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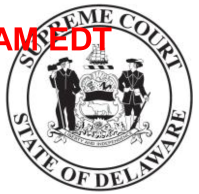

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE RURAL METRO
STOCKHOLDER LITIGATION
RBC Capital Markets, LLC,

Defendant-Below,
Appellant/Cross-Appellee,
v.

Joanna Jervis,

Plaintiff-Below,
Appellee/Cross-Appellant.

C.A. No. 140, 2015
ON APPEAL FROM
THE COURT OF CHANCERY
OF THE STATE OF DELAWARE,
C.A. NO. 6350-VCL

BRIEF FOR THE NATIONAL ASSOCIATION OF CORPORATE DIRECTORS AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT AND IN SUPPORT OF REVERSAL

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INTEREST OF *AMICUS CURIAE*

The National Association of Corporate Directors ("NACD") is the leading association for corporate directors in the United States. NACD's more than 16,000 members include board members from hundreds of United States and overseas corporations, large and small, public and private. Informed by more than 35 years of experience, NACD delivers insights and resources to its director members with the goal of advancing exemplary board leadership and establishing leading boardroom practices. NACD is the voice of directors, representing their interests in matters before Congress, the Executive Branch, and the courts. NACD is independent, apolitical, and non-profit.

NACD submits this brief as *amicus curiae* seeking reversal of the decision below. The Court of Chancery found that the directors of Rural/Metro Corporation ("Rural" or the "Company") breached their fiduciary duties to stockholders by, *inter alia*, (i) deciding to explore possible business combinations without prior Board approval, (ii) deciding to sell the Company to Warburg Pincus LLC ("Warburg") in a cash sale for $17.25 per share (the "Transaction"), and (iii) failing to disclose to stockholders that RBC Capital Markets, LLC ("RBC")—one of two financial advisors engaged by the Board—utilized questionable valuation models and had conflicts of interest. The Court of Chancery incorrectly applied enhanced scrutiny under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del.

1986), to the Board's decision to initiate a sale process. Notwithstanding this Court's repeated instruction that "there is no single blueprint that a board must follow to fulfill its duties" (*Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242-43 (Del. 2009)), and using the wrong legal standard, the lower court incorrectly held that specific actions or inactions of the Board in both initiating a sale process and approving the Transaction were unreasonable under *Revlon*. NACD submits that the decision below is contrary to settled principles of Delaware law, imposes too high a bar for corporate directors in considering and approving change in control transactions, and undercuts directors' ability to rely upon the expert analyses and opinions of financial advisors who play a critical role in advising directors considering such transactions. NACD urges reversal of the decision below.

SUMMARY OF ARGUMENT

> *"Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity.*" – *Revlon*

As this Court has repeatedly held, a fundamental tenet of Delaware corporate law is that corporations operate under the supervision of a board of directors. Directors have a legal responsibility to manage the corporation for the benefit of its stockholders, and this responsibility includes deciding whether and when to pursue a sale of the company. The directors are best equipped to make these judgments, and their decisions are entitled to substantial latitude. In reaching these judgments, directors historically have relied upon expert opinions of the fairness of proposed

transactions, and the Delaware General Corporation Law recognizes that directors may fully rely upon such expert opinions. Ensuring that directors are free from concerns about liability for actions taken in good faith and in reliance on external advisors enables them to make decisions that they reasonably believe are in the best interest of stockholders.

In this case, NACD believes that the Court of Chancery went too far by second-guessing the directors' decision-making and substituting its own judgment concerning the strategic choices that the directors of Rural made, based upon an erroneous interpretation of *Revlon*'s "enhanced scrutiny" standard. The lower court's decision, if left undisturbed, will result in negative policy implications for directors (and ultimately, corporations and their stockholders).

