions under which they should, and should not, consent to conflicts. They might find, for example, that directors who attempt to use engagement letters to disable the fiduciary or other protections available against their M&A advisors, either by disclaiming fiduciary duties or by giving their informed consent at the outset, may well disable themselves from exercising their own fiduciary obligations—just as a board entering into absolute lockups (with no fiduciary-out clause) "disable[s] itself from exercising its own fiduciary obligations at a time when the board's own judgment is most important."[368] Along this line of reasoning, directors who reflexively agree to boilerplate provisions in their engagement letters purporting to disclaim fiduciary duties or reduce fiduciary liability could presumptively be considered to violate their fiduciary duties. Of course, directors may properly consent to M&A advisors' conflicts that they believe, after due consideration, will serve the shareholders' interests. But how can directors reasonably oversee their M&A advisors if, at the outset of the relationship, they sign boilerplate letters giving up (to the extent they can) what is likely the most effective conflict–policing mechanism at their disposal—the fiduciary duty?

In *RBC Capital*, the court went some way toward addressing this concern about directors' capacity to weaken a company's fiduciary and other protections against an advisor's conflicts. Even when directors have given consent, they must "be especially diligent in overseeing the conflicted advisor's role in the sale process";[369] in doing so, they "should require disclosure of, on an ongoing basis, material information that might impact the board's process."[370] Moreover, directors "may be free to consent to *certain* conflicts,"[371] guidance suggesting that directors may not consent to (unspecified) others. And advisors get no "free pass" even when they receive

365. *Id.* (emphasis added).
366. *Id.* at 855 n.129 (emphasis added).
367. *Id.* at 865 n.191.
368. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 938 (Del. 2003).
369. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 855 n.129 (Del. 2015).
370. *Id.* at 856.
371. *Id.* at 855 (emphasis added).

consent.[372] Courts must closely scrutinize directors' willingness to weaken constraints on advisors' disloyalty.

Courts could go further still, especially considering directors' historical reluctance to take M&A advisors' conflicts seriously. Another step would be to make more explicit their vision of M&A advisors as loyal advisors.

More drastically, courts could give shareholders a *direct* cause of action to hold M&A advisors *primarily* liable for their disloyalty.[373] They might, for example, treat shareholders as direct (or third party) beneficiaries of M&A advisors' obligation "not to act in a manner that is contrary to the interests of the board of directors."[374] The merits of doing so are difficult to weigh. On the one hand, such shareholder rights would bolster deterrence; on the other hand, they would invite unmeritorious litigation. They would run counter to Delaware's board-centric model of governance and thus stand little chance of recognition. However, they would directly address the concern that directors have generally failed to hold M&A advisors to account for disloyalty and have often defeated existing fiduciary protections against advisor disloyalty by waiving them or simply failing to enforce them.

But if courts do facilitate these direct suits, they should permit shareholders to bring them even after a merger, bearing in mind that acquirers rarely have incentives to hold a seller's advisor to account, especially if they benefited from the advisor's disloyalty.

Another issue concerns the use of contractual provisions to aid directors in policing their M&A advisors. Though contractual provisions may help directors with this, these provisions—without fiduciary protections—are unlikely to be adequate. To be sure, contractual terms might require M&A advisors to be loyal or to disclose conflicts.[375] These provisions might reduce uncertainty or potential ambiguity as to actors' duties, sharpening their minds as to their obligations and thus possibly diminishing the chance they will breach their duties.[376] But contractual provisions fail to cost-effectively match the rigor and detail of fiduciary doctrine in the M&A advisory context. Fiduciary doctrine draws upon a rich body of guidance concerning the content and scope of duties of loyalty, the operation of informed consent, and the application of these principles to diverse circumstances—guidance reflecting decades of accumulated judicial and scholarly experience that parties cannot feasibly establish in their contracts, at least not cost-

372. *Id.*

373. Although shareholders might seek to derivatively enforce an obligation owed to the corporation, directors' influence over derivative suits might dissuade them from doing so. *See supra* note 217 and accompanying text.

374. *RBC Capital Mkts.*, 129 A.3d at 855 n.191.

