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Banker Loyalty in Mergers and Acquisitions

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Articles

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When investment banks advise on merger and acquisition (M&A) transactions, are they fiduciaries of their clients, gatekeepers for investors, or simply arm's-length counterparties with no other-regarding duties? Scholars have generally treated M&A advisors as arm's-length counterparties, putting faith in the power of contract law and market constraints to discipline errant bank behavior. This Article counters that view, arguing that investment banks are rightly characterized as fiduciaries of their M&A clients and thus required to loyally serve client interests.

This Article also develops an analytical framework for assessing the liability rules that will most effectively deter disloyalty on the part of investment banks toward their M&A clients. Applying optimal deterrence theory, the framework shows why holding only banks liable for disloyalty is unlikely to effectively deter such disloyalty. Instead, it suggests the need for fault-based liability rules to be applied to corporate directors (of M&A clients) for their oversight of the banks they engage as well as the potential need for public enforcement of certain hard-to-detect conflicts.

Applying this framework, this Article assesses existing law, focusing on recent Delaware decisions, generally supporting that law but arguing that it is unlikely to effectively deter advisor disloyalty. It suggests changes to address the regulatory gap.

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Introduction

As advisors to corporations, governments, and other institutions, investment banks often face conflicts of interest.[1] The risk of conflict is especially pronounced in their core role as advisors on merger and acquisition (M&A) transactions. The most significant of corporate events,[2] 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] In these important transactions, conflicts may arise because

1. In accord with its usage in the legal context, the term *conflict of interest* is understood here to refer to circumstances giving rise to a substantial risk that the advisor's own interests, or a duty it owes to another person, will materially and adversely affect its representation of a merger and acquisition client. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 (AM. LAW INST. 2000) ("A conflict of interest is involved if there is a substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person."). For further discussion, see *infra* notes 63–77 and accompanying text.

2. *See* BEVIS LONGSTRETH, MODERN INVESTMENT MANAGEMENT AND THE PRUDENT MAN RULE 71 (1986) ("[T]he takeover phenomenon . . . is the dominant corporate event of recent years . . . .").

3. *See* THOMSON REUTERS, MERGERS & ACQUISITIONS REVIEW: FINANCIAL ADVISORS 2 (2015), http://dmi.thomsonreuters.com/Content/Files/4Q2015_Global_MandA_Financial_Advisory_Review.pdf [http://perma.cc/9BCU-V6Q5]. The figures are for announced M&A transactions in the United States.

banks engage simultaneously in multifarious nonadvisory activities, often giving them opportunities to extract wealth at their clients' expense.

Consider recent examples of the phenomenon under inquiry. In the acquisition of El Paso Corporation by Kinder Morgan, Goldman Sachs advised the seller despite owning 19% of the buyer—a stake valued at $4 billion—and controlling two seats on its board.[4] While advising Del Monte Food Company on its possible sale, Barclays surreptitiously worked with the buyers, even offering to fund their acquisition of Del Monte.[5] When Citigroup advised Toll Holdings on its acquisition of Patrick Corporation, the bank purchased over one million shares in the seller (on the bank's own account) the business day before its client publicly announced its premium-priced offer.[6]

Though firm conclusions are hard to draw, M&A advisors' conflicts systematically and adversely harm their clients, according to empirical evidence.[7] By distorting advisors' advice, conflicts may lead buyers to pay more than they otherwise would or to enter into wealth-destroying deals they otherwise would avoid.[8] Conflicts may lead sellers to sell for less than they otherwise would or to choose one prospective deal over more favorable deals.[9] They may increase bonding and monitoring costs for clients.[10] When conflicts involve the misuse of nonpublic client information, they may reduce market liquidity, increase trading costs, increase the cost of equity capital and volatility, and reduce the accuracy of stock prices.[11]

4. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 435 (Del. Ch. 2012).

5. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 833 (Del. Ch. 2011).

6. *See Australian Sec & Invs Comm'n v Citigroup Glob Mkts Austl Pty Ltd [No. 4]* (2007) 160 FCR 35 (Austl.).

7. For a discussion of the costs of disloyalty and other misconduct by investment banks and bankers, see Andrew F. Tuch, *The Self-Regulation of Investment Bankers*, 83 GEO. WASH. L. REV. 101, 123–33 (2014). Of course, not every conflict of interest will impose net harm on the client. *See infra* notes 72–74 and accompanying text.

8. *See, e.g.*, Andriy Bodnaruk et al., *Investment Banks as Insiders and the Market for Corporate Control*, 22 REV. FIN. STUD. 4989, 4992 (2009) (suggesting that investment banks "induce bidders to enter wealth-destructive deals for their own interests"); *id.* at 5016–24 (finding that clients pay higher premiums and overpay for target companies in which their investment banking advisors have a stake). *But see* John M. Griffin et al., *Examining the Dark Side of Financial Markets: Do Institutions Trade on Information from Investment Bank Connections?*, 25 REV. FIN. STUD. 2155, 2163, 2185 (2012) (finding limited exploitation of nonpublic information by investment banks during the period from 1997 to 2002, based on NASDAQ trading records). For further discussion of the harm caused by conflicts, see *infra* notes 67–71 and accompanying text.

9. The potential for such conduct underlaid the court's cautionary statement in *In re Toys "R" Us, Inc. Shareholder Litigation*, 877 A.2d 975, 1006 n.46 (Del. Ch. 2005), that M&A advisors not "create the appearance that they desire buy-side work, especially when it might be that they are more likely to be selected by some buyers for that lucrative role than by others."

10. *See infra* note 68 and accompanying text.

11. Viral V. Acharya & Timothy C. Johnson, *Insider Trading in Credit Derivatives*, 84 J. FIN. ECON. 110, 114 (2007) ("Insider trading has been the focus of a large body of research in equity markets which has found that insider trading lowers liquidity and increases trading costs, raises the cost of equity capital, and increases volatility." (internal citations omitted)); Merritt B. Fox, *Insider*

When and why is it necessary to regulate investment banks' conflicts of interest? These issues turn specifically on how we characterize investment banks acting as M&A advisors—as fiduciaries, obliged to act loyally toward their clients; as gatekeepers, expected to act independently and perform a guardian-like function for investors; or simply as arm's-length counterparties with no other-regarding duties.[12] Though this fundamental question has attracted little scholarly attention, scholars have generally regarded M&A advisors as arm's-length counterparties, putting faith in the power of contract law and market constraints to discipline errant bank behavior.[13] Delaware courts, the leading forum for resolving M&A disputes, have recently weighed in, with the Delaware Supreme Court sending mixed messages by describing the M&A advisor–client relationship as "primarily contractual in nature" and

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Trading in a Globalizing Market: Who Should Regulate What?, LAW & CONTEMP. PROBS., Autumn 1992, 263, 277, 282–83 (arguing that insider trading reduces share price accuracy).

12. This Article also considers the possibility of characterizing M&A advisors as both fiduciaries and gatekeepers. *See infra* subpart I(D). As to distinctions between these characterizations, see Andrew F. Tuch, *Conflicted Gatekeepers: The Volcker Rule and Goldman Sachs*, 7 VA. L. & BUS. REV. 365, 378–83, 385–87 (2012).

13. *See* William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEXAS L. REV. 1, 7–8, 32 (2014) (characterizing the bank-client relationship as "nominally fiduciary territory," but arguing that investment banks "contract[] out from fiduciary responsibility" and "emerge in practice as arm's-length counterparties constrained less by rules of law than by a market for reputation"). For a critique, see Andrew F. Tuch, *Disclaiming Loyalty: M&A Advisors and Their Engagement Letters*, 93 TEXAS L. REV. SEE ALSO 211, 216–24 (2015) [hereinafter Tuch, *Disclaiming Loyalty*]. *See also* Alan D. Morrison & William J. Wilhelm Jr., *Trust, Reputation, and Law: The Evolution of Commitment in Investment Banking*, 7 J. LEGAL ANALYSIS 363, 407–12 (2015) (arguing that when clients engage M&A advisors affiliated with financial conglomerates, rather than independent M&A advisors, regulation should respect that decision by allowing clients and their advisors "to structure their interaction around contract"); Jonathan Tiegerman, *Kinder Morgan: When Management Conceals a Buyout from the Board of Directors*, 6 J. INT'L BUS. & L. 95, 104 (2007) ("Investment banks [as M&A advisors] risk only their reputations in rendering quality services to their clients; banks are not bound by a legal duty short of a general obligation not to defraud their clients."). Anglo-Commonwealth scholarship has examined specifically whether M&A advisors are fiduciaries, but not whether they are gatekeepers. *See generally* Andrew Tuch, *Investment Banks as Fiduciaries: Implications for Conflicts of Interest*, 29 MELB. U. L. REV. 478 (2005) [hereinafter Tuch, *Investment Banks as Fiduciaries*]. A vein of scholarship opposes the imposition of fiduciary duties on investment banks generally, without examining the M&A context specifically. *See, e.g.*, *Hearing on Wall Street and Fiduciary Duties: Can Jail Time Serve as an Adequate Deterrent for Willful Violations? Before the Subcomm. on Crime and Drugs of the S. Comm. on the Judiciary*, 111th Cong. 1, 4 (2010) (statement of Larry E. Ribstein, Associate Dean, University of Illinois College of Law), http://www.judiciary.senate.gov/imo/media/doc/10-05-04RibsteinsTestimony.pdf [http://perma.cc/2ZFM-KF7M] (arguing that fiduciary duties "are the wrong tool for dealing with any problems that might exist in the investment banking industry" and contrasting fiduciary relationships with "the arm's length relationships between sophisticated parties that are common in investment banking"). As to the industry view, see, for example, Brief of the Securities Industry and Financial Markets Association as Amicus Curiae in Support of Appellant and in Support of Reversal at 3, RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015) (No. 140, 2015), http://www.sifma.org/issues/item.aspx?id=8589954847 [http://perma.cc/Z9RV-DXJV], which referred to the relationship between an M&A advisor and its client as "traditionally defined by contract" and argued against imposing noncontractual duties on M&A advisors.

yet formulating a loyalty-like obligation for those advisors.[14] Given this uncertainty, the ubiquity of bank conflicts,[15] and the potentially far-reaching consequences of requiring loyalty,[16] how we characterize M&A advisors is essential in determining the scope of advisors' responsibilities and those of the corporate directors who engage them.

This Article makes three primary contributions. First, it argues that M&A advisors are properly characterized as fiduciaries of their clients and counters alternative conceptions of their role. Second, it develops an analytical framework for assessing what liability rules will effectively deter M&A advisor disloyalty, a framework it applies to assess potential liability rules. Finally, this Article applies insights from this framework to analyze existing law, showing why recent controversial judicial decisions are not only largely justified but fail to go far enough, and then proposes specific reforms to fill the regulatory gap.

More specifically, Part I argues that M&A advisors are properly characterized as fiduciaries of their clients, and thus justifies requiring advisors to act loyally in the absence of informed client consent.[17] The argument relies on clients' reasonable expectations and on the difficulty, expense, and uncertainty of regulating the relationship by contract. It emphasizes the partisan role M&A advisors perform for their clients and the often adversarial setting in which deals occur—one in which each principal has its "own" advisors, where even amicable relations among principals can quickly deteriorate, and in which bargaining occurs against the backdrop of a potentially "hostile" deal. The account also emphasizes the superior expertise and experience of M&A advisors relative to their clients, as well as bankers' representations of themselves as "trusted advisors"—both of which are consistent with the end-game quality of these deals, the sensitive nonpublic client information advisors possess, and the magnitude of compensation they command. In contending that M&A advisors are best conceived as fiduciaries of their clients, this Article counters arguments that portray clients as sophisticated actors able to protect their own interests by pointing to, among other factors, clients' likely inability to accurately perceive the risk of an individual M&A advisor's disloyalty and M&A advisors' superior expertise and experience.[18]

14. *RBC Capital Mkts.*, 129 A.3d at 865 n.191; *see infra* notes 339–43 and accompanying text. Other recent decisions include *In re Rural/Metro Corp. Stockholders Litigation* (*Rural II*), 102 A.3d 205 (Del. Ch. 2014); *In re Rural Metro Corp. Stockholders Litigation* (*Rural I*), 88 A.3d 54 (Del. Ch. 2014); *In re El Paso Corp. Shareholder Litigation*, 41 A.3d 432 (Del. Ch. 2012); and *In re Del Monte Foods Co. Shareholders Litigation*, 25 A.3d 813 (Del. Ch. 2011). Courts in jurisdictions other than Delaware have partially addressed the question, finding that M&A advisors may be fiduciaries of their clients. *See infra* note 216.

