Brigham Young University Journal of Public Law

Volume 32 | Issue 1 Article 6

11-30-2017

Holding Investment Bankers Liable for Aiding and Abetting Corporate Directors: The Under-deterrent

Maren Worley

Holding Investment Bankers Liable for Aiding and Abetting Corporate Directors: The Under-deterrent

I. INTRODUCTION

Goldman Sachs' first business principle states, "Our clients' interests always come first."[1] Unfortunately, that is not always true for investment bankers—whether they are at Goldman Sachs or any other investment bank—when they are advising corporations, particularly in the trillion-dollar industry of mergers and acquisitions (hereinafter "M&A").[2] Investment bankers, or M&A advisors, are often given the opportunity to extract wealth at their clients' expense, which creates a conflict of interest and incentivizes disloyalty towards the clients.[3] "Economists define a conflict of interest as a situation in which a party to a transaction can gain by taking actions adversely affecting the counterparty."[4] This can be seen in the following:

> Bankers often have ties to acquiring companies and the parties financing their deals, leading to incentives to cater to the other side of the negotiating table. An all-or-nothing success fee gives the banker an incentive to push for any deal at the expense of a good deal. And . . . sell-side advi-

1. Goldman Sachs, *Goldman Sachs Business Principles*, http://www.goldmansachs.com/who-we-are/business-standards/business-principles/ (last visited Sept. 16, 2017).

2. Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEX. L. REV. 1080 (2016) ("M&A transactions are a major component of economic activity: in 2015, over 10,000 such transactions, collectively valued at $2.3 trillion, were announced in the United States.").

3. *See* Tuch, *supra* note 2, at 1080–81.

4. William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEX. L. REV. 1, 27 (2014).

> sors have started showing up as buy-side lenders, importing an added incentive to get the deal closed on the buyer's terms.[5]

Conflicted investment bankers can harm the client by "lead[ing] buyers to pay more than they otherwise would or to enter into wealth-destroying deals they otherwise would avoid," or by "lead[ing] sellers to sell for less than they otherwise would or to choose one prospective deal over more favorable deals."[6] Put simply, when a director approaches an investment banker to advise him and his company on a proposed M&A deal, the investment banker will often advise the director to proceed with the deal, even if it would not be in the company's best interest, because the investment banker knows if he says "no deal," he will not receive any commission.[7]

Economic damage to corporations and the corporations' shareholders clearly justifies searching for and implementing a proper fix—one that sufficiently deters harmful disloyalty. A new solution, which has surfaced in the Delaware Court of Chancery through three recent opinions, is holding disloyal investment bankers civilly liable for aiding and abetting corporate directors in breaching their fiduciary duties to shareholders.[8] Some allege that "[e]ver since the Chancery Court's polarizing decision in the *Del Monte* case . . . financial advisers have been sweating."[9] Albeit, the law is still unsettled.[10] "In 2016, for ex-

5. *Id.* at 10.

6. Tuch, *supra* note 2, at 1081.

7. Both corporate directors and corporate officers seek the advice of investment bankers. Throughout this paper, for simplicity reasons, the term "directors" is used to encompass both the directors and the officers that operate beneath them.

8. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 818 (Del. Ch. 2011); *See In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 448 (Del. Ch. 2012); *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 63 (Del. Ch. 2014).

9. Matt Chiappardi, *Delaware Chancery Cases to Watch in 2017*, LAW360 (Jan. 2, 2017, 1:30 PM) https://www.law360.com/articles/874775/delaware-chancery-cases-to-watch-in-2017 (italics added).

10. *See id.* (explaining "[p]eople are definitely going to be watching how the law develops in terms of financial advisor liability.").

ample, the Delaware Supreme Court affirmed the dismissal of an aiding and abetting claim against a financial advisor because an informed, uncoerced vote of disinterested stockholders approved the transaction."[11] Therefore, even though the idea of liability for aiding and abetting directors may seem intimidating, investment bankers will soon learn of the nebulous application. The test for civil aiding and abetting that must be satisfied before liability attaches is far too difficult to satisfy in this context, which results in under-deterred wrongful behavior. Something must be done because leaving the market alone and relying on reputational governance[12] also leaves disloyalty under-deterred. Therefore, in the alternative, this paper proposes a better solution; namely, an indemnification clause in the engagement letters between directors and banks. An indemnification clause will impose a large enough threat of liability to sufficiently deter bankers from administering self-serving advice, and it will be capped at a reasonable limit of liability, keeping directors' disloyalty in check. In defending the proposition of contractual governance through an indemnification clause, this paper counters the other recently proposed solutions, such as the above-mentioned civil liability through claims of aiding and abetting, in addition to categorizing investment bankers as fiduciaries to the corporation so they can be held directly liable for breaching the fiduciary duties owed to the corporation and its shareholders.[13] To lay a foundation, Part II of this paper explains what duties corporate directors owe the corporation and its shareholders. Next, Part III presents the recent trends and opinions of scholars and the Court of Chancery. Part IV argues that the aiding and abetting approach is an insufficient deter-

11. *Id.*

12. *See* STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 207, 212–17 (2004) (discussing the effect of market forces on sellers of products in the absence of liability rules).

13. Tuch, *supra* note 2, at 1085.

rent for investment banker disloyalty and why an indemnification clause is the proper solution. Part V concludes this paper.

II. Director Breach of Fiduciary Duty

First, it is important to understand what duties the directors of a corporation owe to the shareholders and the corporation to lay a foundation for understanding what exactly investment bankers would be "aiding and abetting." The board of directors owes both a duty of care and a duty of loyalty to the shareholders and the corporation. The duty of care and the duty of loyalty both impose upon the board certain standards and responsibilities, and the Court of Chancery—through several important and key cases in corporate law—has described what these standards and responsibilities are.

The duty of care encompasses ordinary negligence and gross negligence.[14] When the board engages in ordinary negligence (which is essentially just a poor business decision), its actions are protected by the business judgment rule, and therefore do not trigger liability.[15] If, however, the board's actions constitute gross negligence, such as failing to properly inform itself when making an important business decision, it is a breach of the duty of care.[16]

In practice, the board rarely faces liability for breaches of the duty of care because of section 102(b)(7) of Delaware

14. *See* Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1052–53 (Del. Ch. 1996) (ordinary negligence); Smith v. Van Gorkom, 488 A.2d 858, 893 (Del Ch. 1985), *overruled in part by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (superseded by statute 8 Del. C. § 102(b)(7)).

15. *See Gagliardi*, 683 A.2d at 1052–53 ("[The business judgment rule] in effect provides that where a director is independent and disinterested, there can be no liability for corporate loss, unless the facts are such that no person could possibly authorize such a transaction if he or she were attempting in good faith to meet their duty.").

16. *See Van Gorkom*, 488 A.2d at 893 ("[W]e hold that the directors of Trans Union breached their fiduciary duty to their stockholders (1) by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger; and (2) by their failure to disclose all material information such as a reasonable stockholder would consider important in deciding whether to approve the Pritzker offer.").

General Corporate Law (hereinafter "DGCL").[17] This statutory provision provides that a charter can eliminate board liability with certain exceptions, namely intentional misconduct, knowing illegal violations, and actions performed in bad faith (therefore applying to breaches of the duty of care).[18] Although it is merely a statute that permits incorporators to include this exculpatory provision into a corporation's charter and still places the burden of enacting it on the incorporators, almost every charter contains it as if it were mandatory.[19]

Because complaining shareholders that bring only a breach of the duty of care claim will not survive a motion to dismiss if the corporation's charter contains an exculpatory clause, shareholders will nearly always couple it with a breach of the duty of loyalty claim. The duty of loyalty encompasses good faith, director conflict of interest, and transactions for control.[20] A prime example of a breach of good faith is when the board fails to oversee employees by utterly failing to implement any reporting or information system controls or, having implemented such a system, consciously disregarding its responsibilities.[21] Breaches of loyalty for conflict of interest transactions often occur in the M&A context when there is a director sitting on both sides of a transaction (along with failure to cleanse the deal by means such as establishing an independent committee), or in cases in which there is a controlling shareholder that en-

17. 8 Del. C. § 102(b)(7).