First, the Court of Chancery erred by holding that the Rural directors violated their fiduciary duties when a subset of directors initiated a sale process without prior approval of the full Board—even though the full Board thereafter ratified the decision to pursue the sale process. It was legal error to apply *Revlon* scrutiny to the decision to initiate a sale process; enhanced scrutiny under *Revlon* does not apply to the decision to explore strategic alternatives such as the sale of the company. And even if *Revlon* does apply, it was legal error to apply *Revlon* scrutiny in an entirely unforgiving fashion. *Revlon* and its progeny stand for the proposition that a board's overall course of action must be reasonable under the circumstances to seek to secure

the highest value reasonably obtainable, *not* that every step in the sale process must withstand second-guessing with the benefit of hindsight. The Court of Chancery found that although the Board was aware of the ongoing sale process and later ratified it, the directors breached their fiduciary duties by allowing the process to proceed without formal Board approval and without knowledge of potential financial advisor conflicts. This finding was erroneous.

Second, the Court of Chancery erred by holding that the Rural directors violated their fiduciary duties by approving Warburg's bid to purchase the Company for $17.25 per share. The lower court focused on RBC's failure to disclose certain information to the Board, finding that this rendered the Board's decision to approve the Transaction unreasonable. Eschewing *Revlon*'s "reasonableness" standard, the trial court imposed an unprecedented obligation on the directors to engage in ongoing due diligence of RBC's actual or potential conflicts, despite the Board's recognition that RBC had potential conflicts and its consequent engagement of a second financial advisor whose independence was not challenged by the lower court in its ruling. Upholding the Court of Chancery's decision would eviscerate long-standing Delaware law permitting directors to rely on financial advisors and other experts.

Third, the Court of Chancery erred by holding that the Rural directors breached their fiduciary duties by failing to disclose all material information within the Board's control. There is no suggestion in the lower court's opinion that the information in

the proxy statement regarding RBC's fairness opinion differed in material ways from the fairness opinion presented to the Rural Board. The Court of Chancery concluded that RBC presented false information to the Board in its financial presentation, but the court did *not* conclude that the Board knew RBC had provided supposedly false information. The Court of Chancery likewise found the proxy statement failed to disclose RBC's "lobbying" of Warburg, but did not conclude that the Board was aware of RBC's specific efforts with respect to Warburg. These holdings contravene principles of Delaware law, which only require directors to disclose material information in their "control." *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992).

These three critical legal errors will lead to unending challenges to directors' otherwise good faith efforts to discharge their duty to seek the "best price" for stockholders in complex and fast-moving M&A transactions. Reversal is warranted.

ARGUMENT

I. THE RURAL DIRECTORS DID NOT BREACH THEIR DUTY OF CARE BY INITIATING A SALE PROCESS IN DECEMBER 2010

The Court of Chancery erred by applying *Revlon* enhanced scrutiny and holding that "the decision to initiate a sale process in December 2010 fell outside the range of reasonableness." Op. at 53.[1]

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[1] All references to "Op. at _" are to the Court of Chancery opinion dated March 7, 2014, attached as Exhibit A to Defendant-Appellant's Brief, filed on May 19, 2015.

A. *Revlon* Does Not Apply To The Initiation Of A Sale Process

As a threshold matter, the Court of Chancery should not have applied *Revlon* scrutiny to the decision to "initiate" a sale process. Op. at 53. This Court's precedents make clear that *Revlon* scrutiny only applies to decisions made *after* "a recognition that the company was for sale." *Revlon*, 506 A.2d at 182. In *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989), this Court specifically "decline[d] to extend *Revlon*'s application to corporate transactions simply because they might be construed as putting a corporation either 'in play' or 'up for sale.'" *Id.* at 1151. And in *In re Santa Fe Pacific Corp. Shareholder Litigation.*, 669 A.2d 59, 71 (Del. 1995), the "initiat[ion of] an active bidding process" was insufficient to invoke *Revlon*, because the board had not "decided to pursue a transaction which would result in a sale."[2] This case law makes clear that *Revlon* scrutiny is only triggered *after a company definitively decides to sell itself*. The Court of Chancery did not cite any legal authority to support its application of *Revlon* to the decision to explore a possible sale; NACD is unaware of any such authority from this Court.

If the Court of Chancery is correct that the decision to initiate a sale process is subject to *Revlon* scrutiny, rather than the actions that follow from a sale decision, that constitutes a tectonic shift in the fiduciary duty landscape for directors.