15. *See infra* note 63 and accompanying text.

16. *See* discussion *infra* section I(E)(4).

17. *See infra* subparts I(A)–(D).

18. *See infra* section I(E)(1).

In Part II, this Article assesses liability rules to effectively deter disloyalty by M&A advisors toward their clients. Drawing on optimal deterrence theory, it develops an analytical framework to evaluate which liability rules might most effectively deter disloyalty. Part II extends the analysis in Part I by disaggregating the M&A client into its core constituencies: the board of directors and body of shareholders. The framework assesses the potential liability of M&A advisors and corporate directors of M&A clients by analogizing the relationship between an M&A advisor and the board of directors that engages it to the relationship between a tortfeasor and its employer and, further, by analogizing M&A advisor disloyalty to tortious conduct.

This analytical framework reveals how rules holding only M&A advisors liable for their disloyalty are, under existing doctrinal constraints, unlikely to be effective. This result follows from the risk that directors of M&A clients, or those under the directors' authority, will defeat fiduciary or other protections by waiving them or simply failing to enforce them, perhaps because their interests diverge from those of shareholders or because they want to avoid undermining a deal that, while compromised by an advisor's disloyalty, may still be better than no deal.[19] The result also follows from the reluctance of buyers to pursue past wrongs to target companies, particularly if they benefited from those wrongs. The framework shows why additional deterrence measures may be desirable, including imposing fault-based liability on directors for their oversight of M&A advisors as well as external regulatory oversight of hard-to-detect conflicts. It also suggests that directors who defeat fiduciary protections, such as by agreeing to contractually limit M&A advisors' liability for advisor disloyalty, consenting to disloyalty, or simply failing to hold disloyal M&A advisors to account, may act inconsistently with their duties. The framework offers insights on the merits of permitting shareholder suits against M&A advisors for aiding and abetting directors' breaches of duty.[20]

In Part III, this Article evaluates existing law, focusing on recent Delaware decisions, including *Del Monte*,[21] *El Paso*,[22] and *RBC Capital Markets.*[23] These decisions conform in important respects with the analysis in Part II, most notably by conceiving of M&A advisors as fiduciaries (or at least as required to act loyally toward their clients) and by imposing fault-based liability on directors, requiring them to act reasonably in overseeing M&A advisors' conflicts. The Delaware approach, however, is unlikely to

19. *See infra* subpart II(B).

20. *See infra* notes 267–68, 365–67 and accompanying text.

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

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

23. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015). See also the Court of Chancery decisions *Rural II*, 103 A.3d 205 (Del. Ch. 2014), and *Rural I*, 88 A.3d 54 (Del. Ch. 2014).

effectively deter M&A advisor disloyalty: M&A advisors face little risk of *primary* liability for disloyalty; corporate directors face little threat of personal liability for failing to reasonably oversee advisors' disloyalty; and in neither case does the magnitude of threatened liability compensate for the low probability of sanction.

M&A advisors do face potential aiding and abetting liability, but this doctrine is poorly suited to deter M&A advisors' conflicts.[24] That liability arises not for M&A advisor disloyalty, but for the conceptually distinct conduct of knowingly participating in directors' failure to oversee M&A advisors' conduct reasonably. A disloyal M&A advisor may harm its client but escape aiding and abetting liability either because it did not "knowingly participate" in directors' oversight lapses or because directors nevertheless exercised reasonable oversight of their M&A advisors (and thus avoided fiduciary breaches). Further deterrence of M&A advisors' conflicts is desirable.

The analysis also reveals particular gaps in deterrence. The regime largely overlooks buy-side advisor conflicts as well as sell-side conflicts when directors' *Revlon*[25] duties do not apply.[26] The regime also deals poorly with certain hard-to-detect conflicts, such as those created by investment banks' securities-trading operations.

This Article proposes three reforms to buttress deterrence. First, it proposes subjecting directors' decisions to defeat fiduciary protections to greater judicial scrutiny. Second, it suggests requiring increased oversight of hard-to-detect conflicts by the regulators currently tasked with disciplining M&A advisors, namely the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA).[27] Finally, and more controversially, it preliminarily suggests subjecting M&A advisors to *primary* liability through *direct* causes of actions by shareholders for disloyalty.

In Part IV, this Article examines broader implications of the foregoing analysis, focusing on the potential desirability of creating canons of professional responsibility for investment bankers and on the overlapping roles fiduciary doctrine and contract law may play in helping directors satisfy their duties to oversee M&A advisors.

I. The M&A Advisor as Fiduciary

This Part characterizes the M&A advisor as a fiduciary of its client, rather than as either a gatekeeper or an arm's-length counterparty.[28] It thus justifies requiring the M&A advisor to loyally serve its client's interests in

24. *See infra* notes 358–59 and accompanying text.
25. Revlon, Inc. v. MacAndrews & Forbes Holdings Inc., 506 A.2d 173 (Del. 1986).
26. *See infra* subpart III(B).
27. As to the authority of these regulators, see *infra* notes 59–60 and accompanying text.
28. *See supra* note 12.

the absence of informed client consent to waive such loyalty. M&A transactions vary according to their size, structure, complexity, and other features. Nevertheless, the deal process broadly hews to a common mold, as described below, permitting a general assessment of the M&A advisor's role. This Part first considers the M&A process and then introduces theoretical dimensions of analysis.

A. *Transactional Context*

M&A transactions are transformational events, often spelling the end of a corporation's life or its renewal in expanded form.[29] According to economic theory, M&A deals promise economies of scale and other synergies that benefit investors and the general welfare.[30] According to corporate theory, the potential for M&A transactions disciplines underperforming directors and officers by threatening them with removal.[31] Because cost savings are commonly stated motivations for these transactions,[32] job losses often follow their implementation. Storied brands may be discarded, product lines ended, factories disposed of, and firm cultures eroded. Given the stakes, directors and senior managers give these transactions their personal attention.[33]

M&A transactions pit one corporation against another, or against several others, producing in principals and their advisors an attitude of partisanship. When a principal's incumbent directors and officers oppose a transaction proposed by another, they often adopt an explicitly adversarial posture, using a slew of financial and legal strategies to discourage or actively

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29. Conceptually, M&A transactions involve the combination or separation of businesses.

30. *See, e.g.*, RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 809 (11th ed. 2014) (discussing the possible sources of merger synergies).

31. *See, e.g.*, Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 313–14 (1983) (discussing the takeover market's role as "an external court of last resort" protecting the interests of an open corporation's residual claimants).

32. *See, e.g.*, Press Release, Heinz, H.J. Heinz Company and Kraft Foods Group Sign Definitive Merger Agreement to Form the Kraft Heinz Company (Mar. 25, 2015), http://news.heinz.com/press-release/finance/hj-heinz-company-and-kraft-foods-group-sign-definitive-merger-agreement-form-k [http://perma.cc/4ZU4-435F] (referring to an estimated $1.5 billion in annual cost savings resulting from the deal).

33. DAVID P. STOWELL, INVESTMENT BANKS, HEDGE FUNDS, AND PRIVATE EQUITY 15 (2d ed., 2013) ("M&A bankers . . . usually work directly with a company's CEO, CFO, and corporate development team.").

obstruct a sale.[34] In these "hostile" deals, firms often publicly criticize the other side,[35] with the drama playing out under intense public scrutiny.[36] Litigation is commonplace.[37]

Even "friendly" transactions—those supported by the boards of both principals—have strong adversarial elements. These deals may be accompanied by the implicit (and occasionally explicit) threat of a hostile acquisition. In all deals, however apparently harmonious, principals must bargain over terms, including the amount and form of consideration, deal protections, preclosing commitments, and closing conditions. They bargain knowing that a deal will threaten the interests of various corporate constituencies—particularly directors and officers[38]—and that even a deal billed as a "merger of equals" may involve a winner and a loser. They bargain knowing that amicable relations may quickly deteriorate.[39] They bargain knowing that an interloper may spoil the deal by seeking to acquire one or the other[40] and that their deal terms will be publicly disclosed and scrutinized. They may bargain

34. *See* Steven Davidoff Solomon, *A New Kind of Defense Against Hostile Bids*, N.Y. TIMES: DEALBOOK (Sept. 29, 2010, 10:50 PM), http://dealbook.nytimes.com/2010/09/29/a-new-kind-of-defense-against-hostile-bids [https://perma.cc/T552-6VUV] (discussing contemporary trends in defense strategies against hostile bids).

35. *See, e.g.*, David Gelles, *Valeant Switches to Sugar, But Allergan Still Not Biting*, N.Y. TIMES: DEALBOOK (Sept. 24, 2014, 12:06 PM), http://dealbook.nytimes.com/2014/09/24/valeant-switches-to-sugar-but-allergan-still-not-biting [https://perma.cc/QUJ5-D4WY] (referring to "mudslinging" by deal principals); Steven Davidoff Solomon, *The Consequences of Saying No to a Hostile Takeover Bid*, N.Y. TIMES: DEALBOOK (Oct. 28, 2014, 4:10 PM), http://dealbook.nytimes.com/2014/10/28/the-consequences-of-saying-no-to-a-hostile-takeover-bid [https://perma.cc/YQ2D-UZDC] (referring to "the highly charged war of words and ensuing legal battles" in one hostile takeover bid).

36. *See* Solomon, *supra* note 35 (citing contemporary coverage of a contentious deal).

37. *See* BRUCE WASSERSTEIN, BIG DEAL: 2000 AND BEYOND 546 (2000) ("In the most actively contested deals, it is not uncommon for a single takeover contest to generate several lawsuits in various locations."); Matthew D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2014, at 2 (Feb. 20, 2015), http://ssrn.com/abstract=2567902 [http://perma.cc/JWV7-424R] (unpublished manuscript) (suggesting that virtually all M&A transactions provoke one or more lawsuits).

38. *See* IVO WELCH, CORPORATE FINANCE: AN INTRODUCTION 879 (2009) ("[Target managers] often lose not just their independence but also their jobs."); Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1945 (2003) ("Although the drama and hyperbole of a bust up acquisition is typically not present in the context of a 'friendly' merger . . . last period features are still present at the level of the board of directors and senior management, many of whom are likely to be in the last period of their employment.").

39. *See* WASSERSTEIN, *supra* note 37, at 652–53 (referring to "suspicion and delays" that can arise with the advisors on the "other side at the bargaining table").

40. *See, e.g.*, Dana Mattioli, *M&A Boom Gets a Twist: Predators Become Prey*, WALL STREET J. (Oct. 7, 2014, 5:41 PM), http://www.wsj.com/articles/m-a-boom-gets-a-twist-predators-become-prey-1412695520 [https://perma.cc/8FNX-LHFG] ("Several companies that signed agreements this year to buy other outfits have ended up as the prey—targeted by even bigger fish seeking to gobble them up before their own purchases close.").

under pressure from key stakeholders—such as activist investors—pressing for change.[41] Almost inevitably, therefore, principals will adopt an adversarial posture toward other principals.

Given this relational dynamic among deal principals, it has become an article of faith in M&A deal practice that each principal will have its "own" advisors and thus that separate and distinct deal teams, or working groups, will form.[42] Investment banks and lawyers are the most prominent such advisors, with investment banks—described here as M&A advisors—at the "forefront" of deal teams.[43] Principals retain advisors because they themselves generally lack the expertise and experience to conceive, structure, and execute these deals,[44] which are "among the most complex of business transactions."[45] Even principals with their own internal M&A or business development teams will typically retain M&A advisors.[46] Deal advisors have developed a sophisticated body of learning that they bring to bear in transactions.[47]

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41. *See, e.g.*, David Benoit et al., *Hewlett-Packard Split Comes as More Investors Say Big Isn't Better*, WALL STREET J. (Oct. 6, 2014, 8:51 PM), http://www.wsj.com/articles/hewlett-packard-split-comes-as-more-investors-say-big-isnt-better-1412643100 [https://perma.cc/EF9D-AMS7] (discussing the role of hedge funds in M&A).

42. For a description of deal teams, see WASSERSTEIN, *supra* note 37, at 545–82. Virtually never in the same transaction will a single M&A advisor represent both sides. So rare is such dual representation that, when it does occur, it subjects M&A advisors to controversy and often litigation. *See, e.g.*, Higgins v. N.Y. Stock Exch., Inc., 806 N.Y.S.2d 339, 365–66 (N.Y. Sup. Ct. 2005) (shareholder suit challenging Goldman's conflicted advisory role); *If You Can't Beat 'Em, Join 'Em*, ECONOMIST (Apr. 25, 2005), http://www.economist.com/node/3899114 [https://perma.cc/5JB5-H6ZC] ("Some of the exchange's biggest brokers . . . are angry that Goldman Sachs was allowed to act as advisor to both companies . . . . This, the critics assert, constitutes a gross conflict of interest.").