18. *Id.*

19. *See* Tuch, *supra* note 2, at 1143 ("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."); *see also In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 87 (Del. Ch. 2014) (explaining that an exculpatory clause, like the business judgment rule, "promotes stockholder interests by ensuring that directors do not become overly risk-averse. . . .").

20. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (good faith); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (conflict of interest transactions); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–56 (Del. 1985) (change of control in the takeover context); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986) (change of control when sale of the company becomes inevitable).

21. Stone v. Ritter, 911 A.2d at 371.

gages in a transaction that uniquely benefits them or benefits them at the expense of the minority shareholders.[22]

An example of a breach in a change of control transaction is when the board's defensive measures do not meet the *Unocal* standard, which includes having reasonable grounds to believe that an offer represented a threat to the company or the shareholders, and the board's adopted plan was proportionate to the threat.[23] Another example of a breach during a change of control is when the sale and break up of a company becomes inevitable and the board fails to get the best sale price for the shareholders.[24] Or, as the court states in *El Paso*, the board fails to "squeeze the last drop of the lemon out" for the shareholders.[25] The latter example is popularly known as the *Revlon* standard. "[The] *Revlon* review takes the court through all aspects of the deal, both the contract itself and the process that creates it. Anything that impairs sell-side incentives is a fair topic for questioning, including banker conflicts."[26] This is where investment banker disloyalty becomes relevant to director behavior.

III. Recent Trends and Opinions

There are recent trends and opinions regarding investment banker disloyalty both by case law through the Court of Chancery and by scholars through articles, books, and journals. This paper first examines the Court of Chancery's three recent and relevant cases in this regard. Subsequently, this paper examines the recent ideas and arguments posed by scholars.

22. *Weinberger*, 457 A.2d at 710; Williamson v. Cox Commc'ns, Inc., No. Civ.A. 1663-N, 2006 WL 1586375 at *4 (Del. Ch. 2006).

23. *Unocal Corp.*, 493 A.2d at 954.

24. *Revlon Inc.*, 506 A.2d at 182.

25. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 444 (Del. Ch. 2012).

26. Bratton & Wachter, *supra* note 4, at 8.

A. The Court of Chancery

Imposing aiding and abetting liability onto investment bankers is a fairly novel idea, and it is of high importance because it was not simply proposed by scholars as a hypothetical—it is written into the opinions of three recent Court of Chancery cases: *Del Monte*;[27] *El Paso*;[28] and *Rural Metro*.[29] This new form of liability is causing concern on Wall Street and causing both investment banks and attorneys to watch how this area of law further develops.[30]

In *Del Monte*, an investment banker at Barclays secretly and selfishly manipulated the sale process to engineer a transaction that would permit Barclays to obtain lucrative buy-side financing fees.[31] On multiple occasions, Barclays protected its own interests by withholding information from the board that could have led Del Monte to retain a different bank, pursue a different alternative, or deny Barclays a buy-side role.[32] The court specifically acknowledged that the harm was primarily the fault of the investment banker as it stated, "It appears that the Board sought in good faith to fulfill its fiduciary duties, but failed because it was misled by Barclays."[33] Nonetheless, the court stated, "Although the blame for what took place appears at this preliminary stage to lie with Barclays, the buck stops with the Board."[34] Therefore, the court held that the board breached its *Revlon* duties by failing to meet its oversight responsibility that would have checked the investment banker's misconduct.[35] In sum, although the court in *Del Monte* pro-

27. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 818 (Del. Ch. 2011).
28. *El Paso*, 41 A.3d at 448.
29. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 63 (Del. Ch. 2014).
30. Chiappardi, *supra* note 9.
31. *Del Monte,* 25 A.3d at 833.
32. *Id.*
33. *Id.* at 818.
34. *Id.* at 835.
35. *Id.* at 818.

posed the option of holding the investment banker liable for aiding and abetting, it ultimately limited liability to the board and reasoned the board could have—and should have—prevented the disloyalty.

In *El Paso*, the board of El Paso Corporation, advised by Goldman Sachs, decided to enhance the value of the corporation by spinning off one of its two lines of business.[36] Kinder Morgan offered to purchase the entire company, and because Goldman Sachs owned nineteen percent of Kinder Morgan (which was valued at $4 billion), the board sought advice from Morgan Stanley on the Kinder Morgan negotiations.[37] However, Goldman continued to advise El Paso's board on the possible spin-off deal.[38] Morgan Stanley was incentivized by Goldman Sachs to engage in disloyal behavior towards the corporation because it could either approve a deal with Kinder Morgan and get $35 million, counsel the board to go with the spin-off, or pursue another option and get "zilch, nada, zero."[39] The court acknowledged that "the key negotiator on behalf of the Board and a powerfully influential financial advisor each had financial motives adverse to the best interests of El Paso's stockholders."[40] Nonetheless, even with the explicit recognition of obvious disloyalty, the court also acknowledged:

> [A]lthough Goldman has been named as an aider and abettor and it has substantial, some might say even government-insured, financial resources, it is difficult to prove an aiding and abetting claim . . . whether the plaintiffs could ultimately prove Goldman liable for any shortfall is, at best,

36. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 434–35 (Del. Ch. 2012).
37. *Id.* at 434–36.
38. *Id.* at 435–36.
39. *Id.* at 442.
40. *Id.* at 434.

> doubtful, despite [the Goldman investment banker]'s troubling individual failure of disclosure.[41]

In *Rural Metro*, the shareholders sued "a highly compensated advisor that hoped to generate $60 million in fees by inducing the Board to sell Rural when and in the manner it did."[42] The court stated that the investment banker's advice "was overly biased by its financial interests,"[43] and found the investment bank "liable for aiding and abetting breaches of fiduciary duty by the Board."[44] The court also presented its rationale for the imposition of aiding and abetting liability, that is, "[t]he threat of liability helps incentivize gatekeepers to provide sound advice, monitor clients, and deter client wrongs."[45] Furthermore, the court explained that the threat of aiding and abetting liability,

> [C]reates a powerful financial reason for the banks to provide meaningful fairness opinions and to advise boards in a manner that helps ensure that the directors carry out their fiduciary duties when exploring strategic alternatives and conducting a sale process, rather than in a manner that falls short of established fiduciary norms.[46]

The court applied the analysis even further by holding that "a claim for aiding and abetting a breach of the duty of care can be maintained . . . when a third party, for improper motives of its own, misleads the directors into breaching their

41. *Id.* at 448 (footnote omitted).
42. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 88 (Del. Ch. 2014).
43. *Id.* at 93.
44. *Id.* at 63.
45. *Id.* at 88 (footnote omitted).
46. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 89 (Del. Ch. 2014).

[fiduciary duties]."[47] Even so, the court still acknowledged the difficulty of proving an aiding and abetting claim.[48]

In all three of these cases, the Court of Chancery posed the possibility of, or imposed liability for, aiding and abetting, but there are some important and relevant differences among the cases. As will be discussed later in further detail, the determination of what relationship exists between investment bankers and the corporate directors they advise is of high importance in determining whether aiding and abetting does, or even can, apply. The determination of this issue differed among the cases. The court in *Del Monte* and *El Paso* leaned more towards a contractual relationship. In both cases, the court stated, "Delaware upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties."[49] Conversely, the court in *Rural Metro* stated, "Financial advisors provide . . . expert services. In doing so, they function as gatekeepers."[50] Note, however, that none of the cases explicitly classify the investment banker as a "fiduciary."

