Don't rely on others to do your work

Directors are reminded they must always actively manage the processes that determine significant transactions.

BY DOUG RAYMOND

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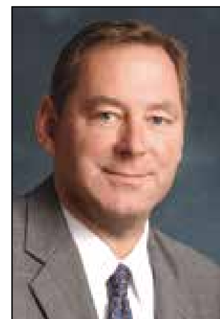

As readers of Directors & Boards know, litigation around public company sale transactions has become ubiquitous. These lawsuits are typically settled, often by making modest changes in disclosure documents and payment of fees to the plaintiffs' lawyers. Sometimes, however, the litigation discovery process turns up issues that reflect more fundamental problems. One such recent case is *In re Rural Metro Stockholders Litigation*, decided recently in Delaware.

In *Rural* the usual suits were brought challenging a 2011 sale of Rural/Metro Corporation to a private equity fund, and raising both disclosure and breaches of fiduciary duty claims against the company's board of directors, as well as claims against the company's financial advisors. The directors and one of the financial advisors settled out of court. The case proceeded to trial against the remaining financial advisor. The opinion makes for an interesting read as the judge reviews some pretty surprising behavior by both bankers and directors, with the court ultimately finding that the directors had breached their duties to the corporation and its stockholders. While there is no single blueprint or formula for board processes, in *Rural* the court provides several object lessons for other directors and boards.

Mission creep: The board authorized a special committee to analyze several specific strategic alternatives but, without further authorization, the committee converted its mandate into a directive to sell the company. Moreover, none of the directors questioned this expansion of the committee's activities. A board must consider and clearly define the scope of delegation to a special committee. Furthermore, a board must exercise sufficient oversight over committees and advisors to ensure they remain within their mandates.

Know who's on your side: The board must take reasonable steps to learn about and evaluate the potential and actual conflicts of interest faced by directors, management and their advisors. While the special committee was technically independent, each member had personal circumstances that strongly inclined each of them to favor a quick sale of the company. On top of this, undisclosed efforts by the company's bankers to finance the bidders' acquisition of the company also created significant conflicts of interest. The board did not provide any guidance to its bankers on providing buyer financing, and did not make any effort to uncover or manage potentially significant conflicts. Consequently, the sales process was managed by the advisors to exclude bidders who would not need the stapled financing offered by the company's investment banker, which had the consequence of excluding potential (mostly strategic) bidders without any benefit to the company's stockholders.

Be not a potted plant: Directors must become reasonably informed about available alternatives. Among other information failures, only the special committee knew that an ongoing auction for another competitor had, unlike what the advisors had predicted, not generated additional interest in Rural but had instead knocked many potential bidders out of the Rural sale process. Neither the committee nor the company's advisors informed the rest of the board of this. Ultimately, there was only a single final bidder.

Know when to hold them: The board, following the lead of its conflicted advisor, did not consider strategic buyers in addition to financial buyers or consider whether to delay or defer the transaction to permit participants in the ongoing auction to bid for the company. Had the Rural board obtained an honest analysis of the potential alternatives, it may have concluded the company should wait before conducting a sale process.

Don't be too much in a hurry: The board must not only receive all relevant information, but must also have enough time to properly digest and consider it. In *Rural*, the very first valuation information the board received came late on a Sunday night, only about two hours before the 11 p.m. meeting to approve the deal. The board also failed to consider extending the process to allow another bidder to participate, even though this bidder may have paid more if it had been given additional time.

Although legal and financial advisors play key roles in significant corporate transactions and board members can rely on their reasonable advice, the *Rural* opinion is a reminder that directors play the most important role in the process. Boards cannot turn significant transactions, particularly sales of control, over to others and expect to be protected if things go badly. The directors must actively manage these processes, and they must actively oversee the work of their advisors. ■

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