43. *See* JOSHUA ROSENBAUM & JOSHUA PEARL, INVESTMENT BANKING: VALUATION, LEVERAGED BUYOUTS, AND MERGERS & ACQUISITIONS 355 (2013) ("[The investment bank] is at the forefront of the negotiations and decision-making process."); WASSERSTEIN, *supra* note 37, at 546 ("Lawyers and investment bankers are the highest-profile outside merger advisers, but many other professionals play important roles.").

44. For further discussion, see *infra* subpart I(E). Some may argue that M&A principals engage M&A advisors to defend against claims of the sort leveled in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). But the companies involved in virtually all major M&A transactions globally turn to M&A advisors for advice, suggesting the advisors perform valuable services in addition to providing legal protection to directors.

45. WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 453 (4th ed. 2012).

46. ROSENBAUM & PEARL, *supra* note 43, at 355 n.1 ("Larger corporations may have internal M&A or business development teams . . . . For most public company M&A transactions, however, investment banks are hired to advise on both the buy-side and sell-side.").

47. The following sources suggest the depth of learning by lawyers and bankers: MEREDITH M. BROWN ET AL., TAKEOVERS: A STRATEGIC GUIDE TO MERGERS AND ACQUISITIONS (3d ed. Supp. 2016) (updated periodically); MARTIN D. GINSBURG ET AL., MERGERS, ACQUISITIONS, AND BUYOUTS (Supp. Sept. 2015) (same); ROSENBAUM & PEARL, *supra* note 43; SAMUEL C. THOMPSON, MERGERS, ACQUISITIONS & TENDER OFFERS: LAW AND STRATEGIES (Supp. 2015) (updated periodically); WASSERSTEIN, *supra* note 37.

As partisan advisors, M&A advisors are typically identified with either the "sell-side" or the "buy-side."[48] In fact, when a deal is announced, advisors are usually publicly acknowledged as advising a single principal.[49] They virtually never act as mere intermediaries linking potential M&A principals (their clients).[50] Nor do they stand aloof in transactions, dispensing advice as sage counsel to the multiple principals involved.[51] To be sure, investment banks may be valued as advisors for their relations or contacts with potential deal counterparties, which they may use to facilitate negotiations.[52] But they are nevertheless aligned with a single principal—explicitly so once they have been formally engaged to advise.

In some transactions, additional deal teams may be used. This occurs most often where directors and senior officers of the principal have financial interests potentially aligned with the "other side" of a proposed transaction, as in a management-buyout or a controlling-shareholder deal.[53] This practice reflects the importance of separate advice and representation for the various financial interests involved in an M&A transaction.[54]

B. *Organizational Structure and Risk of Conflict*

Consider next the organizational structure of M&A advisors. Many are structured as financial conglomerates—diversified financial institutions that comprise a network of subsidiaries operating under the control of a holding company.[55] These firms engage in wide-ranging financial activities, act in

48. *See, e.g.*, FIN. INDUS. REGULATORY AUTH., INVESTMENT BANKING REPRESENTATIVE QUALIFICATION EXAMINATION (TEST SERIES 79): CONTENT OUTLINE 17–20 (2015), http://www.finra.org/sites/default/files/Series_79_Outline.pdf [http://perma.cc/S6NL-68RK]; ROSENBAUM & PEARL, *supra* note 43, at 7.

49. Deal advisors are typically disclosed and identified with the deal principal they are advising (their client) in a press release announcing a transaction. *See, e.g.*, Press Release, Time Warner Cable, Charter Communications to Merge with Time Warner Cable and Acquire Bright House Networks (May 26, 2015), http://ir.timewarnercable.com/investor-relations/investor-news/financial-release-details/2015/Charter-Communications-to-Merge-with-Time-Warner-Cable-and-Acquire-Bright-House-Networks/default.aspx [http://perma.cc/S5GG-5UDL].

50. *See* sources cited *supra* note 42.

51. *See* sources cited *supra* note 42.

52. ROSENBAUM & PEARL, *supra* note 43, at 321 ("Sell-side advisors are selected in large part on the basis of their sector knowledge, including their relationships with, and insights on, prospective buyers.").

53. *See, e.g.*, Kahn v. M & F Worldwide Corp., 88 A.3d 635, 640–49 (Del. 2014) (illustrating the importance of a special committee appointing its own M&A advisor in a controlling-shareholder transaction).

54. Though much of the analysis in this Article would apply to M&A advisors appointed to advise special committees in controlling-shareholder, management-buyout, and related transactions, the analysis is focused on transactions in which a principal's interests are represented by a single deal team.

55. For a general description of financial conglomerates, see Andrew F. Tuch, *Financial Conglomerates and Information Barriers*, 39 J. CORP. L. 563, 570–72 (2014).

multiple legal capacities, and serve numerous clients. From a functional perspective, they lend and borrow money, advise clients, and invest funds for themselves and for clients.

Other M&A advisors eschew the conglomerate model. Often referred to as "independent" advisory firms, they advise exclusively or primarily on M&A transactions, conducting little or no commercial banking, securities trading, or asset management activities.[56] These firms often act on many of the largest deals,[57] but are relatively few in number and enjoy a modest share of the M&A advisory business, despite having enjoyed robust growth in the past decade or so.[58]

Whether structured as financial conglomerates or independent advisory firms, investment banks acting as M&A advisors perform a broker–dealer function.[59] They must therefore register with the SEC as broker–dealers, and both they and their employed investment bankers register with FINRA, the self-regulatory body for broker–dealers.[60] In industry parlance, M&A advisors are also often referred to as financial advisors.

The conglomerate structure employed by many M&A advisors magnifies the risk of conflicts.[61] It increases the risk that the firm's own interests, or a duty it owes another person, will materially and adversely affect the representation of its client and produce a conflict of interest with that client.[62]

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56. *See* Houlihan Lokey, Inc., Registration Statement Under the Securities Act of 1933 (Form S-1) ii (July 10, 2015), http://www.sec.gov/Archives/edgar/data/1302215/000104746915006062/a2225330zs-1.htm [http://perma.cc/D92U-RQJ4] ("[W]e use the term 'independent investment banks' or 'independent advisors' when referring to ourselves and other investment banks or financial advisors that are primarily focused on advisory services and that conduct no or limited commercial banking, lending, or securities sales and trading activities . . . .").

57. *See* Sujeet Indap et al., *Investment Banking: Walking Away from Wall Street*, FIN. TIMES (Sept. 8, 2015, 7:02 PM), http://www.ft.com/intl/cms/s/0/d99d271c-5545-11e5-8642-453585f2cfcd.html#axzz3x99PWvD4 [https://perma.cc/8XJ5-E6LW].

58. Houlihan Lokey, Inc., Registration Statement Under the Securities Act of 1933 (Form S-1) 7 (July 10, 2015), http://www.sec.gov/Archives/edgar/data/1302215/000104746915006062/a2225330zs-1.htm [http://perma.cc/D92U-RQJ4] ("In the last decade, the demand for independent advice has increased dramatically, arising in part from the global financial crisis.").

59. Andrew F. Tuch, *The Self-Regulation of Investment Bankers*, 83 GEO. WASH. L. REV. 101, 118–19 (2014). There are exceptions, such as for firms advising on transactions involving privately held companies. *See* Carter Ledyard & Milburn, Crowell & Moring, and Martin A. Hewitt, SEC No-Action Letter, 2014 WL 356983 (Jan. 31, 2014).

60. Tuch, *supra* note 59, at 104, 118–19.

61. For a typology of conflicts of interest, see Bratton & Wachter, *supra* note 13, at 20–25, and Tuch, *Investment Banks as Fiduciaries*, *supra* note 13, at 487–88.

62. As to the meaning of conflict of interest, see *supra* note 1. For a more detailed discussion, see generally Christoph Kumpan & Patrick C. Leyens, *Conflicts of Interest of Financial Intermediaries: Towards a Global Common Core in Conflicts of Interest Regulation*, 5 EURO. COMPANY & FIN. L. REV. 72, 75–84 (2008).

In fact, conflicts of interest are so prevalent for conglomerates that some commentators regard them as an inherent or inescapable feature of their business model.[63]

While independent M&A advisors do not pose the same risks of conflict as the conglomerates (and many even claim to face no conflicts[64]), there is no reason why they may not also face conflicts of interest. Many of these firms have ventured beyond giving M&A advice, engaging in activities that can present conflicts with M&A clients (such as asset management).[65] Moreover, even firms that only dispense advice may face conflicts—in much the same way as law firms, whose advice-only business model they mimic.[66]

The economic objection to conflicts of interest is grounded in the harm they may cause. Conflicts can distort the advice banks give, leading them to "steer" a client to pay more or to sell for less than the client otherwise would; to choose one prospective deal over a more favorable deal; or to enter into a wealth-destroying deal that it otherwise would avoid.[67] The risk of conflicts may also increase bonding and monitoring costs for clients; some clients may, for instance, monitor their advisors more closely than otherwise by engaging multiple advisors as crosschecks or employing internal experts, thereby incurring potentially heavy, socially wasteful expenditures.[68] Dis-

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63. *See* S. REP. NO. 111-176, at 91 (2010) (providing Paul Volcker's description of conflicts of interest as "inherent" in the participation of financial conglomerates in various financial activities); JOSEPH E. STIGLITZ, THE ROARING NINETIES: A NEW HISTORY OF THE WORLD'S MOST PROSPEROUS DECADE 158 (2003) ("The problems [of conflicts of interest] are endemic to the banking industry, and have long been recognized."); R. M. Goode, *Introduction*, *in* CONFLICTS OF INTEREST IN THE CHANGING FINANCIAL WORLD, at xv, xv (R. M. Goode ed., 1986) (discussing the "inescapable" existence of conflicts of interest in financial conglomerates).

64. Two prominent such firms are Greenhill and Evercore. *See Overview*, GREENHILL, http://www.greenhill.com/firm [http://perma.cc/9CWM-APTA] ("No Investing, Trading, Lending or Underwriting[;] No Products to Sell / No Conflicts"); *World-Class Investment Banking Advisory Services*, EVERCORE, http://www.evercore.com/Investment-Banking [http://perma.cc/5JSN-NU5V] ("We are independent, unencumbered by the potential conflicts of interest inherent in bulge bracket firms and universal banks. We are never in a position where our client's best interests are in conflict with our own.").

65. In the wake of the financial crisis, commentators observe that some independent advisory firms were "ramping up their asset management . . . practices" to grow their businesses. *Boutique Players Struggle to Steal Market Share*, FIN. TIMES (Dec. 20, 2010, 11:15 PM), http://www.ft.com/cms/s/0/f9f95962-0c58-11e0-8408-00144feabdc0.html#axzz3x9ne0c5w [https://perma.cc/97FA-WFBU]. For example, Evercore engages in asset management activities in addition to giving M&A advice. *World-Class Investment Banking Advisory Services*, *supra* note 64.

66. *See, e.g.*, Kurt Orzeck, *Judge Recommends Blocking Kirkland from Repping Teva*, LAW360 (June 9, 2015, 10:44 PM), http://www.law360.com/articles/665964/judge-recommends-blocking-kirkland-from-repping-teva [http://perma.cc/2E64-N5AD] (reporting on a judge's recommendation to bar a law firm from representing a client on its proposed acquisition of a target company based on the law firm's prior representation of the target).

67. For a discussion of the costs of disloyalty and other misconduct by investment banks and investment bankers, see Tuch, *supra* note 59, at 123–33.

68. These expenditures are analogous to the social costs victims incur in preventing crimes and torts—costs included in the net harm caused. *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 474 (6th ed. 2012) (including resources spent on preventing harm in the total social

torted advice may also produce unnecessary transaction costs for clients, including not only fees paid to M&A advisors but also those paid to lawyers and accountants.[69]

Investment banks may also harm a client by misusing nonpublic information.[70] For example, the premature public disclosure of a deal may invite unwelcome bids, damage the client's negotiating position, and harm a client's relations with its employees, suppliers, or other stakeholders.[71] Disclosure to a competing company may harm the client's operational success.