B. Scholars

Not surprisingly, after the Court of Chancery presented aiding and abetting liability in the context of investment banker disloyalty, strong opinions and propositions from scholars followed. Andrew F. Tuch's article titled *Banker Loyalty in Mergers and Acquisitions* stands by the novel assertion that the proper classification of investment bankers is that they are fiduciaries of their M&A clients and therefore required to loyally

47. *Id.* at 99 (footnote omitted).

48. *Id.* at 85.

49. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 840 (Del. Ch. 2011); *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 450 n.59 (Del. Ch. 2012).

50. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 88 (Del. Ch. 2014).

serve client interests.[51] Tuch defends this position by arguing that regulating the relationship by contract is difficult, expensive, and uncertain, and therefore, the investment banker should be required to "act loyally in the absence of informed client consent."[52] Put simply, he stands for the proposition—similar to Delaware corporate law[53]—that because every contract is incomplete, the fiduciary doctrine should act as a gap-filler in this context as well. He also supports his position by emphasizing the superior expertise and experience of investment bankers and how the bankers represent themselves as "trusted advisors."[54]

Although Tuch argues that investment bankers are fiduciaries, which fits into the aiding and abetting test if true, he contends that aiding and abetting liability "is poorly suited to deter [investment bankers'] conflicts."[55] He defends this by framing it within optimal deterrence theory, which posits that "potential wrongdoers are optimally deterred when they expect to bear liability equal to the social costs they create. Potential wrongdoers are then led to avoid all intentional conduct that is socially harmful and to take precautions to minimize the social costs of accidental misconduct."[56] Tuch suggests that the optimal deterrence could instead be achieved by "subjecting [investment bankers] to *primary* liability through *direct* causes of actions by shareholders for disloyalty."[57]

William W. Bratton and Michael L. Wachter together assert their own ideas in their article titled *Bankers and Chancellors*.[58] These scholars present their argument by explaining

51. Tuch, *supra* note 2, at 1085.

52. *Id.* at 1083.

53. *See* Auriga Capital Corp. v. Gatz Props., LLC, 40 A.3d 839, 853 (Del. Ch. 2012) (holding that default fiduciary duties exist as "equitable gap fillers" even when they are not established in the contract).

54. Tuch, *supra* note 2, at 1083.

55. *Id.* at 1085.

56. *Id.* at 1112.

57. *Id.* at 1085.

58. Bratton & Wachter, *supra* note 4.

their perception of how the banker-director relationship operates in realty. These scholars claim that "advisory services . . . are grounded in relationships rather than discrete engagements,"[59] and that "bankers and their clients do not use their contracts to minimize conflicts and improve incentives."[60] These statements seem to lean towards the fiduciary gap-filling contention, but that argument is never explicitly asserted. However, the authors present the Court of Chancery case *Shoe Town*, and explain how the court held that "[u]nder Delaware's default rule, bankers owe no duties to shareholders and shareholders accordingly have no direct action against a banker."[61] They also distinguish the banker-director relationship from the lawyer-client relationship by explaining how conflicts in relation to lawyers trigger "red flags," whereas conflicts in relation to business people, such as investment bankers, are simply "problems to be managed."[62] In regards to a solution, these scholars propose a "safe harbor for banker conflicts conditioned on full disclosure and engagement of a second, unconflicted banker."[63]

In the book *Better Bankers, Better Banks*, Claire A. Hill and Richard W. Painter take a different approach.[64] The authors start by identifying the prominent damage that banker conflicts cause on the economy: "Every month—if not week—brings new reports of allegations, settlements, and, in some cases, admissions involving the banking industry."[65] However, the banks' shareholders typically pay the fines and settlements; the individual bankers rarely pay out of their own pocket and are

59. *Id.* at 20.
60. *Id.* at 26.
61. *Id.* at 33.
62. *Id.* at 26.
63. *Id.* at 11.
64. CLAIRE A. HILL & RICHARD W. PAINTER, BETTER BANKERS, BETTER BANKS: PROMOTING GOOD BUSINESS THROUGH CONTRACTUAL COMMITMENT (2015).
65. *Id.* at 2.

almost never put in jail for wrongdoings.[66] The authors further explain the problem that "[l]aw has not sufficiently constrained bank behavior."[67] For example, in 2012, JP Morgan lost at least $6 billion due to one of its banker's ill-advised and excessive risk taking.[68] "Even where law is able to specify what banks should not be doing, enforcement is often exceedingly difficult: banks have many ways to obscure, if not conceal, what they are doing."[69]

Hill and Painter assert that personal liability will sufficiently deter inappropriate risk taking.[70] Therefore, they advocate for "covenant banking," where the "bankers [are] personally liable from their own assets for some of their banks' debts and [where] they [are] personally liable from several years of their past, present, and future compensation for some portion of fines and fraud-based judgments (including settlements) against the bank."[71] The authors suggest implementing this liability by an agreement, or a "covenant," between the banker and his bank.[72] This would be a specific type of covenant—a personal guarantee—in which the highly compensated bankers would be asked to make a substantial portion of their personal assets available to pay the debts of the bank if it fails.[73]

They claim this would help "instill a culture that discourages bad behavior and its underlying ethos, the competitive pursuit of narrow material gain."[74] The authors explain that "different people should be attracted to the banking profession to begin with, people who would make banking less volatile."[75]

66. *Id.*
67. *Id.*
68. *Id.* at 42.
69. *Id.* at 7.
70. *Id.* at 146.
71. *Id.* at 7-8.
72. *Id.* at 8.
73. *Id.* at 152.
74. *Id.* at 8.
75. *Id.*

They defend their "covenant banking" proposition by explaining that it will discourage bad behavior successfully to the extent that it will attract "less volatile" people to the profession.[76]

IV. Implications

The recent trends and opinions mentioned above have several implications. As previously discussed, although the idea may be rightful in theory, the imposition of civil aiding and abetting liability onto investment bankers is improper because it will rarely, if ever, apply, leaving the investment banker under-deterred from administering self-serving advice to the directors. First, it is not plausible to classify investment bankers as "fiduciaries" of the corporation for the board member they advise. Therefore, the "fiduciary" factor in the aiding and abetting liability test cannot be satisfied. Second, even if there were a fiduciary relationship and the imposition of fiduciary duties in this context, it is far too difficult to satisfy the "knowing participation" requirement. Both of these failures in the application leave the disloyalty under-deterred. Next, because reputational governance is also insufficient to deter investment banker disloyalty, which leaves the bankers under-deterred as well, *something* must be done to fix this issue. Finally, contract governance is the most preferable remedy for this issue, specifically an indemnification clause because it will provide sufficient deterrence for the harmful disloyalty.

A. Aiding and Abetting is Improper

Aiding and abetting requires four elements to be met before any liability attaches: (1) the existence of a fiduciary relationship; (2) a breach of the fiduciary's duty; (3) knowing participation in that breach by the defendants; and (4) damages

76. *Id.*

proximately caused by the breach.[77] Although it seems fair to hold the investment bankers liable to those who are harmed by the disloyalty (namely, the shareholders on behalf of the corporation), the innovative idea of imposing aiding and abetting liability onto investment bankers is flawed. The test for aiding and abetting liability is far too difficult—if not impossible—to satisfy in this context, and the court has explicitly acknowledged this fact.[78] First, it is not feasible to classify investment bankers as "fiduciaries" to the director, the company, and/or its shareholders. Therefore, factors (1) and (2) of the aiding and abetting test cannot be satisfied, as they require a fiduciary relationship, implementation of fiduciary duties, and a breach of said duties. Second, even if there was a fiduciary relationship and corresponding duties imposed, the third factor of the test—"knowing participation"—is nearly impossible to prove. There are only certain limited circumstances in which it can be proven; therefore, in the majority of cases, investment bankers will be left under-deterred from administering self-serving advice. Contract law—not civil aiding and abetting—creates the proper deterrent for the relevant disloyalty.