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[2] Conversely, "[a] board's decision not to pursue a merger opportunity is normally reviewed within the traditional business judgment framework." *Gantler v. Stephens*, 965 A.2d 695, 706 (Del. 2009).

"[D]irectors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon." *Time Inc.*, 571 A.2d at 1150. In order to carry out these duties, directors must be able to consider freely the exploration of strategic alternatives (including a sale), without such discussions triggering *Revlon*'s duty to maximize short-term value.[3] The decision to explore a sale does not alter the corporation's fundamental financial prospects, has no material impact on stockholders, and is too far removed from any injury to stockholders to warrant enhanced scrutiny. There is no legitimate reason to deprive directors of the protection of the business judgment rule as they explore strategic alternatives including a sale and reach the conclusion that a potential sale should be pursued.

The Court of Chancery's holding would significantly increase the legal risk shouldered by directors when assessing whether to pursue strategic alternatives. Stockholder litigation is costly and time-consuming, disincentivizes qualified individuals from serving as directors, and prevents directors from acting in the best interests of the corporation free from concerns about potential liability. A requirement that *Revlon*-level scrutiny applies before a decision to sell the company has been made would be a wide open invitation for stockholder litigation second-

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[3] The Court of Chancery's characterization of directors' fiduciary duties as limited to maximizing Rural's "value over the long-term for the benefit of its stockholders" (Op. at 35), also was error. This Court has counseled it "unwise to place undue emphasis upon long-term versus short-term corporate strategy." *Time Inc.*, 571 A.2d at 1150. Indeed, if directors must always maximize long-term value, then it would never be permissible to sell the company, and *Revlon* and its progeny would be superfluous.

guessing legitimate exercises of business judgment whenever a company explores a *potential* sale as part of the board's ongoing review and evaluation of the strategic corporate direction and alternatives.

B. The Board's Decision To Initiate A Sale Process Satisfied *Revlon*

Even if *Revlon* scrutiny does apply, the Court of Chancery incorrectly held that the commencement of a sale process by a subset of directors was "unreasonable" and constituted a breach of fiduciary duty by the entire Board. Op. at 53.

1. Commencement Of A Sale Process Without Formal Board Approval Does Not Violate *Revlon* As A Matter Of Law

The Court of Chancery held that "the decision to initiate a sale process falls short under enhanced scrutiny because it was not made by an authorized corporate decisionmaker." Op. at 53. However, the commencement of a sale process by a subset of members of a board, without immediate formal board authorization, does not violate *Revlon*. *Revlon* requires the court "to examine whether a board's *overall course of action* was reasonable under the circumstances as a good faith attempt to secure the highest value reasonably attainable." *C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1066 (Del. 2014) (emphasis added). Actions may "f[a]ll short of ideal" and still satisfy *Revlon*. *Id.*

Here, the Court of Chancery's conclusion that the Special Committee "got too far out in front of the Board" is not a basis to infer that the full Board's "overall course of action" was unreasonable. Op. at 56. The Court of Chancery found that the

Board authorized the Special Committee to consider strategic alternatives, including a sale of the company (Op. at 8); was aware of the ongoing sale process, having received an email update referencing the "sale process" and stating that potential bidders had been contacted (Op. at 12-13); and subsequently adopted a formal resolution after due deliberation "ratif[ying] and restat[ing] its delegation to the Special Committee" to pursue a sale of the company (Op. at 21).[4] These findings indicate that the Board was reasonably informed of the Special Committee's actions.