375. *See generally* Klinger-Wilensky & Emeritz, *supra* note 232 (providing examples of terms of engagement letters).

376. Tuch, *Disclaiming Loyalty*, *supra* note 13, at 225.

effectively.[377] Parties' attempts to craft a conflicts regime will be difficult, costly, and uncertain. Moreover, contract law cannot safeguard loyalty as effectively as fiduciary doctrine; as Professor Daniel Markovits argues, a fiduciary's orientation after being engaged is necessarily other regarding and must adjust "open-endedly to the interests of the other as circumstances develop," whereas a contract promisor's posture in that situation is based on self-interest, depends on the contract, and need not adjust "open-endedly."[378] Since fiduciary duties arise extra-contractually, they also provide protection for clients when an advisory engagement has commenced but has not been formally documented in an engagement letter. Fiduciary doctrine provides beneficiaries with a unique arsenal of remedies beyond those available for breach of contract. And the often-harsh rhetoric accompanying transgressive behavior by fiduciaries threatens greater reputational harm than the consequences of breach of contract can deliver.

Of course, contractual protections can usefully supplement fiduciary protections. The clients of M&A advisors might, for instance, require M&A advisors to disclose activities that, while not constituting conflicts in a legal, doctrinal sense (because they do not give rise to a "substantial risk" of "material and adverse" representation), nevertheless would potentially concern the client for their capacity to compromise the advisor's conduct.[379] Thus, contractual provisions might be used to stiffen or extend fiduciary protections in certain areas, and perhaps clarify potential ambiguity.

As for gaps in liability, rather than general underdeterrence, private law again presents limited options. Courts could take a bolder approach by scrutinizing directors' conduct even outside the change-of-control situations to which *Revlon* duties now apply. They could take account of how directors actually responded when conflicts came to light, enlarging the scope of enhanced scrutiny to include directors' postdeal conduct for the color it adds to their deal conduct. While these possible shifts in *Revlon* doctrine would add deterrence force, courts are likely to resist them.[380]

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377. *Cf.* Langbein, *supra* note 134, at 660–62 (likening the law governing trusts by default to an extensive body of default contract terms that "impounds the experience of decades of trust practice, legislation, and case law" and thereby spares trust planners "the difficulty, uncertainty, and expense" of designing those terms afresh); Sitkoff, *Economic Structure*, *supra* note 131, at 1044 (claiming that the mass of authority produced by the common law process concerning fiduciary duties has made their application simpler and more predictable without removing the advantages of open-ended standards).

378. Markovits, *supra* note 132, at 212–16; *see also* D. Gordon Smith, *Contractually Adopted Fiduciary Duty*, 2014 U. ILL. L. REV. 1783, 1784 ("My thesis is that the fiduciary duty of loyalty, properly understood, cannot be adopted contractually.").

379. As to the meaning of conflict of interest used in this Article, see *supra* note 1.

380. In *RBC Capital Markets*, the Delaware Supreme Court reaffirmed existing doctrine in determining when *Revlon* duties apply; its analysis suggested no change in law. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 851–54 (Del. 2015).

Finally, courts are poorly suited to controlling certain hard-to-detect conflicts, such as those created by investment banks' securities-trading positions, or determining the effectiveness of banks' information barriers in mitigating the effects of conflicts.[381] Because monitoring trading activity and verifying information flows within firms requires increased effort and an investigative apparatus that courts lack, public enforcement should close the gap.[382]

IV. Other Implications

Self-regulation could usefully play a central role in regulating M&A advisors' conduct.[383] M&A advisors are subject to self-regulation by FINRA because of their designation as broker–dealers.[384] Self-regulation offers distinctive advantages over other techniques for regulating professional conduct, including the capacity to regulate ethics more effectively than the broad brush of government regulation.[385] Agencies could specify standards of conduct in the form of canons of professional responsibility for investment bankers that would incorporate guidance on M&A advisors' relations with their clients.[386] The creation of canons may provide clarity as to bankers' obligations and increase bankers' sense of professionalism, thereby potentially magnifying the force of extralegal mechanisms of social control, such as reputation, in deterring banker disloyalty.