1. Lack of fiduciary relationship

A fiduciary is "[a]n individual in whom another has placed the utmost trust and confidence to manage and protect property or money."[79] Investment bankers cannot be classified as a fiduciary of the corporation or its shareholders. They are agents whom directors merely seek advice from. Therefore,

77. *See, e.g.*, *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 838 (Del. Ch. 2011) (citing Malpiede v. Townson, 780 A.2d 1075, 1096 (Del. 2001)).

78. *See* Bratton & Wachter, *supra* note 4, at 62–63 ("The plaintiff must meet a scienter requirement, proving not only the existence and breach of a fiduciary relationship but the defendant's knowing participation in the breach. These claims accordingly are thought to be hard to prove.").

79. WEST'S ENCYCLOPEDIA OF AM. LAW (2d ed. 2008), http://legal-dictionary.thefreedictionary.com/fiduciary.

aiding and abetting liability fails to apply properly to investment banker disloyalty, leaving self-serving conduct underdeterred. As Tuch explains, there are certainly public policy reasons for the existence of fiduciary relationships, such as maintaining confidence in the integrity of the relationship in which loyalty is expected and helping to reduce agency costs.[80] However, it is still not feasible to impose the fiduciary relationship and its accompanying duties onto the investment banker, based on both the logic and the manner in which the market actually operates.

The Court of Chancery properly stated in *Shoe Town* that "it makes little sense to strap those investment banks, who are retained, with the duties of a fiduciary,"[81] since bankers serving only as agents are typically not deemed trustees and thus owe no fiduciary duty to shareholders.[82] "Indeed, it escapes reason to say that an investment bank hired by a management group . . . would stand in a relationship with a given corporation and its stockholders similar to the relationship of a trustee to his cestui que trust."[83] Although these statements remain reasonable, the Court of Chancery made them prior to deciding *Revlon*. *Revlon* gives shareholders a cause of action that *Shoe Town* did not recognize: a derivative suit—a shareholders' suit on behalf of the corporation—by holding that a board of directors has a fiduciary duty of care and loyalty to its shareholders when approving a corporate merger.[84] This is why the Court of Chancery has subsequently held that "a banker conflict that puts the sell-side board and its deal into *Revlon* jeopardy is effectively prohibited."[85] But it does not logically follow that just because the shareholders currently have a more accessible cause

80. Tuch, *supra* note 2, at 1101.

81. Bratton & Wachter, *supra* note 4, at 33 (citing *In re* Shoe Town, Inc. Stockholders Litig. No. 9483, 1990 WL 13475, at *7 (Del. Ch. Feb. 12, 1990)).

82. *Id.*

83. *Id.*

84. *Id.* at 47.

85. *Id.* at 47-48.

of action against the director that they should also have a cause of action against the banker for aiding and abetting the director. The Court of Chancery's logical statements in *Shoe Town* should still be applicable. Director disloyalty and an investment banker should be viewed as two separate things, even if they are sometimes intertwined because the director is a fiduciary of the corporation and its shareholders whereas the investment banker is not. In the legal world where lawyers are fiduciaries to the clients they advise, disloyalty is not tolerated. Lawyers face disciplinary action in the case of a conflict of interest.[86] "[W]hy should banker conflicts be tolerated at all in a world where nobody would proceed with a sale process where the same law firm represented both sides?"[87] Investment bankers are treated and viewed differently, so it is illogical and impractical to impose the same duties.

Furthermore, the realistic operation of the investment banker market undercuts the argument that investment bankers are—or even should be—fiduciaries. "Where an investment bank is providing a fairness opinion for long-standing clients, it 'may be influenced to find a transaction fair to avoid irritating management and other corporate actors who stand to benefit from the transaction,' as '[t]his will ensure future lucrative business.'"[88] In theory, this would be true. The court in *Del Monte* stated that "Barclays and Del Monte ha[d] enjoyed a close relationship."[89] But long-standing clients are shifting away from being the norm. The investment banks are now notorious for high turnover because of the high-pressure environment.[90] "In

86. MODEL CODE OF PROF'L CONDUCT r.1.7 (AM. BAR ASS'N 2016).

87. Bratton & Wachter, *supra* note 4, at 7.

88. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 106 (Del. Ch. 2014) (citing Steven M. Davidoff, *Fairness Opinions*, 55 AM. U. L. REV. 1557, 1587 (2006)).

89. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 819 (Del. Ch. 2011).

90. *See* Robert C. Bird & Darren Charters, *Good Faith and Wrongful Termination in Canada and the United States: A Comparative and Relational Inquiry*, 41 AM. BUS. L.J. 205, 247 (2004) ("[S]ome businesses by their nature suffer from rapid turnover (e.g., a high-pressured investment banking position).").

the high-pressure environment of an investment bank, the typical professional stays on the job between seven and nine years before changing careers or leaving for other areas of finance."[91] In 2010, a private equity recruitment firm, PER, calculated that 250 people joined a combination of Bank of America, Citigroup, Credit Suisse, Goldman Sachs, JP Morgan, and Morgan Stanley. After three years, PER reported that only 140 of those people were even working in the banking field.[92]

> As banks have done progressively larger transactions, and as some bankers have become more mobile—moving from bank to bank rather than staying with the same bank for their whole careers—much has changed about bankers' relationships to their banks, and consequently, banks' relationships to their customers and clients. This is especially so for those bankers who in a good year may make enough to live on for the rest of their lives.[93]

The banks' priorities are moving away from an emphasis on stable business practices and personal relationships and toward aggressive new strategies for enhancing profitability.[94] Unlike the "family lawyer" or "family accountant" expected to act loyally even in the absence of a contract, the same expectation is not—and should not—be present for a director's advising investment banker.

91. Dawn Kopeckie, *Young Bankers Fed Up with 90-Hour Weeks Move to Startups,* BLOOMBERG MARKETS (May 8, 2014 at 10:01 PM), https://www.bloomberg.com/news/articles/2014-05-09/young-bankers-fed-up-with-90-hour-weeks-move-to-startups.

92. Sarah Butcher, *Nearly Half of Junior M&A Bankers at Top Banks Quit Within Three Years* (Apr. 19, 2013), http://news.efinancialcareers.com/us-en/139375/nearly-half-of-junior-ma-bankers-at-top-banks-quit-within-three-years/.

93. HILL & PAINTER, *supra* note 64, at 103.

94. *Id.* at 76.

Additionally, even if investment bankers were fiduciaries and therefore owed fiduciary duties to their clients, it is certain that neither banks nor bankers want to be fiduciaries. So just as most corporate bylaws do (i.e. by exculpatory provisions per DGCL § 102(b)(7)), the banks will simply contract around the fiduciary duties. And, as explained further below, the market will be no discipline to "weed out" the bankers that do contract around the fiduciary duties as opposed to the bankers that do not. The contract between the corporate director and the advising investment banker should deter, not enable the administration of self-serving advice.

2. Difficult to prove "knowing participation"

Investment banks and bankers have numerous "ways to obscure, if not conceal, what they are doing."[95] Therefore, even if investment bankers were fiduciaries and owed fiduciary duties despite the assertions above, it is far too difficult to prove "knowing participation" to sufficiently deter the investment banker from handing out self-serving advice. If investment bankers literally "aid" the directors in engaging in any of the conduct explained in Section III above, liability for aiding and abetting logically applies. For example, suppose a director sits on both sides of a proposed M&A transaction. If the director approached an investment banker and explained that he needed a fairness opinion to appear to satisfy his fiduciary duties, the investment banker would be "aiding and abetting" the director's breach of his duty of loyalty by approving the deal. The investment banker still has his own incentive to approve the deal so he can finance it, and if he says it is not a good deal or refuses to assist a conflicted director, then he gets nothing. The investment banker in this example is aware the director is breaching his duty of loyalty, satisfying the "knowing" prong of

95. *Id.* at 7.

the aiding and abetting liability test, and the investment banker is aware that in approving the deal, he is assisting the director breach his duty of loyalty. This is a narrow circumstance, as it is usually much less obvious that the director and investment banker are acting in concert—if they are even acting in concert at all. And even though this situation contains wrongful conflicted behavior that is clearly punishable, it would be difficult to detect this behavior and prove this conversation occurred. This is why the Court of Chancery has explicitly acknowledged the difficulty of prevailing on an aiding and abetting claim.[96] Therefore, even in a situation where the "knowing participation" is satisfied in reality, it would still nonetheless be difficult to prove in the courtroom.