The Court of Chancery's decision on this issue, taken to its logical conclusion, is that formal board authorization is required *as a matter of law* before *any* sale discussions can occur. This is inconsistent with this Court's focus on the board's "overall course of action," *C&J Energy*, 107 A.3d at 1066, and creates unnecessary difficulties for directors—especially because what it means to "initiate a sale process" remains unclear. Without further guidance, "commencement" could mean that in the absence of formal board authorization, an executive's or director's informal discussion with a third party about possible interest in a transaction constitutes a breach of fiduciary duty. To illustrate, such a rule could transform Rural CEO Michael DiMino's call with the EMS CEO discussing whether "the companies should be put together" (Op. at 8-9), into a breach of DiMino's fiduciary duties. Directors

[4] Such ratification is consistent with longstanding Delaware law permitting boards to ratify actions of management. *Klig v. Deloitte LLP*, 36 A.3d 785, 794 (Del. Ch. 2011).

should be free to informally explore potential strategic alternatives without an increased threat of liability, particularly when the record is clear that the board, as here, ratified these efforts in the best interests of the company.

2. Commencement Of A Sale Process Where A Potential Conflict Has Not Been Disclosed Does Not Violate *Revlon*

The Court of Chancery also held that "the decision to initiate a sale process fails the enhanced scrutiny test because RBC did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS." Op. at 53. But the Court of Chancery's finding that the Board was unaware of a possible financial advisor conflict does not mean that the Board's "*overall course of action*" fell outside the range of reasonableness. The Court of Chancery recognized as much: it highlighted several factors and market conditions that supported the initiation of a sale process in December 2010 (Op. at 9, 10, 55-56), and acknowledged that it would have been reasonable for the Board to have made the same decision had it had the benefit of the supposedly withheld information. Op. at 56. Since the court below agreed that the Board "selected one of several reasonable alternatives," the court should not "second-guess that choice" or "substitute [its] business judgment for that of the directors." *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45 (Del. 1994).

* * *

There is no basis for concluding that the commencement of a sale process in

late 2010 prevented the Board from seeking to achieve the best value reasonably available, which is what *Revlon* requires. The mere initiation of a sale process—if directors have strategic reasons for doing so and are not conflicted, and are reasonably informed of and subsequently ratify the decision—is not a breach of the duty of care.

II. THE RURAL BOARD'S DECISION TO APPROVE THE WARBURG BID DID NOT VIOLATE *REVLON*

The Court of Chancery erred in concluding that the Rural Board breached its duty of care by approving Warburg's $17.25 per share bid for the company.

As an initial matter, it was legal error for the Court of Chancery to evaluate whether the directors breached their duty of care under the Court of Chancery's subjective standard of "reasonableness." Op. at 49.[5] "Gross negligence"—not "reasonableness"—is the controlling standard of conduct for breaches of the duty of care. *Malpiede v. Townson*, 780 A.2d 1075, 1089 (Del. 2001).

In addition, the Court of Chancery erred in holding that the Board's decision to approve Warburg's bid "fell outside the range of reasonableness." Op. at 58. *Revlon* requires the court "to examine whether a board's *overall course of action* was reasonable under the circumstances as a good faith attempt to secure the highest value reasonably attainable." *C&J Energy*, 107 A.3d at 1066 (emphasis added). The

[5] Although plaintiffs only alleged a duty of care violation, the Court of Chancery's analysis "stop[ped] with the application of the standard of review" and solely evaluated "whether the Board's actions fell within a range of reasonableness." Op. at 49. This was error.

question is not whether the trial court agrees with the Board's choices in the pursuit of maximum available value, but whether the Board's overall process falls wholly so far outside the range of reasonableness as to constitute gross negligence:

> There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decisionmaking body best equipped to make these judgments. . . . If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination.

QVC, 637 A.2d at 45. In *C&J Energy*, this Court recognized that "[a]lthough the record before us reveals a board process that sometimes fell short of ideal," the board's "overall course of action" was reasonable enough to satisfy *Revlon*'s interest in ensuring maximum value for stockholders. 107 A.3d at 1066. The same is true here: When viewed in its entirety, the "overall course of action" employed by the Rural Board "reasonable under the circumstances" and far from grossly negligent. *Id.*

The Court of Chancery's opinion identifies the following actions undertaken by the Rural Board (or its Special Committee) to engage actively in the sale process and secure the highest value reasonably attainable:

October 2010 – The Board received an expression of interest from a potential acquirer, but concluded it was too low. Op. at 3.

December 8, 2010 – The Board authorized the Special Committee to retain advisors and report on possible strategic alternatives, including a sale. Op. at 8.