Of course, not all conflicts harm clients. As noted, this Article defines a conflict of interest as circumstances where there is a substantial risk that an M&A advisor's own interests, or a duty it owes another person, will materially and adversely affect its representation of an M&A client.[72] Not all potentially adverse events, however substantial the risks, will materialize. Advisors may act loyally despite their conflicting incentives. Moreover, even if a conflict leads to distorted advice, a client may nevertheless receive net benefits. For example, an M&A advisor to a target may offer staple financing to prospective bidders, giving the advisor incentives to favor certain bidders, but nevertheless creating a strong pool of bidder interest that would not otherwise exist and that might provide net benefits to its client.[73] What is relevant for the analysis below is the net social harm that conflicts produce.[74]

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harm caused by crime); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 205 (7th ed. 2007) (including the costs of protection in the total social harm caused by theft and by its tort counterpart, conversion).

69. Some evidence also suggests that insider trading (which may be a form of M&A advisor disloyalty) may lower liquidity and increase trading costs. *See supra* note 11 and accompanying text.

70. *See supra* note 11 and accompanying text.

71. Deal design often reflects a desire to avoid these potential harms. *See, e.g.*, Maureen Farrell, *Morgan Stanley Gets a WhatsApp Bounce, but J.P. Morgan Still No. 1*, WALL STREET J.: MONEYBEAT (Feb. 20, 2014, 3:19 PM), http://blogs.wsj.com/moneybeat/2014/02/20/morgan-stanleys-gets-a-whatsapp-bounce-but-j-p-morgan-still-number-one/ [http://perma.cc/MR5M-XCZY] ("The bankers and lawyers on the deal raced to put the deal [Actavis PLC's acquisition of Forest Laboratories] together in less than a month to avoid any leaks or rival bidders popping up.").

72. As to the meaning of a conflict of interest, see *supra* note 1.

73. *See In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1006 n.46 (Del. Ch. 2005) (suggesting that these circumstances might be "wholly consistent with the best interests" of the M&A advisor's client).

74. A further issue is whether any harm suffered by one M&A client is likely to be captured by or redistributed to another client, in which case the net social harm would be reduced by the amount of the transfer or redistribution. *See* POSNER, *supra* note 68, at 185–86 (distinguishing between net social harm and redistributions of wealth). Although some losses from distorted advice may be redistributed to deal counterparties, the monitoring and transaction costs in particular are unlikely to be redistributed. Another complexity concerns whether the M&A advisor's benefit from conflicted representation should be treated as a social gain and thus partially offset the client's harm. There is no consensus among economists on that general question. *Cf.* COOTER & ULEN, *supra* note 68, at 444 (discussing the "complexity [concerning] the criminal's perceived benefit from crime"). Precise estimates of net social harm of conflicts are not realistically calculable.

In this Article, a conflict that produces harm is regarded as a "real conflict" or simply as disloyalty. By contrast, an "apparent conflict" produces no harm, despite the substantial risk of it doing so. Of course, a conflict can be regarded as real or potential only if its effect is known; conflicts whose effect is unknown fall into neither category.

C. Client Relations

Typically, M&A advisors are actively involved in the M&A deal process from the beginning. They may conceive the deal, either when they are invited by managers to analyze the various "strategic alternatives"—such as a sale, a recapitalization, or an initial public offering—available to a corporation,[75] or when they initiate contact with managers to pitch ideas for potential transactions.[76] Some M&A advisors receive an ongoing retainer, but most are engaged on a transaction-specific basis.[77] Because of the speed with which deals unfold, commentators recommend that companies have ongoing relationships with M&A advisors familiar with the company and its prospects.[78] When an M&A advisor is engaged, an engagement letter will document the relationship, broadly describing the transaction, the nature of services contemplated, the remuneration structure, and other terms.[79]

Once engaged, M&A advisors evaluate, explore, select, and implement strategic alternatives.[80] In doing so, they generally perform twin roles: advising their clients and acting on their behalf during the deal process.[81] Consider the advisory role first. Bankers advise on the merits of entering into a proposed transaction; on financial and strategic alternatives to it; on the timing, structuring, and pricing of a transaction; on the structuring of a

75. *See* ROSENBAUM & PEARL, *supra* note 43, at 315.

76. *See In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 819 (Del. Ch. 2011) ("To facilitate transactional activity, investment bankers routinely pitch deals to parties they hope might be interested."); WELCH, *supra* note 38, at 856 ("Sometimes, the client initiates the contact when she wants to buy or sell a target business. At other times, an investment banker has an idea that he brings to the client.").

77. *See* Charles W. Calomiris & Donna M. Hitscherich, *Banker Fees and Acquisition Premia for Targets in Cash Tender Offers: Challenges to the Popular Wisdom on Banker Conflicts*, 4 J. EMPIRICAL LEGAL STUD. 909, 911–12 (2007) (discussing the engagement of M&A advisors on a transaction-specific basis).

78. MEREDITH M. BROWN ET AL., TAKEOVERS: A STRATEGIC GUIDE TO MERGERS AND ACQUISITIONS 295 (2001).

79. For a detailed discussion, see NORTON ROSE FULBRIGHT, M&A IN 2013: INVESTMENT BANKING ENGAGEMENT LETTERS (2013), http://www.nortonrosefulbright.com/files/20131017-ma-in-2013-investment-banking-engagement-letters-106426.pdf [http://perma.cc/TBQ7-AGH6]; Bratton & Wachter, *supra* note 13, at 36–43.

80. *Rural I*, 88 A.3d 54, 90 (Del. Ch. 2014).

81. This distinction between M&A advisors' advisory and representative (or agency-like) functions is drawn in Bratton & Wachter, *supra* note 13, at 31–32.

sales process; and on financing for a transaction.[82] They also advise on myriad tactical issues relating to the value and forms of consideration, the desirability of putting deals to shareholder votes, the disclosure of information to other deal participants, the types of bidding practices, and the management of relations with shareholders and other constituencies.[83] In giving advice, they deploy human capital, rather than financial capital.[84] They draw upon knowledge of financial instruments, valuation methods, corporate structures, industry trends, accounting practices, and regulatory environments—all matters on which FINRA may test them before qualifying them for practice.[85] Their advice reflects judgment and financial acumen acquired over time,[86] and it is typically given to senior managers and directors.[87]

Consider next the activities M&A advisors perform on behalf of their clients, beginning with sell-side advisors. According to FINRA, these activities include coordinating with the client's legal, tax, and other advisors; marketing the transaction; managing the bidding process by receiving indications of interest from potential buyers and communicating with those bidders; and executing the transaction.[88] Sell-side advisors perform these activities to "maintain a competitive atmosphere and keep the process moving."[89] In addition, as final bids are made, sell-side advisors will

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82. *See* WASSERSTEIN, *supra* note 37, at 561–62 (describing the services provided by investment bankers); WELCH, *supra* note 38, at 856–57 (describing "M&A advice" as typically including "offer[ing] valuation services for potential targets," "help[ing] to position [a target] so that it can be sold," "help[ing] to find potential acquirers or targets," "ha[ving] expertise in negotiation," "help[ing] [to] conduct due diligence," and performing other services, including helping with tax structures, arranging financing, and navigating legal issues); Tuch, *Investment Banks as Fiduciaries*, *supra* note 13, at 489 (describing the various services provided by M&A advisors).

83. Tuch, *Investment Banks as Fiduciaries*, *supra* note 13, at 489.

84. ALAN D. MORRISON & WILLIAM J. WILHELM, JR., INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW 292 (2007) ("[T]acit and general human capital . . . sit at the heart of the [M&A] business . . . ."); *see also* WELCH, *supra* note 38, at 862 ("[T]he limiting resource [in investment banking] is not financial capital (though having more capital definitely helps) but expertise and human talent.").

85. *See* FIN. INDUS. REGULATORY AUTH., *supra* note 48, at 17–20 (listing competencies that entry-level investment bankers should be accountable for knowing).

86. The term judgment is often used to describe the work of the investment banker. *See, e.g.*, Dana Cimilluca & Patrick O'Connor, *Eric Cantor to Join Wall Street Investment Bank*, WALL STREET J. (Sept. 2, 2014, 10:53 AM), http://www.wsj.com/articles/eric-cantor-to-join-wall-street-investment-bank-1409630638 [https://perma.cc/YTV2-3N5D] (citing as reasons for an investment banker's hire "his 'judgment and experience' and ability to open doors—and not just for help navigating regulatory and political waters in Washington").

87. Indeed, the ability to advise top corporate management is seen as a measure of an investment bank's connections and influence, which are greatly prized in the industry. CHARLES R. GEISST, INVESTMENT BANKING IN THE FINANCIAL SYSTEM 200 (1995).

88. *See* FIN. INDUS. REGULATORY AUTH., *supra* note 48, at 17–19; ROSENBAUM & PEARL, *supra* note 43, at 315–46, 355–417.

89. ROSENBAUM & PEARL, *supra* note 43, at 333.

negotiate the final terms with the remaining bidders before negotiating (together with their client's legal counsel) the final agreement with the winning bidder.[90] They will also "take the lead" in preparing confidential marketing material to provide to prospective bidders[91] as well as in preparing the materials for their clients to present to prospective bidders.[92] They may also monitor their clients' data rooms, handle bidder requests for further information, and coordinate bidders' access to their clients' managers and physical sites.[93]

Acting as buy-side advisors, M&A advisors communicate on their clients' behalf with the seller and act as a liaison with their clients' other advisors; undertake due diligence; and help arrange financing through potential lenders.[94] Buy-side advisors are "at the forefront of the negotiations and decision-making process" for their clients.[95] They will also liaise on behalf of their clients with shareholders and other constituencies, and coordinate and execute the transaction their clients authorize.[96]

In addition to performing these roles, investment banks provide fairness opinions, a role regarded (here) as a distinct investment banking activity, and one standing outside the M&A advisory role characterized in this Part. Fairness opinions are typically addressed to a company's board of directors and opine on whether the transaction in question is fair to the company's shareholders from a financial point of view.[97] Banks may perform either, or both, M&A advisory and fairness-opinion roles in a single deal. Though the preparation of fairness opinions may raise concerns about an advisor's lack of independence from its client and occasionally also its disloyalty, those concerns are beyond the focus of this Article.[98]

Almost inevitably, the relationship between a client's senior managers and its M&A advisor will be close. Over the course of several months, the advisor will be brought into the client's inner sanctum, becoming privy to managers' confidences in much the same way as the corporation's legal advisors. A sell-side advisor will undertake detailed due diligence of its client to

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90. *See id.* at 336–40.

91. *Id.* at 322.

92. *See id.* at 322–28.

93. *See id.* at 329.

94. *See* FIN. INDUS. REGULATORY AUTH., *supra* note 48, at 19–20.

95. ROSENBAUM & PEARL, *supra* note 43, at 355.

96. *See* WELCH, *supra* note 38, at 856–57.

97. For a discussion of fairness opinions, see generally Lucian Arye Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27; Steven M. Davidoff, *Fairness Opinions*, 55 AM. U. L. REV. 1557 (2006); and Charles M. Elson, *Fairness Opinions: Are They Fair or Should We Care?*, 53 OHIO ST. L.J. 951 (1992).

98. Though conflicts of interest may afflict banks providing fairness opinions, the concern in that context often goes to whether the bank's interests are too closely aligned with those of its client so as to compromise its independence, rather than whether the bank's loyalty is compromised.

gain a "comprehensive understanding" of the client and its prospects.[99] In so doing, the advisor will acquire substantial nonpublic information concerning immediate challenges and prospects, intended future direction, and, critically, forecasted financial results. This information will be necessary for the advisor to prepare confidential marketing materials for prospective bidders as well as to anticipate areas of potential buyer skepticism.[100] It will also allow the advisor to perform valuation analyses that will frame the seller's price expectations and guide negotiations with bidders.[101] The advisor's contact with managers will be frequent and at critical stages of the transaction the principal and its advisors will often occupy a single physical working space. This close and frequent contact is inherent in the M&A advisory function.

Clients typically confide in and trust their M&A advisors.[102] Clients disclose to them sensitive, nonpublic information, trusting that they will protect rather than exploit that information. Clients task M&A advisors with negotiating and otherwise acting on their behalf, trusting that advisors will not misuse this authority. Clients also defer to M&A advisors on important matters. Joshua Rosenbaum and Joshua Pearl explain that "[w]hile senior company management and the Board of Directors play a crucial role in the transaction, they typically defer to the banker as a hired expert on key deal issues, such as valuation, financing, deal structure, process, timing, and tactics."[103] This deference may be explained both by clients' lack of expertise relative to M&A advisors and by clients' inability to actively oversee every aspect of advisors' activities.[104]

M&A advisors often tout their loyalty toward their clients. For example, Goldman Sachs' widely publicized business principles state that "our clients' interests always come first" and "[t]o breach a confidence or to use confidential information improperly or carelessly would be unthinkable."[105] The firm has claimed to have an "extraordinary focus on [its]

99. *See* ROSENBAUM & PEARL, *supra* note 43, at 321.