Similarly, in *Rural Metro*, the Court posed a similar scenario by stating that "[i]f the third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting."[97] Again, this is the Court's hypothetical scenario in which the investment banker is aware the director is breaching their fiduciary duties to the shareholders and actively assists the director. In this situation, liability for aiding and abetting logically follows so long as it could be proven that collusion occurred.

However, the board of directors typically turns to investment bankers to assure they *satisfy* their fiduciary duties—not to help them *breach* their fiduciary duties. The directors and senior management under the directors are typically not M&A experts, so they rely on investment bankers "for expert advice about market conditions and alternative modes of sale."[98]

96. *See, e.g.*, *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 448 (Del. Ch. 2012) ("[A]lthough Goldman has been named as an aider and abettor and it has substantial, some might say even government-insured, financial resources, it is difficult to prove an aiding and abetting claim.").

97. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 97 (Del. Ch. 2014).

98. Bratton & Wachter, *supra* note 4, at 12.

The board of a selling company seeks help from investment bankers not only in whether to sell the company, but also what to sell, how to sell, who to sell it to, and how much to sell it for.[99] With the board under fiduciary obligations to the company and shareholders, there is typically enough to deter the directors from engaging in fraudulent behavior exemplified above and inviting the investment banker to help them along. Therefore, the situation in these hypothetical scenarios is not the particular type of investment banker behavior that needs proper attention because it rarely—if ever—occurs with such simplicity and surety.

The more common context in practice, as evidenced through the recent case law, is where the investment banker's disloyalty derives solely from his personal desire to finance the deal, absent the director's breach of fiduciary duties. For instance, in *Del Monte*, the Court of Chancery explicitly acknowledged that in that instance, the taint of self-interest came from a conflicted financial advisor rather than from management; it was "fraud upon the board."[100]

Therefore, although Tuch's argument is flawed in categorizing investment bankers as "fiduciaries," Tuch is correct in contending that the optimal deterrence theory is not achieved by aiding and abetting. If the investment banker gets a percentage of the deal on which they are advising, which is usually the case,[101] the payout for the banker is immense. This is why bankers are incentivized to encourage a deal regardless if it is a good deal for the corporation in the first place. In order for the disloyal bankers to be sufficiently deterred, they must expect to bear liability equal to the social costs they create. If the invest-

99. *See id.* ("Transaction planning has only just begun with an affirmative answer to the question as to 'whether' to sell.").

100. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 836 (Del. Ch. 2011).

101. *See* Tuch, *supra* note 2, at 1097 ("[Investment bankers'] fees are typically calculated as a percentage of the deal consideration, often between 0.5% and 1.0%, contingent on the contemplated deal closing.").

ment banker knows the complaining party almost never satisfies the test for aiding and abetting liability or knows the complaining party is almost never able to prove *knowing* participation, the investment banker will determine—as they currently do—that the benefit of a large payday in the tens of millions of dollars substantially outweighs the minor risk of liability.

B. Reputational Governance Alone is Insufficient

The aiding and abetting approach is not the proper solution to deter investment banker disloyalty—but something must be done, because leaving the market alone and allowing the threat of reputational harm to govern will not deter this wrongful behavior either. Some argue that the force of market discipline will sufficiently deter investment bankers from engaging in disloyal conduct. The argument assumes that once the banker gives self-interested advice to one corporate director and the corporation suffers, other corporate directors will refrain from obtaining that banker's advice.[102] However, this assumption is flawed. As stated and evidenced above, the investment banking market is increasingly shifting away from the focus of personal relationships and more towards the focus of monetary gain.[103] Therefore, the field's high turnover rates not only undercut the fiduciary argument, but also undercut the sufficiency of reputational governance. And even though reputation *should* generally serve as a constraint to conflicted behavior, there are times when it does not. In fact, "[s]ome bankers apparently believe that their clients won't hold problematic

102. *See, e.g.*, Christopher Rebel J. Pace, *Determining Price Inadequacy with Neutral Decision Making and Expert Assistance: A Principled Way to "Just Say No"*, 16 DEL. J. CORP. L. 57, 92 n.159 (1991) ("'[A] professional reputation for quality work is an important asset to an investment bank', so bankers are reluctant to jeopardize this reputation by doing low quality work.") (quoting Lucian Arye Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, DUKE L.J., 27, 43 (1989)).

103. HILL & PAINTER, *supra* note 64, at 89–90 (explaining that there is now less emphasis in hiring prospective investment bankers on connections and charisma, and more emphasis on what he or she can do with his or her knowledge to make money).

behavior against them—or even, that some sorts of problematic behavior are a sign of intelligence and skill."[104] And even when a banker is performing badly, rather than the market disciplining the banker into behaving, the banker is often tempted "to sell bad investments to credulous but technically 'sophisticated' customers and clients" or to "doubl[e] down on, or not fully disclos[e], risk."[105]

Banks do invest in their reputation and goodwill, so it should follow that banks and bankers:

> "would not opine that a transaction were fair if it were not so, and to a certain extent, we do see banks and bankers refuse to issue fairness opinions when the offered consideration is not fair. However, such refusals are the exception, not the rule, because incentives lead rational bankers to opine that a transaction is fair even when it may not be fair."[106]

There is a low likelihood that the market will detect a low-quality fairness opinion, so concern for reputation provides a poor discipline. "[M]arket discipline is a crude measure for constraining misconduct, especially for difficult-to-detect conflicts of interest. Information about past conduct by individual M&A advisors may not be widely disseminated, and even where it is, it may not allow a reliable assessment of a bank's performance."[107] Therefore, "rational bankers will issue low-quality opinions more willingly."[108] Fairness opinions are typically two pages that disclose a conclusion but offer "scant analysis," and what analysis is contained may be "obscured through the use of 'abstract, oblique, general language.'"[109] Therefore, it is hard for future clients to detect a good fairness opinion from a poor

104. *Id.* at 2–3.

105. *Id.* at 20.

106. Steven J. Cleveland, *An Economic and Behavioral Analysis of Investment Bankers When Delivering Fairness Opinions*, 58 ALA. L. REV. 299, 308 (2006).

107. Tuch, *supra* note 2, at 1109.

108. Cleveland, *supra* note 106.

109. *Id.* at 308–09 (quoting DALE ARTHUR OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS 15 (1999)).

one—or if a fairness opinion has been tainted with disloyalty—so reputation is a weak discipline for investment bankers.

> Even if there are reputational motivations that could keep the investment bankers in line, the vast monetary incentive is most likely much stronger. "Bankers act as they do because they are rewarded for doing so. Those rewards include money, but they also include status, improved professional prospects, and presumably, a sense of pride and achievement."[110] "In traditional investment banking, the business model assumed that revenue would come from repeat interaction with customers. In order for a bank to be successful, reputational capital was as important as financial capital."[111] Nearly twenty years later, former Goldman Sachs vice president Greg Smith stated, "To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money . . . It's purely about how we can make the most possible money off of them. If you were an alien from Mars and sat in on one of these meetings, you would believe that a client's success or progress was not part of the thought process at all."[112]

Simply put, reputation is not enough—contract law is the proper fix for this harmful problem.

C. Contractual Governance is Preferable

The Court of Chancery "upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties."[113] Where aiding and abetting is often difficult to enforce and therefore leaves investment bankers under-deterred from administering self-serving advice, the court enforces contracts with high regard.