A further implication concerns recent and important scholarly contributions in the field concerning how directors might reasonably oversee M&A

381. *See* Tuch, *supra* note 55, at 572–80 (examining the effectiveness of information barriers in financial conglomerates and the challenges facing those tasked with regulating their use).

382. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 580 ("When the identification or apprehension of violators is difficult and requires effort, enforcement by public agents may be required.").

383. *See* Tuch, *supra* note 59, at 105–10 (arguing that the current self-regulation system "underdeters investment bankers' misconduct" and proposing "the formation of a dedicated self-regulatory body with expertise in investment banking"). The proposal encompasses the breadth of investment bankers' conduct, rather than simply the preparation of fairness opinions. It is thus considerably broader than the investment banking standard-setting body proposed by Professor Steven Davidoff Solomon to promulgate and enforce rules and guidelines for fairness opinions. *See* Davidoff, *supra* note 97, at 1615–19 (proposing an "Investment Banking Authority" to promulgate guidelines and standards for valuation practice, ensuring that they are kept up-to-date and adhered to, and supervise fairness opinion preparation procedures and internal controls).

384. As to the authority of FINRA, see *supra* notes 59–60 and accompanying text.

385. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 186 (1982) (quoting William O. Douglas, then Chairman of the SEC, discussing the "unquestioned advantages" of self-regulation over direct SEC enforcement).

386. Although FINRA's rules function as the equivalent of the rules of professional responsibility governing other professionals, such as lawyers and accountants, they are tailored generally to broker–dealers, rather than specifically to M&A advisors or to investment bankers, and thus fail to govern M&A advisors' conflicts. *See* Tuch, *supra* note 59, at 170–74 (suggesting ways to enliven and rehabilitate the self-regulation of investment bankers).

advisors' activities as they seek to satisfy their *Revlon* duties. As argued above, it is difficult to see why fiduciary duties should not be a core part of the solution. In this respect, this analysis differs from that of Professors William Bratton and Michael Wachter, who regard M&A advisors "in practice as arm's-length counterparties constrained less by rules of law than by a market for reputation"[387] and further claim that the recent Delaware cases "presuppose that bankers and clients have opted to define their relationships contractually"[388] and envisage directors imposing contractual provisions on M&A advisors to "facilitate oversight."[389] Nevertheless, Professors Bratton and Wachter suggest a standard of conduct closely mimicking the fiduciary duty; in particular, they suggest contractual provisions in engagement letters requiring M&A advisors to disclose their conflicts of interest and to act with "absolute fidelity."[390] But if M&A advisors are arm's-length counterparties, what basis exists for expecting loyalty of them and for sanctioning directors for failing to police their conflicts of interest? The judicial expectation of directors in their dealings with M&A advisors must depend on how we characterize M&A advisors. If M&A advisors are fiduciaries, courts may justifiably sanction directors for failing to oversee their conflicts of interest. If they are arm's-length counterparties only, then disciplining directors for failing to keep them loyal lacks apparent justification.

The analysis in this Article also has implications for the general phenomenon—of which M&A advisors' conflicts is one manifestation—in which beneficiaries of fiduciary duties must rely on an interposed actor to enforce fiduciary protections. In the investment banking context, shareholders rely on corporate directors (interposed actors) to enforce the fiduciary duties owed by M&A advisors (fiduciaries). Those beneficiaries of fiduciary duties are therefore subject to twin principal–agent problems: the first is the classic Berle–Means agency problem between shareholders and managers;[391] the second, that between managers and a fiduciary. This twin agency phenomenon greatly magnifies the risk that fiduciary protections will be defeated, a point illustrated by the analysis in subpart II(B).

This phenomenon exists in various guises throughout the capital markets. It arises in any context where the beneficiaries of fiduciary duties are so numerous that they must appoint fiduciaries to act on their behalves—as corporate shareholders must. The pooled investment vehicle—often structured as a mutual fund or pension fund—is a common instance. In that

387. Bratton & Wachter, *supra* note 13, at 8.

388. *Id.*

389. *Id.* at 61 (referring to "monitoring the advisor's activities and using contract to facilitate oversight and position the board to take appropriate action").