100. *Id.*

101. *Id.* at 315 ("These valuation analyses are used to frame the seller's price expectations . . . and ultimately guide negotiations of the final purchase price.").

102. *See* Steven M. Davidoff et al., *The* SEC v. Goldman Sachs*: Reputation, Trust, and Fiduciary Duties in Investment Banking*, 37 J. CORP. L. 529, 533 (2012) ("[T]rust and reputation are still central to advisory businesses, which remain unsusceptible to codification and formal contracting or rule-making."); *id.* at 546 ("[T]rust-based trade remains important in traditional banking businesses where information is hard to come by and service quality is difficult to record."). *But see* ROBERT G. ECCLES & DWIGHT B. CRANE, DOING DEALS: INVESTMENT BANKS AT WORK 63–71 (1988) (discussing tensions in relationships between investment banks and their clients).

103. ROSENBAUM & PEARL, *supra* note 43, at 355–56.

104. For example, in a competitive auction, a bidder is said to trust its M&A advisor with "outmaneuvering other bidders while not exceeding the client's ability to pay." *Id.* at 356.

105. *Business Principles and Standards*, GOLDMAN SACHS, http://www.goldmansachs.com/who-we-are/business-standards/business-principles/ [https://perma.cc/TZQ9-ZRBY]. Similarly, in its promotional materials on investment banking, J.P. Morgan claims to "focus[] on being a trusted

clients."[106] Independent advisory firms make similar claims; though they may label themselves independent, what they trumpet is not their independence from their clients but their loyalty toward them.[107] In ad hoc remarks, investment bankers claim to be trusted advisors for their M&A clients.[108] Though self-serving, these statements are central to how clients conceive of their M&A advisors;[109] they are certainly central to how investment bankers portray themselves.[110]

The fees M&A advisors receive also reflect the notion that their services promote their clients' interests. Their fees are typically calculated as a percentage of the deal consideration, often between 0.5% and 1.0%, contingent on the contemplated deal closing.[111] Advisors may also receive fixed fees

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advisor on corporate strategy and structure." *Investment Banking*, J.P. MORGAN, https://www.jpmorgan.com/pages/jpmorgan/au/cib/ib [http://perma.cc/AN6P-LUNF].

106. JONATHAN R. MACEY, THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET 48 (2013) (quoting a Goldman Sachs conference call).

107. *See* sources cited *supra* note 64 and accompanying text.

108. *E.g.*, Alison Frankel, *Tortured Opinion Is Strine's Surrender in El Paso Case*, REUTERS (Mar. 1, 2012), http://blogs.reuters.com/alison-frankel/2012/03/01/tortured-opinion-is-strines-surrender-in-el-paso-case/ [https://perma.cc/G8E9-FJ6J] (quoting an investment bank responding to judicial criticism of its conflicts by claiming: "We . . . want to be clear that we stood by our client through this process . . . ."); Arash Massoudi, *Goldman Sachs Names Karen Cook Chairman of Investment Banking*, FIN. TIMES (July 7, 2015, 3:00 PM), http://www.ft.com/intl/cms/s/0/af515b7a-24a5-11e5-9c4e-a775d2b173ca.html#axzz3x8yM7NG3 [https://perma.cc/5W4H-54X5] (referring to a bank memorandum describing a banker as a "trusted adviser to many corporate leaders"); Dana Mattioli & Gillian Tan, *Deal Advisers Take It on the Chin*, WALL STREET J. (Aug. 6, 2014, 7:20 PM), http://www.wsj.com/articles/with-demise-of-time-warner-and-t-mobile-deals-advisers-take-it-on-the-chin-1407364153 [https://perma.cc/V7S9-7B23] (quoting investment bankers claiming to give advice in clients' best interests, even where that means advising them not to pursue deals); Liz Moyer & Matthias Rieker, *Wells Fargo Scores Citadel Investment-Bank Talent, Deals*, WALL STREET J. (Aug. 16, 2011), http://www.wsj.com/articles/SB10001424053111903480904576510020766912988 [https://perma.cc/P3FU-WGSC] (quoting an investment banker aiming to "deepen the relationships [we] already ha[ve] so that more CEOs and boards view [us] as the trusted adviser for all their strategic banking needs, including . . . M&A"); *see also Austl Sec and Invs Comm'n v Citigroup Glob Mkts Austl Pty Ltd [No. 4]* (2007) FCA 963, at 20 (Austl.) (quoting an investment banker promising to "back to the hilt" its client's transaction "even if it gets a little hairy," a claim interpreted by the court as indicative of a fiduciary relationship between the bank and its client).

109. *See Investment Banking: Does It Pay to Hire Top Banks?*, ECONOMIST (Mar. 21, 2012, 7:38 PM), http://www.economist.com/blogs/freeexchange/2012/03/investment-banking [https://perma.cc/5LT7-N33P] (referring to investment banks as "[companies'] most trusted advisers").

110. A storied history of investment banks and investment bankers associates them with "trust" and "loyalty." *See* WASSERSTEIN, *supra* note 37, at 563 ("[U]ltimately, the investment banking business is about building a long-term trusting relationship with clients."); Heidi N. Moore, *Merrill Lynch: Gasp, You Only Love Me for My Money*, WALL STREET J. (Feb. 4, 2008, 1:12 PM), http://blogs.wsj.com/deals/2008/02/04/merrill-lynch-gasp-you-only-love-me-for-my-money/ [https://perma.cc/XLE2-VQ46] ("Investment banks love to talk about being trusted advisers.").

111. WELCH, *supra* note 38, at 867 ("Advice for the typical [M&A] deal can cost the transacting firms anywhere between 0.5% and 1% of the acquisition size."). Contingency fees may instead be expressed as a sliding scale percentage of deal consideration. *See* Calomiris & Hitscherich, *supra* note 77, at 913 (focusing on fees paid by target companies).

that are considerably smaller than the contingent fees.[112] Total advisory fees for a single transaction often measure in the tens or hundreds of millions of dollars.[113] Considering that banks deploy teams with relatively few individual bankers,[114] their advice is perhaps the most costly advice a corporation receives.[115] Banks that provide financing for their clients receive additional remuneration.

D. *Characterization*

How should we characterize the M&A advisor's role?[116] If we characterize it as either a fiduciary or a gatekeeper, broadly accepted justifications would then exist for imposing conflict of interest rules—but not if we characterize it as an arm's-length counterparty.[117] How we characterize M&A Advisors governs when and why we should regulate their conflicts.

112. These fees may be credited against the contingency fee if a deal closes. Calomiris & Hitscherich, *supra* note 77, at 912–13.

113. As to the fees some transactions generate, see Michael J. De La Merced, *Big Fees for Advisers If Charter Wins Over Time Warner Cable*, N.Y. TIMES: DEALBOOK (Jan. 14, 2014, 12:49 PM), http://dealbook.nytimes.com/2014/01/14/big-fees-for-advisers-if-charter-wins-over-time-warner-cable/?_r=1 [https://perma.cc/QKD8-Y22J] (estimating investment banking fees for one deal at between $180 and $220 million); Anita Raghavan, *Big Deals, Not Such Rich Fees for Bankers*, N.Y. TIMES: DEALBOOK (Aug. 20, 2014, 10:56 AM), http://dealbook.nytimes.com/2014/08/20/big-deals-not-such-rich-fees-for-bankers/ [https://perma.cc/JJ4K-LZXD] (providing examples of deals in which investment banking fees were in the tens and hundreds of millions of dollars).

114. *See* KAREN HO, LIQUIDATED: AN ETHNOGRAPHY OF WALL STREET 85 (2009) (explaining that deal teams are "usually composed of one or two analysts, an associate, a vice president, at times a senior vice president or director, and a managing director").

115. *See id.* at 258 (referring to investment bankers as "arguably the most highly compensated workers in the world"). As to investment banking remuneration, see *supra* note 111–15 and accompanying text.

116. The analysis here concerns the relationship between an M&A advisor and client in the usual course of events, which are described in subparts I(A)–(C). On occasion, fact patterns may differ, such as where a client engages multiple M&A advisors for advice on a single transaction, significantly limits the advisor's role, itself has highly experienced internal deal advisors on whom it relies, and has a demonstrated record of M&A activity.

117. Conflict of interest rules serve a function similar to that of imposing liability on gatekeepers for disclosure errors: they shape gatekeepers' incentives to deter corporate wrongdoing. Although gatekeepers already have incentives as reputational intermediaries to deter wrongdoing by their clients, liability bolsters these incentives. The gatekeeper literature advocates imposing liability on gatekeepers for their exerting influence over clients or other actors such that the controls on those other actors "yield the 'right' amount of compliance with legal rules—bearing in mind that enforcing these duties is itself costly." Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 857–58 (1984); *see also* Howell E. Jackson, *Reflections on Kaye, Scholer: Enlisting Lawyers to Improve the Regulation of Financial Institutions*, 66 S. CAL. L. REV. 1019, 1040–45 (1993). Conflict of interest rules may operate to limit financial interests that would compromise gatekeepers' independence and would therefore weaken their vigilance over clients. The intuition: an independent gatekeeper is more likely to perform its guardian-like responsibilities. For a more detailed explanation, see Tuch, *supra* note 12, at 384–92.

While actors may perform both fiduciary and gatekeeping roles, they rarely do so simultaneously in performing a single activity.[118] A fiduciary must act loyally toward its client in the absence of informed client consent; a gatekeeper, by contrast, performs a guardian-like role for investors, exercising its influence over its client to deter wrongdoing, typically the commission of disclosure errors.[119] To buttress its role, a gatekeeper must often act independently, eschewing conflicts that may compromise its independence.[120] According to Professor John Coffee, "[t]he term 'gatekeeper' has frequently been used to describe *independent* professionals who serve investors, preparing, verifying, or assessing the disclosures that they receive."[121] Generally speaking, therefore, the fiduciary is required to promote its client's interests, to act loyally (in the absence of client consent), and thus to avoid conflicts that compromise its ability to do so. The gatekeeper, on the other hand, may actively resist acting loyally in order to deter its client's wrongs, a function it typically performs by acting independently of its client's interests.

Though investment banks may perform gatekeeping roles in underwriting securities offerings and providing fairness opinions,[122] the gatekeeping label is inapposite to the M&A advisor's role under scrutiny. First, the wrong here is inflicted by the M&A advisor upon the client. It arises from the M&A advisor's disloyalty, such as from compromised advice or other conduct. The gatekeeping template instead targets the wrongs of the client by imposing responsibilities on the gatekeeper to deter those wrongs.[123]

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118. For instance, the underwriter may be a fiduciary of its corporate client (the issuer) in giving advice. EBC I, Inc. v. Goldman, Sachs & Co., 832 N.E.2d 26, 28 (N.Y. 2005). It may nevertheless perform a gatekeeping role in reviewing its client's disclosures to investors. Securities lawyers are fiduciaries of their clients, and yet may have particular gatekeeping functions in reviewing their clients' securities law disclosures. *See, e.g.*, John C. Coffee, *The Attorney as Gatekeeper: An Agenda for the SEC* 7, 20–21 (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 221, 2003), http://ssrn.com/abstract=395181 [http://perma.cc/J2ND-GBF9] (considering the multiple roles securities lawyers may perform, including advising on transactions and serving as gatekeepers of corporate disclosures). Professor Arthur Laby provides an alternative conception of gatekeepers, classifying them as either independent or dependent, based on their orientation toward their clients. Arthur B. Laby, *Differentiating Gatekeepers*, 1 BROOK. J. CORP. FIN. & COM. L. 119, 120 (2006). That classification highlights tensions between an actor's apparent gatekeeping and fiduciary roles. *See id.* at 128–32.

119. *See* Coffee, *supra* note 118, at 6 (referring to gatekeepers as having "guardian-like responsibilities to investors who rely upon the disclosures that [the gatekeeper] . . . typically prepares or at least reviews").

120. Examples include rules requiring independence of research analysts, auditors, and underwriters.

121. *Id.* (emphasis added).

122. Coffee, *supra* note 118, at 8 (referring to the underwriter of an initial public offering as performing a gatekeeping function); *see also id.* (referring to the investment bank furnishing a "fairness opinion" as a gatekeeper).