110. HILL & PAINTER, *supra* note 64, at 108–09.

111. *Id.* at 101.

112. *Id.* at 102–03.

113. *See, e.g.*, *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 840 (Del. Ch. 2011) (citing NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 35 (Del. Ch. 2009)).

Contract law is, and should remain, the proper remedy for investment banker disloyalty—there is neither a need nor a reason to bring in civil aiding and abetting.

The Court of Chancery continually protects the board from unreasonable liability on the theory that the protection promotes shareholder interests.[114] It is unreasonable—due to the difficulty and the expense of monitoring costs—to hold the director liable for breaching the *Revlon* duties for failure to monitor the investment banker. Directors cannot easily monitor the advising investment bankers like an employer can easily monitor an employee, so it would be unfair and illogical to impose the same vicarious liability onto two different circumstances.[115] Additionally, "directors are entitled to rely on the advice of [experts such as investment bankers] as long as they believe that the advice was within the expert's professional competence, the expert was selected with reasonable care, and reliance is in good faith."[116] Therefore, directors should be protected in this context because of the near-impossibility of sufficiently monitoring the investment banker, and because they are entitled to rely on the investment banker. In other words, directors should not be held liable for failing to sufficiently monitor the investment banker or relying on the banker's advice in good faith. The liability should fall where the fault is—with the self-serving investment banker—but the director should contract for the protection by negotiating an engagement letter fa-

114. *See, e.g.*, Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1052 (Del. Ch. 1996) (reasoning that "it is in the shareholders' economic interest to offer sufficient protection to directors from liability. . . .").

115. Tuch, *supra* note 2, at 1124–25.

116. Alexandros N. Rokas, *Reliance on Experts from a Corporate Law Prospective*, 2 AM. U. BUS. L. REV. 323, 323 (2013); *see also* 8 Del. C. § 141(e) ("A member of the board of directors . . . in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers of employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.").

vorable to the director's corporation. Specifically, the director should contract for indemnification.

Indemnification means providing "security against hurt, loss, or damage" or an exemption from "incurred penalties or liability."[117] Section 145 of DGCL provides an allowance for director indemnification by the corporation,[118] so director indemnification is not a novel idea that remains unknown as to whether the courts will enforce it or not. But director indemnification has limits, as it should. DGCL § 145 only allows indemnification of the director if the director did not contribute to the disloyalty.[119] The director must meet the proper standards of conduct (i.e., duty of loyalty or care).[120] DGCL § 145 also provides several different ways to determine whether the director did in fact meet his or her standards of conduct.[121]

Director indemnification is already a recognized and often-implemented provision in corporate charters. It is not a new or controversial idea like some of the scholars' propositions.[122] Indemnification is a tool that keeps directors' self-serving behavior in check because they know as long as they perform in good faith and succeed in litigation, they will not be responsible for fees. In other words, as long as they do not

117. MERRIAM-WEBSTER'S DICTIONARY (2017), https://www.merriam-webster.com/dictionary/indemnity.

118. 8 Del. C. § 145(c) ("To the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding . . . or in defense of any claim, [or] issue . . . such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.").

119. *See generally* 8 Del. C. § 145.

120. See Section II of this paper for further details on director breach of care and loyalty duties.

121. 8 Del. C. § 145(d) (providing that it may be determined whether or not the director met his or her standards of conduct in a number of ways, including, "(1) By a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum; or (2) By a committee of such directors designated by majority vote of such directors, even though less than a quorum; or (3) If there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion; or (4) By the stockholders.").

122. For instance, Tuch admits that his suggestion of subjecting M&A advisors to primary liability through direct causes of actions by shareholders for disloyalty is a more controversial suggestion. Tuch, *supra* note 2, at 1085.

breach their duty of loyalty,[123] they will not have to worry about paying for litigation that may come against them. At the same time, it does not create a scenario in which directors become excessively risk-averse due to fear of liability, which in turn promotes shareholders' interests.[124]

The same idea and rationale could easily be applied to the context of a corporate director seeking advice from an investment banker. The investment banker could agree contractually to indemnify the director in the event the director is subject to a derivative lawsuit and the court finds the director did not act in bad faith. For example, the engagement letter between the bank and the director, instead of containing boilerplate language favorable to the bank and banker, should include a provision similar to that provided in DGCL § 145 that states if it is determined that the banker administered self-serving advice that caused the director of the company whom it is advising to incur costs in defending the action or to pay damages in relation to the action, and it is also determined that the director is not also culpable, the banker will indemnify the director for any legal expenses or damages incurred in that action. The particular parties could choose the method of determining whether the investment banker and director were disloyal. It is probably preferable that the court determine whether or not the director qualifies for indemnification by the investment banker, but just like DGCL § 145(d) provides, it could also be determined by a committee of independent directors, independent outside legal counsel, etc.—whatever is most preferable to the specific parties. The parties could also choose what specific fees are to be covered, specific procedures and time frames, etc. Therefore, in

123. As noted above, the Court of Chancery has determined that good faith is a subsidiary element of the duty of loyalty. *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 370 (Del. Ch. 2006).

124. *See, e.g.*, Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1052 (Del. Ch. 1996) (reasoning that "it is in the shareholders' economic interest to offer sufficient protection to directors from liability for negligence, etc., to allow directors to conclude that, as a practical matter, there is no risk that, if they act in good faith and meet minimal proceduralist standards of attention, they can face liability as a result of a business loss.").

cases similar to *Del Monte* where the court recognizes there has been "fraud upon the board"[125] and the court finds that the board did not engage in wrongful behavior other than seeking advice from a self-serving investment banker for which there was no way the director could have known, the investment banker will be held liable for the expenses the director incurred in defending the action.

This indemnification clause not only protects the inculpable director but also promotes shareholders' interests. It is in the shareholders' best interest to allow the board to engage in appropriate risk taking without the fear of liability. This is why the court and legislature shields the board from liability time and time again, such as through the implementation of the business judgment rule and statutory protections such as the allowance of exculpatory provisions, director indemnification, and director and officer insurance.[126] Therefore, it is clear that encouraging directors to make decisions without the fear of liability is important. It is also important that directors seek outside advice when negotiating or contemplating a high-stakes corporate deal. If directors know that they will be on the hook for the investment bankers' disloyal conduct should the deal turn out badly, as aiding and abetting is nearly impossible to prove and impose, directors may be discouraged from turning to investment bankers. This inhibits the directors from fulfilling their fiduciary duties to the highest extent.

An indemnification clause between the banker and the director will also promote shareholders' interests by keeping the director's self-serving behavior in check. The remedy for indemnification would fall short in a scenario—as in, for exam-

125. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 836 (Del. Ch. 2011) (quoting Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1283 (Del. 1989)).

126. *See* Gagliardi, 683 A.2d at 1052–53 (business judgment rule); 8 Del. C. § 102(b)(7) (exculpatory clause); 8 Del. C. § 145(c) (director indemnification); 8 Del. C. § 145(g) (director and officer insurance).

ple, *El Paso*[127]—where it is clear both the investment banker *and* the director were acting in their own self-interest. But an indemnification clause would make that situation highly unlikely. Just as the corporation-director indemnification clause in the Delaware Code incentivizes the board to act in good faith,[128] this indemnification clause would do the same. The courts will certainly support enforcing a remedy that promotes shareholders' interests. In *Rural Metro*, the court stated, "[T]he directors' fiduciary duties require that they seek 'to promote the value of the corporation for the benefit of its stockholders.'"[129] "Stockholders' best interest must always, within legal limits, be the end. Other [corporate] constituencies may be considered only instrumentally to advance that end."[130] The indemnification clause is in line with shareholder's interests, both in that it protects the board from unreasonable liability and incentivizes the board to act loyally so they can be indemnified; accordingly, indemnification is a proper solution.