390. *Id.* at 54.

391. *See generally* BERLE & MEANS, *supra* note 223, at 119–25.

context, investment managers (interposed actors) act on behalf of a mass of investors.[392] Whenever they engage the services of advisors—such as investment advisors,[393] lawyers, or other agents—as they must, the twin agency phenomenon occurs.

The problems arising from twin agency relationships have been documented within the corporation, but have not previously been extended to corporations' relationships with third parties. Ronald Gilson and Jeffrey Gordon have observed what they call a new agency problem that results from the rise of institutions owning securities for beneficial owners.[394] In addition to the agency costs between managers and shareholders, they describe agency costs between institutional shareholders and their investors, the beneficial owners of securities. They suggest that initiatives should foster the development of a complementary set of specialists, notably, activist investors, to ensure effective monitoring of corporate directors.[395] They do not consider liability rules as a vehicle for ensuring good governance. In contrast, the analysis in this Article generalizes the problem to third parties outside the corporation and examines regulatory initiatives, both public and private, to address the twin-agency phenomenon.

The framework developed here offers salutary lessons for dealing with this phenomenon. One involves the potential benefits of holding the interposed actor liable to the beneficiaries for the wrongs of the fiduciary, as in holding directors responsible for M&A advisor disloyalty. Another lesson concerns the articulation of the duties owed by the interposed actor: the analysis suggests courts should impose fault-based liability on that actor, requiring it not only to police the fiduciary's conduct *ex ante*, but to be prepared to sanction it *ex post*. The analysis also suggests merit in courts carefully scrutinizing the terms on which interposed actors engage fiduciaries.[396]

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392. There is little doubt that investment managers owe fiduciary duties to their asset management clients. *See, e.g.*, Bd. of Trs. of AFTRA Ret. Fund v. JPMorgan Chase Bank, N.A., 806 F. Supp. 2d 662, 680 (S.D.N.Y. 2011). Firms themselves acknowledge that they owe fiduciary duties when acting as investment managers. *See, e.g.*, GOLDMAN SACHS, BUSINESS STANDARDS COMMITTEE IMPACT REPORT 8 (2013), http://www.goldmansachs.com/a/pgs/bsc/files/GS-BSC-Impact-Report-May-2013-II.pdf [https://perma.cc/C93V-H637] (referring to the bank's "fiduciary responsibilities when acting as an investment manager").

393. Investment advisers are fiduciaries, pursuant to the Supreme Court's interpretation in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), of § 206 of the Investment Adviser's Act of 1940.

394. *See* Gilson & Gordon, *supra* note 223, at 865 (questioning the canonical Berle–Means account of dispersed share ownership and describing the rise of concentrated institutional share ownership).

395. *Id.* at 902–16.

396. *See supra* subpart III(C).

Conclusion

This Article characterizes M&A advisors as fiduciaries of their clients and thus justifies rules requiring them to loyally serve their clients' interests. Applying deterrence theory, the Article suggests the inadequacy of a simple regime imposing liability on M&A advisors and demonstrates the potentially useful role of imposing fault-based liability on individuals who serve as directors of M&A clients and, for certain hard-to-detect conflicts, of requiring greater oversight by regulators.

The Delaware approach comports in important respects with the proposed rules, particularly in envisioning M&A advisors as loyal advisors of their clients. However, it leaves M&A advisor disloyalty underdeterred. M&A advisors rarely face liability for disloyalty, either primary or secondary; directors rarely face personal liability for failing to oversee M&A advisors; and in neither case does the magnitude of threatened liability compensate for the low probability of sanction. This Article suggests greater judicial scrutiny of directors' practice of disclaiming or contractually displacing fiduciary duties or otherwise limiting M&A advisors' potential liability for disloyalty. It recommends greater regulatory policing of hard-to-detect conflicts. And finally, it preliminarily suggests giving shareholders a direct cause of action to hold M&A advisors primarily liable for disloyalty, even after a merger. Banks' conflicts of interest may be inevitable, but they do not pose insuperable regulatory challenges.