123. *See supra* note 119.

In the current context, only if we regard the wrong to be deterred as that of the client (or its directors) would we characterize the M&A advisor as a gatekeeper, in consonance with that term's conventional meaning.

Second, the gatekeeper is a desirable target for liability because of its capacity to monitor and influence, and thereby to deter, wrongdoing by the client.[124] Do M&A advisors have that capacity? In some respects—such as in deterring disclosure wrongs—they surely do. Nevertheless, there is tension in subjecting directors to liability for failing to reasonably oversee their M&A advisors, while also subjecting M&A advisors to liability (as gatekeepers) for failing to monitor and influence directors.

Taken together, this analysis suggests a mismatch between the use of gatekeeper theory and the end to be achieved—banker loyalty. If we hold an M&A advisor liable as a gatekeeper, therefore, we do so not for its disloyalty toward its client, but for the conceptually distinct conduct of failing to deter the client's wrongdoing.

Consider next whether M&A advisors are fiduciaries of their clients. Identifying fiduciary relationships has vexed scholars.[125] While some actors are conventionally understood as fiduciaries because of their status or position, such as trustees of a trust, agents, partners, or corporate directors and officers, other actors may also be fiduciaries.[126] In identifying fiduciary relationships or duties, one influential strand of scholarship focuses on whether one party has reasonable or justifiable expectations of loyalty of another.[127]

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124. Professor Reinier Kraakman conceived of gatekeepers as actors with the capacity to monitor and to control, or at least to influence, the conduct of their corporate clients and thereby to deter wrongdoing by them. Kraakman, *supra* note 117, at 890. As to the monitoring function of gatekeepers, see *id.* at 891 and Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 62–66 (1986). *But see* JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 4 (2006) (suggesting that gatekeepers may lack capacity to control or influence corporate issuers).

125. Various scholarly formulations prescribe indicia or criteria for determining when fiduciary duties should arise. *See, e.g.*, J.C. SHEPHERD, THE LAW OF FIDUCIARIES 21–34 (1981); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1782–89 (2001); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 880; Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 432–36 (1993); Tamar Frankel, *Fiduciary Duties*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127, 127–28 (Peter Newman ed., 1998); Paul B Miller, *The Fiduciary Relationship*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 63, 63 (Andrew S Gold & Paul B Miller eds., 2014); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1402 (2002).

126. *See* Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 933–34 (2006).

127. Professor Paul Finn regards fiduciary duties as arising when one actor is entitled to expect that another actor in a relationship with it will act loyally, that is, in its interests, in and for the purposes of the relationship. *See* P. D. Finn, *The Fiduciary Principle*, *in* EQUITY, FIDUCIARIES AND TRUSTS 1, 46, 54 (T.G. Youdan ed., 1989). This view is typically treated as requiring reasonable expectations of loyalty by one actor of the other (the fiduciary). *See* MATTHEW CONAGLEN, FIDUCIARY LOYALTY: PROTECTING THE DUE PERFORMANCE OF NON-FIDUCIARY DUTIES 249–50 (2010). Professor Deborah DeMott argues that fiduciary duties "can best be understood as

Though formulations differ, this scholarship treats expectations as an amalgam of both actual and imputed expectations of the actor in question, and in so doing, recognizes that fiduciary duties may properly arise even where past misdeeds by an actor have rendered actual expectations of loyalty unrealistic.[128] This scholarship locates expectations in particular indicia in a relationship; these include the reposing of trust or confidence, the delegation of discretion, the inequality of bargaining power, the vulnerability of one actor to another, the parties' course of dealings over time, and the absence of allegiances to outside parties.[129] This scholarship also identifies expectations of loyalty by drawing analogies to status-based fiduciary relationships. It recognizes the importance of public policy considerations in informing which relationships should be fiduciary, including "the need to maintain public confidence in the integrity and utility of a range of socially important relationships in which loyal service is properly to be expected."[130]

In important respects, the reasonable expectations approach overlaps with the economic justification for fiduciary duties. Economic theory accepts the desirability of loyalty in (economic) agency relationships—relationships in which one party (the principal) delegates discretion to another (the agent) without being able to fully observe the other's conduct.[131] Fiduciary duties are justified because the principal cannot adequately regulate the agent's affairs by contract.[132] In particular, the agent's greater

responsive to circumstances that justify the expectation that an actor's conduct will be loyal to the interests of another." DeMott, *supra* note 126, at 926. Professors Margaret Blair and Lynn Stout point to the "legal expectation" of other-regarding, or loyal, behavior by one actor as the "essence of a fiduciary relationship." Blair & Stout, *supra* note 125, at 1743; *see also* Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 775 (2012) ("As the SEC edges closer to imposing a fiduciary duty on brokers that give advice, it can look to investors' reasonable expectations as a justification for doing so."). The reasonable expectations approach is used here because of its strong influence on case law. CONAGLEN, *supra*, at 250–51. Though influential, the approach has been criticized as indeterminate. *See, e.g.*, Robert Flannigan, *The Boundaries of Fiduciary Accountability*, 2004 N.Z. L. REV. 215, 253–55.

128. DeMott, *supra* note 126, at 938; *see also* Finn, *supra* note 127, at 47.

129. *See* DeMott, *supra* note 126, at 940–51; Finn, *supra* note 127, at 54; Miller, *supra* note 125, at 67.

130. *Hughes Aircraft Sys Int'l v Air Servs Austl* (1997) 76 FCR 151, 237 (Austl.).

131. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976); *see* Robert H Sitkoff, *An Economic Theory of Fiduciary Law*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 128, at 197, 198–99 [hereinafter Sitkoff, *Economic Theory*]; Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 B.U. L. REV. 1039, 1040 (2011) [hereinafter Sitkoff, *Economic Structure*].

132. *See* Alison Grey Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. REV. 738, 749–50 (1978) (discussing the barriers to contractual self-protection); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1048–51 (1991) (discussing obstacles faced by the parties to a fiduciary relationship in articulating a fiduciary's conduct in advance and difficulties of the beneficiary in monitoring the fiduciary's conduct); Easterbrook & Fischel, *supra* note 125, at 426–27 (discussing the transaction-cost benefits of fiduciary duties); Daniel Markovits,

expertise and the constantly changing environment in which the agent operates, one in which all future contingencies cannot be anticipated, stand in the way of the principal fully articulating the agent's conduct by contract, at least cost-effectively. Fiduciary doctrine provides terms that the parties would have agreed to had they foreseen the particular contingencies that occurred, saving the parties the expense and difficulty of contracting afresh for a regime of their own.[133] These terms include a "package" of interpretive authority that draws on decades of judicial and scholarly expertise.[134] As Professor Robert Sitkoff explains:

> Instead of trying in advance to reduce to writing provisions for every future contingency, the parties need only specify those contingencies that are important and likely enough to warrant the transaction costs of express provision. For all other contingencies, fiduciary obligation fills the gap.[135]

While a principal may monitor its agent, it cannot engage in active monitoring to an extent that would solve the agency problem between M&A advisors and clients and render fiduciary duties undesirable.[136] By filling gaps in incomplete contracts, fiduciary duties address the agency problem.

Many factors necessary to justify fiduciary duties in economic analysis correspond with those that identify reasonable expectations of loyalty.[137]

Sharing Ex Ante *and Sharing* Ex Post*: The Non-Contractual Basis of Fiduciary Relations*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 125, at 209, 216 ("The beneficiary engages the fiduciary, after all, precisely because she cannot adequately regulate her affairs by contract."); Sitkoff, *Economic Theory*, *supra* note 131, at 199 ("Often the principal cannot spell out in advance precisely what the agent should do in all possible future circumstances.").

133. *See* Easterbrook & Fischel, *supra* note 125, at 427 ("The duty of loyalty replaced detailed contractual terms . . . ."); Sitkoff, *Economic Theory*, *supra* note 131, at 202 ("Fiduciary law thus minimized *transaction costs*.").

134. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 660–62 (1995); Sitkoff, *Economic Structure*, *supra* note 131, at 1044.

135. Sitkoff, *Economic Theory*, *supra* note 131, at 202.

136. Some commentators describe the principal's monitoring as "imperfect[]." *See, e.g.*, Richard R W Brooks, *Knowledge in Fiduciary Relations*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 125, at 225, 228. Professor Sitkoff asserts that "[a]ctive monitoring [by the principal] is not a satisfactory answer to the agency problem." Sitkoff, *Economic Structure*, *supra* note 131, at 1041.

137. One potential difference concerns the extent to which parties can disclaim the existence of a fiduciary relationship or fiduciary duties, as opposed to simply varying the content or scope of fiduciary duties or obtaining informed consent to conduct that would otherwise breach fiduciary duties. This Article does not pursue this issue in detail, other than to make two preliminary observations. First, the better doctrinal view is that such fiduciary disclaimers may not succeed in preventing a fiduciary relationship from arising. *See infra* note 214. Second, even the contractarian approach should not be taken to necessarily support giving effect to such fiduciary disclaimers. That approach is premised on a contract reflecting the agreement of negotiating parties that act in their best interests; this premise may not hold true where negotiating representatives of one of the counterparties have compromised interests. Particularly where the other counterparty contributed to compromising those interests, one might reject treating any fiduciary disclaimer as accurately reflecting the parties' agreement. As to M&A advisors exacerbating the divergence of interests between their clients and their clients' representatives, see section I(E)(1).

Both approaches look to one actor's delegation of decision-making discretion and its vulnerability or limited ability to self-protect. While the reasonable expectations theory places greater emphasis on trust and confidence than economic analysis does, the reposing of trust and confidence will often arise in relationships in which one actor confers discretion on another actor with superior expertise.

Consider now how these approaches for identifying fiduciary relationships apply to M&A advisors and their clients. The M&A advisor–client relationship is marked by the delegation of discretionary authority to advisors. M&A advisors have special expertise and experience, a point underscored by clients' willingness to pay millions of dollars to advisors for advice and representation. M&A advisors receive sensitive, nonpublic client information, which makes clients vulnerable to exploitation. Clients defer to their bankers' advice and representation. Investment banks tout not only their skills, but also their loyalty toward clients.[138] These factors contribute to client expectations of loyalty as do the adversarial nature of M&A transactions, the high stakes they involve, the practice of principals having their "own" advisors, the partisan roles M&A advisors play, and the absence of advisor allegiances to other transaction participants. In deals, clients may have little option but to rely on their M&A advisors and to trust them to promote their (clients') interests—factors also pointing toward the reasonableness or legitimacy of expecting loyalty of M&A advisors within the scope of their advisory activities.[139]

Other factors also lend support to characterizing M&A advisors as fiduciaries. Clients task M&A advisors with acting for their benefit and on their behalf in transactions.[140] Advisors' functions are so complex and varied and developments in deals so difficult to anticipate that attempting by contract to specify advisors' conduct in every eventuality would make little sense, economic or otherwise. The inadequacy of contract in this respect reflects the tacit human capital investment bankers deploy—capital that is "hard to measure and virtually impossible to contract upon."[141] Though

138. *See supra* notes 105–08 and accompanying text. Regarding suggestions that clients engage M&A advisors for legal defense, see *supra* note 44.

139. The existence of fiduciary disclaimers in client engagement letters might be taken to undermine claims that clients reasonably expect loyalty of their advisors. But even if these provisions were effective, their existence suggests only that clients are willing to forgo their fiduciary protections, not necessarily that they lack reasonably grounded expectations of loyalty. Importantly, the effect of these provisions is contested, making it difficult to infer much from their inclusion in engagement letters. *See supra* note 214 and accompanying text. Of course, if an M&A advisor unambiguously declared its intention to act contrary to its client's interests, to have real (harm-imposing) conflicts rather than merely apparent conflicts, to act in this manner across the scope of its representation rather than in a narrow respect, then its willing client would clearly lack reasonable expectations of loyalty for purposes of fiduciary characterization.

140. *See supra* notes 88–96 and accompanying text.

141. Alan D. Morrison & William J. Wilhelm, Jr., *The Demise of Investment Banking Partnerships: Theory and Evidence*, 63 J. FIN. 311, 312 (2008); *see also id.* ("Tacit human

clients may monitor certain bank conduct—remaining alert to apparent conflicts of interest, for example—they often cannot verify the soundness of the advice they receive, especially regarding the numerous tactical and strategic judgments their investment bankers make; thus, active monitoring is no answer to the agency problem between M&A advisors and their clients. Characterizing M&A advisors as fiduciaries spares their clients the expense, difficulty, and uncertainty of attempting by contract to articulate a governance regime from scratch to respond to the many imponderables that may arise during a deal.