This indemnification approach is also consistent with the principles of equity and fairness. An indemnification that imposes liability onto the banker only when the director is not also at fault is fair. The court in *Del Monte* explicitly recognized and stated that "it appears that the Board sought in good faith to fulfill its fiduciary duties, but failed because it was misled by Barclays."[131] It is entirely unjust to impose liability on the board that put forth all efforts to fulfill its duty of loyalty simply because the market has constructed a shield around the investment banker in which liability cannot seem to find a logical

127. *See* Bratton & Wachter, *supra* note 4, at 56 ("*El Paso* turns up the heat several notches. Here the board and the banker made the moves indicated in the conflict-management playbook. . . .").

128. 8 Del. C. § 145.

129. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 80 (Del. Ch. 2014) (quoting eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010)).

130. *Id.* at 80 (quoting Leo E. Strine Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 147 n.34 (2012)).

131. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 818 (Del. Ch. 2011).

hook. Of course, there are instances where the board is not so innocent, but in those cases the indemnification clause would not apply as a protection. In a scenario like *Del Monte*, the indemnification will place liability where it equitably should be while not putting an unjust burden on the investment banker (i.e., forcing the investment banker to be strictly liable for company losses). The court will certainly appreciate this rationale because, as mentioned above, the court rightfully takes advantage of any opportunity to protect board members from liability if they act in good faith.

Of course, contractual governance is a privately ordered solution. In other words, both the banker and the director must mutually agree to include the indemnification provision in the engagement letter. One might inquire as to why directors have not already pursued this remedy. The answer is that the market is currently dysfunctional. The first problem is that "one of the first agreements that the principals in a business transaction execute—one that materially affects their respective rights—has been neglected: investment banking engagement letters."[132] Normally, the investment banker attempts to start the relationship with the director seeking its help on behalf of its company "with [a] 'standard form' engagement letter, which is always one-sided in favor of the investment banker."[133] Thus, there is an issue with the director not putting forth enough care to negotiate for more favorable terms, the investment banker having too high of bargaining power, or a combination of both. Another problem within the market, which possibly relates to the issue of unequal bargaining power, is that investment banks will not want to agree to indemnify the director—in fact, *limiting*

132. Louis R. Dienes & Alison M. Pear, *An Annotated Form of Investment Banking Engagement Letter*, 25 CAL. BUS. L. PRACTITIONER 108, 108 (2010), http://www.kelrun.com/files/2013/05/Pear_AnnInvesLtr.pdf.

133. Richard Harroch, *Negotiating Investment Banker Engagement Letters*, FORBES (June 24, 2016, 10:01 AM), http://www.forbes.com/sites/allbusiness/2016/06/24/negotiating-investment-banker-engagement-letters/#10999fbcb62d.

indemnification liability is probably one of the banker's main objectives when engaging in a business relationship.[134] The bank and bankers want the company and directors to indemnify *them*.

Historically, when the market's functionality fails, America has turned to a government solution—particularly in the banking market.[135] But it is difficult for Congress to control bank and banker behavior. For instance, investment bankers often have a vast amount of resources "to figure out both how to comply minimally or only facially with regulations and how to complicate regulatory efforts to get them to comply more maximally."[136] Additionally, bankers often construct methods to "help their clients get around regulations" and often "hire lawyers, accountants, and other advisors to help them get around regulations."[137] Furthermore, there are also limitations on what state and local regulation can do to improve investment banker activity. For instance, if the bank does not like a state's particular laws, they can simply move their transactions to a different state.[138] This threat usually disincentivizes states from imposing further regulations than federal law.[139]

There comes a point where government ordered solutions, whether at the state or federal level, only further complicate the system without actually solving the problems. A privately ordered solution of contracting for indemnification will work better to target the current market dysfunction and deter disloyal investment banker behavior. Making the change within

134. *See* Dienes & Pear, *supra* note 132, at 109 ("The investment banker's major objectives will include: (1) defining the type of transaction for which it is being engaged broadly, so that the client's liability for payment of the banker's fee is triggered easily; (2) defining the exclusivity of its services as broadly as possible; (3) limiting the circumstances that allow the client to avoid paying its fee; and (4) limiting indemnification liability.").

135. *See, e.g.*, HILL & PAINTER, *supra* note 64, at 127 (stating that "[b]ankers' conduct in the U.S. has been regulated at the federal and state levels for a long time.").

136. *Id.* at 128.

137. *Id.* at 134.

138. *Id.* at 140.

139. *Id.*

the engagement letters puts the individual directors and bankers at the battlefront. The engagement letter is not a complex set of rules or abstract principles that are unclear or avoidable—it is a contract in which the investment banker is personally involved and to which the investment banker will be much more inclined to adhere. It requires the director to exercise care and effort in negotiating a fair engagement letter rather than simply signing and agreeing to boilerplate language favorable to the bank. Additionally, it allows the parties to tailor the contract to their needs, as opposed to a one-size-fits-all, government-ordered solution.[140]

The question still remains as to how and why the banks and the bankers would agree to indemnify the corporate directors, especially if the banks have higher bargaining power. One option, notwithstanding the shortcomings of implementing regulations stated above, is to require banks that are publicly held companies subject to the U.S. securities law filing requirements to disclose to the banks' shareholders the specifics of indemnification agreements between their advising bankers and corporate directors, and if they have not implemented such agreements, require banks to explain the reason why.[141] Just as the indemnification clause promotes the interests of the advice-seeking company's shareholders, it similarly promotes the interests of the bank's shareholders; once it becomes known as a useful deterrent for self-serving and overly risky investment bankers, the bank's shareholders will certainly want to see it included. This could operate as a market discipline for the banks because if shareholders are unhappy, they can sell their interests, resulting in a decrease of the bank's share price. There-

140. *See, e.g.*, HILL & PAINTER, *supra* note 64, at 147 (stating that requiring the parties to enter into a "covenant" as opposed to voluntary adoption would have to be specified by means of a minimum standard, which would not be preferable because one size cannot be expected to fit all).

141. *See id.* at 148–49 (explaining a similar SEC filing requirement to incentivize banks to adopt personal liability agreements for their highly compensated bankers).

fore, "[s]uch required disclosure might help motivate more banks to adopt such agreements."[142]

For banks that are not publicly held corporations and therefore not subject to federal securities law, even if such a requirement described above could not be adopted or enforced, the motivation to implement an indemnification clause can still occur through the negotiations of the individual parties. Negotiations are most optimal if both parties are willing to grant concessions, so even competitive negotiators must give themselves room to concede.[143] Therefore, if the director starts the bargain higher than his target point, the banker is likely to agree to the indemnification provision once the director concedes higher demands. The most favorable terms the director could realistically negotiate for himself and his corporation is an indemnification of damages arising "'primarily' or 'principally' from [the] investment bankers' actions."[144] However, because that essentially means the investment banker just has to be found slightly more liable than the director, it is likely that neither the bank nor banker will agree to hold the banker solely liable when both the banker and director were at fault to some degree.[145] Therefore, the director could start the negotiation with the primary and principal liability language and subsequently concede to an indemnification of damages arising *solely* from the investment bankers' actions. The director also has room in negotiating the method of how liability is determined. If the banker is truly unwilling to agree to indemnify the director, at the minimum, the director should put a halt on indemni-

142. *Id.* at 148.

143. DONALD G. GIFFORD, LEGAL NEGOTIATION: THEORY AND PRACTICE 57, 151 (2d ed. 2007) (stating that the highest degree of satisfaction is achieved if the parties solve problems in a way that will "satisfy both their underlying interests" and that "[e]ven negotiators using mostly competitive tactics . . . find it necessary to make concessions.").

144. *See* Dienes & Pear, *supra* note 132, at 112 (explaining that it is challenging for a client to contract for indemnification at a lower standard than if the investment banker is "primarily" or "principally" liable).