December 13, 2010 – Shackelton advised the Board that he was setting up a meeting to interview potential financial advisors. Op. at 9.

December 20, 2010 – Shackelton informed the Board that the Special Committee would meet on December 23 to interview and select an advisor. Op. at 9.

December 23, 2010 – The Special Committee interviewed financial advisors and received banker pitch books containing valuation materials. Op. at 19. The Special Committee engaged both RBC and Moelis & Co., LLC ("Moelis") due to concerns about RBC's potential conflicts of interest. Op. at 11-12.

December 26, 2010 – Shackleton emailed the full Board that the Special Committee was pursuing a "sale process" and soliciting bids. Op. at 8, 12.

December 2010 and January 2011 – 28 private equity firms were contacted; 21 executed confidentiality agreements. Op. at 15.

January 29, 2011 – Shackleton updated the Board on timing of bids. Op. at 16.

January and February 2011 – 6 indications of interest were received. Shackleton emailed the full Board the indications of interest. Op. at 16.

February 6, 2011 – The Special Committee met and received a presentation from its financial advisor. Op. at 16-17.

February 9-18, 2011 – Management met with all 6 interested firms. Op. at 16-17.

February 22, 2011 – The Special Committee met, set a bid deadline, and decided not to solicit bids from strategic acquirers. Op. at 17-18.

March 15, 2011 – The full Board met, assessed the sale process, and passed a resolution ratifying and restating its delegation to the Special Committee to pursue the sale process. Op. at 21.

March 22, 2011 – Warburg and CD&R each offered to acquire Rural for $17.00 per share. Op. at 22-23.

March 23, 2011 – The Special Committee met to discuss the two proposals. Op. at 23. Directors who were not members of the Special Committee attended by invitation. Op. at 25. The Special Committee directed its financial advisors to negotiate price with Warburg. Op. at 25.

March 25, 2011 – Warburg increased its bid to $17.25 per share but stated it was the "best and final offer." Op. at 26. Shackelton nevertheless attempted to negotiate a higher price, but was rejected by Warburg. Op. at 27.

March 27, 2011 – The Board received fairness opinions from RBC and Moelis, both of which found the $17.25 per share price was fair. The Board deliberated for over one hour before approving the Transaction. Op. at 31.

March 28, 2011 to June 30, 2011 – The Transaction was announced. The Board had a fiduciary out that enabled it to consider higher bids. No other bidders emerged. *See* Defendant-Appellant Brief at 11-12.

This robust course of action falls well within the range of reasonableness—and in no way approached gross negligence. During the months leading up to the Transaction, the Rural directors were engaged in assessing a variety of strategic alternatives, were knowledgeable about the Company and its value, took action to address potential conflicts by engaging two separate financial advisors to jointly oversee a robust process, and ensured maximum value for stockholders by allowing consideration of topping bids.[6] Consequently, the Court of Chancery improperly applied *Revlon* to require perfection rather than assess the Board's *underlying course of action overall* to determine if those actions were a reasonable attempt under the circumstances to maximize value.

When evaluating a potential change in control transaction, a board is not required under Delaware law to receive a "fairness opinion" from a financial advisor if it otherwise is aware of information sufficient to value the company for sale

[6] As the Court of Chancery noted, "[w]hat typically drives a finding of unreasonableness is evidence of self-interest . . . or a similar non-stockholder-motivated influence that calls into question the integrity of the process." Op. at 40-41. But the Court of Chancery did not find that a majority of the Board had improper motives or personal interests. Indeed, the Court of Chancery's finding that the Board was effectively left in the dark undermines any finding that the Board took action based on any improper motives or personal interests.

purposes. *C&J Energy*, 107 A.3d at 1068 n.91 (noting "the board's knowledge as to the value of C&J"); *Lyondell*, 970 A.2d at 244 (directors "were generally aware of the value of their company"). To the extent a board *does* obtain a valuation opinion, the directors are "fully protected" under DGCL Section 141(e) where, as here, the Board reasonably relied upon the opinion of an expert financial advisor. And this Court has recognized that the absence of topping bids from the market evidences that a board had adequate information to evaluate a sale. *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1287 (Del. 1989). Here, the Board obtained two fairness opinions.