Drawing analogies with conventional fiduciary relationships may also aid in characterizing the M&A advisor's role. Strong parallels exist with the lawyer–client relationship. Like M&A advisors, lawyers form part of a deal team in advising an M&A client. These advisors are similar in terms of the discretion they exercise, the open-ended nature of their activities, and the partisan roles they play. They also receive sensitive nonpublic information and have superior expertise and experience relative to their clients.

Applying the reasonable expectations and contractarian approaches suggests that M&A advisors should be characterized as fiduciaries of their clients, meaning they would owe duties of loyalty.[142] The precise content and scope of fiduciary duties of loyalty would vary by context as well as by agreement (since the relationship would also be governed by contract).[143] Generally, though, fiduciary duties will limit a fiduciary's range of conduct, requiring the fiduciary to act with undivided loyalty or to avoid conflicts of interest—requirements that can be suspended with the principal's or client's

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capital . . . covers forms of knowledge and skills that do not easily lend themselves to codification or to arms-length exchange.").

142. In Anglo-Commonwealth law and scholarship, scholars debate the syllogistic relationship between the existence of a fiduciary relationship and the incidence of fiduciary duties. For a detailed discussion, see CONAGLEN, *supra* note 127, at 7–11. The prevailing approach in U.S. law and scholarship, which this Article takes, regards fiduciary duties as arising because a fiduciary relationship exists.

143. This Article does not examine the precise content and scope of the fiduciary duties that would arise, but proceeds on the basis that M&A advisors must loyally serve their clients' interests in the absence of informed client consent. In scholarship, the precise contours of the duty (or obligation) of loyalty is contested. For a discussion, see generally Lionel D. Smith, *Can We Be Obliged to Be Selfless?*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 125, at 141. The duty of loyalty used here, though not fully specified, is sufficient, it is contended, to support the framework in Part II; in particular, it justifies requiring directors to oversee their M&A advisors' conflicts of interest. *See also infra* notes 387–90 and accompanying text (critiquing scholarship that regards M&A advisors as arm's-length counterparties and yet would require directors to oversee M&A advisors' conflicts).

fully informed consent.[144] Importantly, by allowing parties to opt out of the loyalty requirement by informed consent, fiduciary doctrine recognizes the possibility that a conflict of interest may not cause net harm to a client.[145]

E. Countervailing Considerations

Various objections might be offered to characterizing M&A advisors as fiduciaries of their clients.

1. Clients' Capacity to "Fend for Themselves."—Can clients "fend for themselves," adequately protecting themselves against the risk of harm from M&A advisor disloyalty?[146] If they can, the rationale for fiduciary intervention may fall away.

Formally, this claim rests on the supposed ability of market forces to effectively induce M&A advisors to behave loyally. Theoretically, clients, aware that their M&A advisors face potential conflicts, will distinguish among advisors, adjusting their willingness to pay for investment banking services according to an individual advisor's potential for disloyalty, and thereby implicitly deter advisor disloyalty.

To be sure, this argument finds potential justification in the classic model of harm developed by Professor Steven Shavell, under which market forces will induce sellers of products to behave optimally even in the absence of liability for providing inferior products or services.[147] In this model, customers will discount the prices they are willing to pay to reflect expected product risks; if their perceptions are accurate and firms operate in a perfectly competitive environment, firms will be led to behave optimally—to avoid losing business.

There is, however, little to suggest that M&A advisors do in fact discount their fees to reflect the risk of disloyalty or that clients can accurately perceive the risks of disloyalty posed by M&A advisors individually

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144. *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY § 8.01 (AM. LAW INST. 2005) (stating the general duty of loyalty for agents); *id.* § 8.06 (providing for a principal's informed consent); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§ 121, 122 (AM. LAW INST. 2000) (limiting lawyer conflicts but providing for waiver through informed consent). For further discussion of informed consent, see Tuch, *Disclaiming Loyalty*, *supra* note 13, at 216–24.

145. For discussion of this possibility, see *supra* notes 72–74 and accompanying text.

146. Some commentators claim—in related contexts—that clients fully appreciate the risk of conflicts, but they provide no supporting evidence for this claim. *See, e.g.*, Thomas J. Moloney et al., *Fiduciary Duties, Broker-Dealers and Sophisticated Clients: A Mis-Match that Could Only Be Made in Washington*, 3 J. SEC. L. REG. & COMPLIANCE 336, 343 (2010) ("[A]ny trust being placed in a broker-dealer, outside a formal investment advisory relationship, is done with a full appreciation of [broker-dealers'] potential multiple roles and the attendant risks.").

147. *See* STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 207, 212–17 (2004) [hereinafter SHAVELL, FOUNDATIONS] (discussing the effect of market forces on sellers of products in the absence of liability rules); Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 5, 16–17 (1980) [hereinafter Shavell, *Strict Liability*] (discussing the market effects of different liability rules).

at the time of contracting. Indeed, although sophisticated in many respects, many clients will be inexperienced in M&A dealmaking.[148] Former Delaware Chancellor William Allen acknowledged this reality, explaining that outside directors in particular "[f]requently . . . have had little or no experience in the sale of a public company" and "[n]aturally, they turn for guidance to their specialist advisors who will typically have had a great deal of relevant experience."[149] M&A advisors fail to disclose the risk of disloyalty they pose to their clients, lacking incentives to do so;[150] rather, they proclaim their loyalty toward clients.[151] No third party—such as a rating agency—has perfect incentives to track and report the risk of disloyalty each M&A advisor poses.[152] Nothing suggests M&A advisory fees vary between investment banks according to the risk of disloyalty each advisor represents.[153] These reasons undermine the formal case that clients' capacity to fend for themselves will obviate the need for liability rules.[154]

Aside from this formal argument, one might point to the broad notion that M&A clients, as generally sophisticated actors with access to competent legal counsel, can contract to protect their interests.[155] The inquiry here concerns not clients' ability to accurately perceive the risk of advisor

148. *See, e.g.*, *In re* Daisy Sys. Corp., 97 F.3d 1171, 1178 (9th Cir. 1996) ("[E]ven though both parties were sophisticated corporations, the fact that [the M&A advisor] was retained to advise [the client] in a type of transaction with which [the client] had no experience suggests that the requisite degree of 'superiority' [to establish a fiduciary relationship] may have existed.").

149. William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy?*, 45 BUS. LAW. 2055, 2061 (1990); *see also In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 831 (Del. Ch. 2011). As to claims that legal advisors will supply the necessary sophistication, see *infra* note 236 and accompanying text.

150. SHAVELL, FOUNDATIONS, *supra* note 147, at 216–17 ("[F]irms clearly lack appropriate incentives to provide information about the dangerousness of their products and services.").

151. *See supra* notes 105–08 and accompanying text.

152. No viable business model exists to allow rating agencies to profit from providing ratings despite the value they hold for users of this information. Generally speaking, such agencies would not capture the value of the information they produced because they could not effectively exclude free-riders from acquiring the information. For discussion of these obstacles as they apply to credit ratings agencies, see COFFEE, *supra* note 124, at 283–307.

153. As to investment banking remuneration, see *supra* notes 111–15 and accompanying text. While some evidence suggests fees are generally uniform (set as a percentage of deal consideration), WELCH, *supra* note 38, at 867, other evidence describes fees as "highly negotiable" and as "vary[ing] considerably" due to factors including investment banks' experience. Calomiris & Hitscherich, *supra* note 77, at 913. Even if fees do vary according to factors other than deal size, this author is aware of no evidence suggesting M&A advisors' potential for disloyalty plays any role in the fees M&A advisors charge.

154. Even if their clients perceived the average risk of harm by advisors as a whole, M&A advisors would not be led to act desirably because no single advisor that did so would be rewarded for it. *See* Shavell, *Strict Liability*, *supra* note 147, at 5.

155. *See supra* note 146 and accompanying text.

disloyalty, but clients' use of contract to regulate M&A advisors' activities to obviate the need for fiduciary duties—an issue related to the contractarian approach for identifying or justifying fiduciary duties.[156]

Even putting aside the premise as to client sophistication, this claim faces obstacles. First, even under the contractarian approach the question is not whether parties are sophisticated or even whether they can protect their interests by contract; the concern is whether they can *adequately*, or *cost effectively*, self-protect using contract.[157] Fiduciary duties are justified under this approach as a transaction cost-saving device. Second, courts do impose fiduciary duties for the benefit of sophisticated actors.[158]

The contractarian approach, even if manipulable,[159] supports the imposition of fiduciary duties on M&A advisors. There are good reasons, as outlined above, for thinking that contract fails to adequately regulate the M&A advisor's role in these highly complex transactions.[160] Moreover, difficulties in contracting may afflict even sophisticated parties; few doubt, for example, the need for fiduciary protections for sophisticated corporate clients dealing with lawyers—experts whose activities (like those of M&A advisors) would be difficult and costly to specify by contract.

Rather than focusing on client sophistication, the contractarian theory gives regard to client expertise and experience. These factors go to the likely adequacy of contract in regulating an actor's conduct. Clients fall on spectrums of expertise and experience[161]: those clients with in-house M&A deal advisors and long records of M&A deal activity will have greater expertise and experience than other clients. But whatever their expertise and experience, it seems clear that their levels will be inferior to those of their M&A advisors. M&A advisors specialize in M&A advice. They stand at the crossroads of capital markets, thereby gaining insights and information that other market participants lack,[162] and they qualify and register as broker–

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156. *See supra* notes 131–33 and accompanying text.

157. *See supra* notes 135–36 and accompanying text.

158. DeMott, *supra* note 126, at 937–38.

159. Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 55, 68 (John W. Pratt & Richard J. Zeckhauser eds., 1985) (describing the contractarian approach as "frequently indeterminate and therefore manipulable").

160. *See supra* text accompanying notes 138–41.

161. For evidence suggesting that even investment banks regard their corporate clients as falling on a spectrum of sophistication, with some materially more sophisticated than others, see, for example, *Wall Street and the Financial Crisis: The Role of Investment Banks: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov't Affairs*, 111th Cong. 28 (2010) (referring to e-mail correspondence by a Goldman Sachs employee distinguishing among institutional clients on the basis of their sophistication).

162. *See, e.g.*, WELCH, *supra* note 38, at 857 (describing investment bankers' M&A advice as "requir[ing] expertise that few acquirers or targets have themselves"); Peter D. Goodson, *Investment Banking as a Profession: Pathway to Glory or Road to Oblivion*, *in* THE INVESTMENT BANKING HANDBOOK 1, 5 (J. Peter Williamson ed., 1988) (discussing the "unique perspective bankers bring to client opportunities," and observing that "[m]ost corporate managements do a major deal once or

dealers—earning a designation necessary to act as M&A advisors, one attesting to and perhaps even contributing to their superior expertise.[163] According to the contractarian approach, in circumstances such as these, fiduciary doctrine saves parties the cost, difficulty, and uncertainty of providing terms by contract.

Finally, in identifying fiduciary duties there are clear dangers in too readily imputing the sophistication of senior corporate managers, or even their expertise and experience, to their enterprises. This is particularly so when investment banks have played a role in exacerbating the divergence of interests between senior managers and their enterprises. Most prominently, they have done so by offering stock in "hot" IPOs to managers in their personal capacities (a practice described as "a flagrant attempt to ingratiate themselves to [managers]"[164]), by assisting managers in finding new positions,[165] and by giving them personal loans.[166]

Nothing here should be taken to suggest that clients are wholly incapable of fending for themselves. Though they can contractually specify M&A advisors' functions, the cost and difficulty of doing so suggests the need for fiduciary duties. And while advisors can monitor their advisors, their more limited expertise and experience suggests that they cannot do so actively enough to satisfactorily solve the agency problem between M&A advisors and clients and so obviate the need for fiduciary duties. As explained further below,[167] clients can surely take some steps to protect against M&A advisor overreaching, but even under the contractarian approach these steps fail to undermine the basis for imposing fiduciary duties.

2. Pervasiveness of Disloyalty.—One might doubt whether clients reasonably expect loyalty of their M&A advisors based on anecdotal and empirical evidence of M&A advisor disloyalty.[168] In its 2013 report on the

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twice in a career," whereas "[b]ankers do deals continuously," and further that "[t]he experience of bankers comprises a unique perspective that cannot be attained strictly from the corporate side").

163. *See supra* notes 59–60 and accompanying text.