145. *Id.*

fying the investment bank or banker and likewise refuse to include that language. As Arthur Rosenbloom explains,

> [T]he conduct of an investment banker cannot be truly objective if he is both indemnified and getting a bonus if the deal goes through. Who would respect an audited financial statement if the auditor had an indemnification from the company to the effect that if there was anything negligent, false or misleading in the financial statements, the auditor would not be responsible?[146]

Then, as a last resort, if the banker refuses to agree to both indemnify the director and to omit his or her own indemnification provision, the director should seek advice from a different bank. These several options give the director leverage, which helps mend the market dysfunction of unequal bargaining power. This also creates market discipline for the investment banker because he or she will be incentivized to reach some agreement when the banker knows he or she will lose the director's business and the potential payout of an M&A deal if he fails to.

To be taken seriously and eventually reach an agreement of indemnification, the director cannot be greedy and bargain for an unreasonable indemnification. For example, if the director tries to hold the investment banker responsible for the corporate losses of *any deal gone wrong* for which he or she advised, if the bank and banker agreed to that, the banker would certainly think twice before advising the director to take the deal when it is in fact a poor deal. However, that punishment would be far too unreasonable. First, neither a bank nor a banker would ever agree to include that provision in the en-

146. Arthur H. Rosenbloom, *Investment Banker Liability: A Panel Discussion*, 16 DEL. J. CORP. L. 557, 570 (1991).

gagement letter. And even if they did or were somehow forced to, it would rarely be clear as to when a company suffered losses solely because of the investment banker's advice. Therefore, to hold the investment banker strictly liable would be highly unfair. Just like corporate directors, it is good if investment bankers engage in some risk—just not excessive or careless risk. Furthermore, investment bankers typically have deep pockets, but not deep enough to cover large corporate losses. And if the banks were the parties that end up absorbing the indemnification, the result would again be under-deterred behavior, as the bankers would then be hiding behind the deep-pocketed bank.

However, an indemnification for legal fees incurred by the director when the investment banker is disloyal and the director fulfills his fiduciary duties *is* reasonable. Court fees can be extremely expensive, so they are enough to make the investment banker second-guess before administering bad advice, but they are not so large that there is no realistic ability to pay. If one can competently defend the assertion that banks should force their bankers to sign personal guarantees in which these highly paid bankers are asked to make a substantial portion of their personal assets available to pay the debts of the bank if it fails,[147] or investment bankers should be subject to primary liability through direct causes of actions by the *shareholders*[148] (which the Court of Chancery has specifically rejected before),[149] it is certainly reasonable to claim that the advising investment banker can pay the director's court fees for litigation that the investment banker caused from self-interested advice. The limit on the imposition of fees only where the director has indeed satisfied his or her duties as director and the cap on just the legal fees the director incurs in defending the action cabins the bank exposure, making the potential liability reasonable.

147. HILL & PAINTER, *supra* note 64, at 152.

148. *See* Tuch, *supra* note 2, at 1085 (emphasis added).

149. Bratton & Wachter, *supra* note 4, at 33.

Where the realities of how the market operates undercut both the fiduciary argument and the reputational governance argument, it could be argued that it also undercuts the plausibility of contractual governance. Often in practice, "bankers and their clients do not use their contracts to minimize conflicts and improve incentives. . . ."[150] But, they *should*. It is generally true that no contract is complete, which is why state corporate law implemented fiduciary duties in the first place—to operate as a gap-filler and impose the duty of loyalty and liability for breach thereof even absent a contract. But in the M&A context where the stakes are high and the potential losses detrimental, the parties should put forth the effort to create contracts that are as complete as possible. Although this could arguably increase transaction costs, adding this indemnification provision into (or as an exhibit to) the contract will not unreasonably increase the costs. For example, DGCL § 102(b)(7) technically puts the burden of transaction costs on incorporators by requiring them to explicitly include an exculpatory provision in the charter if the parties desire one.[151] But that provision is so common that it is nearly always in the charter or bylaws and is not increasing transaction costs.[152]

An indemnification clause in the investment banker-director engagement letter would operate the same way once it became evident that such a contract provision deters both investment banker and director disloyalty as well as promotes shareholders' interests. This would especially be true if a disclosure requirement were implemented. But even if at first the clause required some extensive negotiation between the director and investment banker, it would soon become boilerplate

150. *Id.* at 26.

151. 8 Del. C. § 102(b)(7) ("[T]he certificate of incorporation may also contain any or all of the following matters: . . . A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director. . . .").

152. *See supra* note 19 and accompanying text.

language that is simply copied and pasted from the past engagement letter into the next. Even if the transaction costs are slightly increased due to the inability to settle on the terms of the indemnification, the additional costs of the transaction are still going to be significantly lower than the cost of economic damage in engaging in a bad deal in the million- or billion-dollar range due to the investment banker's self-serving advice to forgo the deal.

V. CONCLUSION

The Court of Chancery correctly states, "The threat of liability helps incentivize gatekeepers to provide sound advice, monitor clients, and deter client wrongs."[153] But it is clear that holding investment bankers liable for aiding and abetting corporate directors in breaching their fiduciary duties does not sufficiently incentivize loyalty, leaving the self-serving behavior under-deterred. The stringent test for aiding and abetting cannot be satisfied. Liability for aiding and abetting requires four elements to be met before liability attaches: (1) the existence of a fiduciary relationship; (2) a breach of the fiduciary's duty; (3) knowing participation in that breach by the defendants; and (4) damages proximately caused the breach.[154] There is no fiduciary relationship in the context of an investment banker, so elements (1) and (2) cannot therefore be met. And even if there was a fiduciary relationship with fiduciary duties imposed, the "knowing participation" requirement is nearly impossible to prove in all but very limited scenarios. Investment bankers who advise and close deals that earn them fees in the tens of millions of dollars are governed by a test that can rarely, if ever, apply. The test is a simple cost-benefit analysis done by the investment

153. *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 88 (Del. Ch. 2014).

154. *See, e.g.*, *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 838 (Del. Ch. 2011) (citing *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001)).

banker who undoubtedly understands economics. The typical results will certainly not discourage self-serving advice.

The economic damage that investment banker disloyalty causes corporations demonstrates the importance of finding a solution. It is clear that finding a solution to investment banker disloyalty that creates sufficient deterrence and does not unreasonably increase transaction costs is a difficult task. But an indemnification clause in or incorporated as a part of the engagement letter between the investment bank and the corporate director seeking advice is a reasonable and desirable solution. Director indemnification is already a recognized practice in the Delaware statutes and courts, and it can easily be transitioned to apply in this context. It will promote shareholders' interests by both shielding the board from liability when it has only sought advice from a self-serving advisor, and incentivizing the directors to perform in good faith and fulfill the duty of loyalty so they may qualify for indemnification. The indemnification clause approach also promotes principles of fairness and equity by not holding the wrong party responsible for large expenses in defending an action.

With the complexity and amounts of government ordered solutions and regulations, a privately ordered solution is preferable to target the problem, create a sufficient deterrent, and mend the market dysfunction. The directors will be forced to put forth more effort into the engagement letter with the bank than they historically have and negotiate for indemnification, but it is probable that the banks and bankers will agree when the indemnification is only for situations where the fault lies solely with the investment banker's self-interested advice. This limit on the director's qualification for indemnification renders it reasonable while still imposing liability large enough to sufficiently deter the investment banker from advising the director to proceed with a bad deal in order to simply get a payday. Furthermore, contracting for indemnification will not unreasonably increase transaction costs because if it is successful, it will become boilerplate language in the banker-director contract, just as DGCL § 145 indemnification clauses and DGCL § 102(b)(7) exculpatory clauses are boilerplate provisions in corporate charters and bylaws. Contract law—not civil aiding and abetting—is the proper place to turn for sufficient deterrence.

Maren B. Worley[*]

[*] J.D. Candidate, April 2018, J. Reuben Clark Law School, Brigham Young University. I would like to thank Professor Matthew Jennejohn for the high-quality teaching in both Contracts and Business Organizations class and the helpful assistance and guidance for this article.