Thus, any supposed "flaws" in RBC's fairness analysis do not impugn the reasonableness of the Board's decision to sell the Company for $17.25 per share. The Court of Chancery concluded that the Board's lack of awareness of what the court found were RBC's conflicting interests made the Board's conduct unreasonable, but the Board *recognized this precise issue* and hired a second financial advisor to counteract any possible bias in RBC's advice. The trial court also brushed aside facts demonstrating that the Board had sufficient information to analyze Warburg's $17.25 per share offer separate and apart from RBC's valuation: the Board received an unsolicited offer of $15.00 per share a few months earlier; the Special Committee had received valuations from three financial advisors in the banker pitch books; the Board received a valuation from Moelis that found the Warburg offer was fair; and no topping bids emerged after the Transaction was announced. Op. at 24, 29-31. Given

these facts, it was clearly reasonable for the Board to approve Warburg's bid.

To the extent the Court of Chancery concluded that the directors' overall course of action was unreasonable because they "failed to provide active and direct oversight of RBC" or failed to detect the supposed "flaws" in its fairness analysis (Op. at 58, 61-63), the court held the directors to a standard that the law does not demand. A board is not required to perform searching and ongoing due diligence on its financial advisor in order to detect conflicts of interest or errors in its analysis. (This is especially true where, as here, a board supervises an advisor by engaging a second, indisputably independent advisor to participate in the auction process.) Such a requirement would impose too high a burden on directors, and the protections afforded by DGCL Section 141(e) would be rendered a legal nullity. That as a matter of public policy the Board should not be required to perform due diligence on the financial advisor's ongoing activities is underscored by the trial court's observation that "directors are not expected to have the expertise to determine a corporation's value for themselves." Op. at 47.

In NACD's view, the Court of Chancery went too far in second-guessing the business judgment of directors free from conflicts of interest and engaged in good faith in a viable process of review in connection with a sale process.

III. THE RURAL DIRECTORS DID NOT BREACH THEIR FIDUCIARY DUTIES BY FAILING TO DISCLOSE UNKNOWN INFORMATION

Directors of Delaware corporations owe a fiduciary duty "to disclose fully and

fairly all material information *within the board's control* when [the corporation] seeks shareholder action." *Stroud*, 606 A.2d at 84 (emphasis added). Where information is not "within the board's control" or knowledge, a board is not liable for nondisclosure. *Pfeffer v. Redstone*, 965 A.2d 676, 686-87 (Del. 2009); *Malpiede*, 780 A.2d at 1086.

Here, the Court of Chancery held that the proxy statement was misleading because "[i]nformation that RBC provided to the Board in connection with its precedent transaction analyses was false, and that false information was repeated in the Proxy Statement." Op. at 79. The Court of Chancery did *not* conclude, however, that (i) the discussion of RBC's fairness analysis in the proxy statement falsely or misleadingly represented the fairness analysis that RBC had presented to the Board, or (ii) the Board was aware that RBC's fairness analysis contained allegedly false information. As a matter of law, the Board cannot be liable for failing to disclose supposed flaws in the fairness analysis of which it was indisputably unaware.

In addition, the court's holding that the directors breached their fiduciary duties because the proxy statement failed to speak completely on the subject of RBC's financing efforts is incorrect as a matter of law. Op. at 82. NACD is unaware of any decision from this Court holding that a proxy statement must disclose every detail of a financial advisor's efforts to obtain business from other clients. It should be enough to disclose RBC had permission to seek to offer buy-side financing, as Rural did here.

The Court of Chancery's holding on this issue imposes an impossible burden

on directors to determine which financial advisor activities must be disclosed, and it would hold directors liable for a failure to disclose information withheld from them. Directors should not be required to perform scorched-earth diligence on a financial advisor's ongoing activities, and should not be saddled with the prospect of legal liability for failing to disclose information outside of their control.

CONCLUSION

The decision below should be reversed.

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