164. CHARLES R. GEISST, WALL STREET: A HISTORY 388 (revised and expanded ed., 1997). As to the practice of investment banks allocating stock in "hot" initial public offerings to the senior managers of potential or current investment banking clients, see Therese H. Maynard, *Spinning in a Hot IPO—Breach of Fiduciary Duty or Business as Usual?*, 43 WM. & MARY L. REV. 2023, 2023–28 (2002).

165. *See* WELCH, *supra* note 38, at 874 (discussing factors influencing corporate managers' selection of M&A advisors, including advisors' ability to help with job placements).

166. *See, e.g.*, Liz Hoffman, *Valeant CEO Forced to Sell Company Stock in Margin Call*, WALL STREET J. (Nov. 6, 2015, 7:02 PM), http://www.wsj.com/articles/goldman-sells-valeant-shares-used-as-collateral-by-ceo-1446815823 [https://perma.cc/QZU8-T3DY] (describing loans totaling $100 million by an investment bank to a company's chief executive officer where the bank had recently earned an estimated $85 million in fees from that company).

167. *See infra* subpart II(C).

168. *See supra* notes 4–6 and accompanying text. For discussion of investment banking misconduct, see Tuch, *supra* note 59, at 123–34. As to bankers' alleged misconduct in the collapse

banking industry, the U.K. Parliamentary Commission on Banking Standards observed that "in recent times, shockingly poor standards and culture have been revealed" in the real of investment banking.[169] It also quoted one commentator who observed that in some institutions "the idea of fiduciary obligation to customers was ebbing away."[170] Such evidence may lead clients to trust their banks less, to rely on them less, and ultimately not to expect loyalty from them at all.

Nevertheless, evidence of banks' disloyalty or even growing client suspicions about banks' loyalty need not indicate that clients lack reasonably grounded expectations of loyalty in their own advisors. It may be that clients do not lack such expectations, but that they have formed them more wisely, selecting their bankers more deliberately to avoid those whom they distrust or from whom they expect no loyalty.[171] After all, the notion that a client would knowingly engage a disloyal M&A advisor is incompatible with the nature of what's being provided—advice on a high-stakes transaction that may end the independence of one company and change the future direction of both, advice that comes at a price reflecting what's at stake for the client.

3. Market Practices.—Do market practices obviate the need for fiduciary protections? Consider first the force of market discipline. The idea is that facing the threat of earning a bad reputation and weakened earning potential, an M&A advisor will take measures to limit conflicts of interest to which its client has not consented. Market forces can have real power, especially in an industry under as much media and other scrutiny as the financial services industry. But market 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. Moreover, empirical evidence suggests the factor of banks' reputations in constraining misconduct is weakening.[172] Professor Jonathan Macey goes so far as to assert that "the traditional model

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of Enron in particular, see generally Hillary A. Sale, *Banks: The Forgotten(?) Partners in Fraud*, 73 U. CIN. L. REV. 139 (2004).

169. PARLIAMENTARY COMM'N ON BANKING STANDARDS, CHANGING BANKING FOR GOOD, 2013-14, HL 27-II, HC 175-II, at 99 (UK).

170. *Id.* at 135 (quoting John Plender & Delphine Strauss, *How Traders Trumped Quakers*, FIN. TIMES (July 7, 2012)); *see also id.* at 131–32 (providing a discussion of the decline in loyalty).

171. Along similar lines, that an experienced investor is wary of her broker does not mean she necessarily trusts her broker less than a novice investor; she may simply "trust more wisely." ROBERT C. SOLOMON & FERNANDO FLORES, BUILDING TRUST IN BUSINESS, POLITICS, RELATIONSHIPS, AND LIFE 100 (2001).

172. *See* Alan D. Morrison et al., *Investment-Banking Relationships: 1933-2007*, at 30–36 (Saïd Bus. Sch., Research Paper 2014-1, 2014), http://ssrn.com/abstract=2376481 [http://perma.cc/UZ48-7Y8N] (presenting evidence on the weakening role of investment banking reputations in constraining conflicts of interest and other misconduct).

of reputation, that predicts that investment banks . . . will put their customers' interest ahead of their own and avoid conflicts of interest, no longer has much, if any, explanatory force."[173] Of course, whether reputation is sufficient to deter disloyalty is an empirical question and cannot be resolved here. Nevertheless, the theoretical case for imposing fiduciary duties does not rest on the inadequacy of reputation to deter disloyalty: even the contractarian approach to identifying or justifying fiduciary duties makes no explicit reference to the reputational mechanism.[174]

Consider next whether the existence of independent advisory firms and their vigorous competition with financial conglomerates renders fiduciary duties unnecessary.[175] Clients that value loyal or conflict-free M&A advice, so the argument goes, may engage independent M&A advisors, thus disciplining potentially disloyal M&A advisors structured as financial conglomerates. Independent firms' market share has increased in recent years, possibly reflecting a concern about the conflicts afflicting financial conglomerates.[176] But the simple existence of independent advisory firms does not undermine the grounds for fiduciary protections. Recall that these firms cannot be assumed to be conflict free, despite their structure.[177] Even if they were conflict free, it would be difficult to determine whether other M&A advisors were disciplined by the competition because clients cannot accurately perceive the risk of disloyalty and because senior managers may nevertheless engage favored bankers.[178] Thus, much like the formal argument concerning clients' capacity to fend for themselves, the availability of potentially unconflicted M&A advisors fails to clearly undermine the case for fiduciary protections.

4. Firm Structure.—The next possible objection concerns the potential incompatibility of fiduciary duties with the organizational structure of major investment banks.[179] As financial conglomerates, major investment banks are susceptible to conflicts with the interests of their M&A clients.[180] Given

173. MACEY, *supra* note 106, at 49.

174. *See supra* notes 131–36 and accompanying text.

175. As to the existence of independent advisory firms, see *supra* notes 56–58 and accompanying text.

176. *See supra* note 58 and accompanying text.

177. *See supra* notes 64–66 and accompanying text.

178. As to these factors, see *supra* notes 148–54, 164–66 and accompanying text.

179. *See, e.g.*, Moloney et al., *supra* note 146, at 343 (describing the multiple roles performed by investment banks and asserting that they "present[] significant complications for the idea that broker-dealers should owe fiduciary duties of some sort to their 'clients'"); Lanny A. Schwartz et al., *Investment Banks Face Challenges Under New Municipal Advisor Rules*, N.Y.L.J. (Dec. 16, 2013), http://www.newyorklawjournal.com/id=1202632187190/Investment-Banks-Face-Challenges-Under-New-Municipal-Advisor-Rules [http://perma.cc/GZ3X-SK56] (discussing challenges that investment banks face when they owe fiduciary duties and the possible need to limit certain activities).

180. *See supra* notes 61–63 and accompanying text.

the scope of potential conflicts of interest, one might argue, the imposition of fiduciary duties on M&A advisors may constrain the activities in which they may simultaneously engage, depriving clients of the benefits of financial conglomeration, such as those flowing from economies of scale and scope. If imposing fiduciary duties prevented such conduct, it would be wealth destroying.

Even if this policy concern were a matter properly to be reflected in fiduciary doctrine, the concern is overstated. Fiduciary duties generally limit conflicts of interest, except with the client's informed consent.[181] The client that expects to benefit from a bank performing multiple roles (that would violate its fiduciary duties) may, after full disclosure, consent to such conduct. Fiduciary doctrine is thus sensitive to the possibility that some conflicts may benefit clients.

If enough clients refused to consent to conflicted representation by their M&A advisors, or otherwise irreconcilable conflicts arose, investment banks could be led to question the merits of financial conglomeration. Major financial conglomerates have done this, with some even considering spinning off their M&A advisory businesses.[182] But investment banks employ a range of measures to address, and attempt to resolve, the difficulties created by fiduciary doctrine, including using information barriers.[183] The merits of financial conglomeration are complex and contested; they are not assessed here.[184] But it is far from evident that characterizing M&A advisors as fiduciaries will lead to the dismantling of financial conglomerates and, if it did, that it would cause societal harm.

* * *

This Part developed a theoretical account of the role played by M&A advisors, contending that they are fiduciaries of their clients. It thus justified requiring M&A advisors to loyally serve their clients' interests in the absence of informed client consent. This account is based on clients' reasonable

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181. *See supra* note 144 and accompanying text.

182. *See, e.g.*, Anita Raghavan, *A Deal Maker Tries to Tune Up UBS's Investment Bank*, N.Y. TIMES: DEALBOOK (Oct. 9, 2014, 8:36 PM), http://dealbook.nytimes.com/2014/10/09/a-deal-maker-tries-to-tune-up-ubss-investment-bank/ [https://perma.cc/D9LB-HCT4] (discussing proposals for a financial conglomerate to spin-off its investment bank).

183. The information barrier may function to conceptually carve the investment bank into multiple, distinct firms, permitting analysis of fiduciary questions at the level of a business unit or subsidiary, making it more likely that fiduciary duties will be discharged than if analysis occurred at the level of the corporate enterprise. *See generally* Tuch, *supra* note 55, at 581–92. Although judicial guidance is sparse, recent guidance gives effect to information barriers, in part because failing to consider them effective might force the financial conglomerate to disaggregate. Bd. of Trs. of the AFTRA Ret. Fund v. JPMorgan Chase Bank, N.A., 806 F. Supp. 2d 662, 690 (S.D.N.Y. 2011).

184. For a recent review of the evidence on the merits of financial conglomeration, see generally SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2010).

expectations of loyalty coupled with clients' difficulty in contractually specifying advisors' activities and in later evaluating them. Claims that portray M&A advisors as arm's-length counterparties of their clients fail to defeat the case for characterizing M&A advisors as fiduciaries.

II. Structuring Liability Rules

This Part assesses liability rules based on how effectively they deter M&A advisor disloyalty and thereby promote such advisors' loyalty toward clients. This assessment generates insights that will be useful for evaluating existing law in Part III. Recognizing the deterrence function that fiduciary duties perform,[185] the analysis applies optimal deterrence theory, a theory widely employed in economic analysis to assess the deterrent effect of liability rules.[186]

A. Framework for Analysis

Under optimal deterrence theory, potential wrongdoers are optimally deterred when they expect to bear liability equal to the social costs they create.[187] Potential wrongdoers are then led to avoid all intentional conduct that is socially harmful[188] and to take precautions to minimize the social costs of accidental misconduct.[189] By leading wrongdoers to bear the social costs of their misconduct, this liability rule achieves the social goal of minimizing total accident costs.[190]

Though typically applied to assess liability rules for accidents and crimes, the theory provides useful insights here because of the strength of the analogy between accidents in particular and the M&A advisory context. The

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185. CONAGLEN, *supra* note 127, at 80–84 (arguing that fiduciary doctrine performs a deterrent role and contending with counterarguments); Sitkoff, *Economic Theory*, *supra* note 131, at 201 ("[T]he functional core of fiduciary obligation is *deterrence*.").

186. As to optimal deterrence theory, see generally STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW (1987) [hereinafter SHAVELL, ACCIDENT LAW]; SHAVELL, FOUNDATIONS, *supra* note 147, at 177–287, 473–514; GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS (1970); Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

187. SHAVELL, FOUNDATIONS, *supra* note 147, at 482–83. The theory adopts the standard neoclassical assumption of complete and perfect rationality by actors, and the claim above regarding optimal deterrence applies to the risk-neutral wrongdoer. Because actors vary in their tolerance, they will not be equally deterred by different combinations of probability and magnitude of sanction with the same expected value. *Id.* at 479–83. The risk-averse actor, one whose experience of disutility resulting from sanctions increases out of proportion to its size, will be more deterred by a combination with a higher sanction than one with a lower sanction but the same expected value. *Id.* The reverse is true of the risk-lover. *Id.*

188. *See* Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 144, 155 (Alon Harel & Keith N. Hylton eds., 2012).

189. CALABRESI, *supra* note 186, at 26; *see also* SHAVELL, ACCIDENT LAW, *supra* note 186, at 1–3.

190. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 178.

analogy is strongest with unilateral accidents—accidents in which only injurers' behavior, and not victims' behavior, influences accident risks.[191] Like injurers involved in unilateral accidents, M&A advisors may impose harm on outside actors (their clients) who do not realistically influence the risk of the harm.[192] The harm here is that caused by disloyalty. Not all conflicts cause harm,[193] of course, thus the wrong does not include all conflicts, whether real or apparent.[194] Instead, it comprises real conflicts, those resulting in disloyalty. The analogy with accidents is broadly supported by legal doctrine, which regards disloyalty (or, more specifically, breach of fiduciary duty) as a tort.[195]

In assessing liability rules for their deterrent effect, it is useful to disaggregate the corporation into its core constituencies: a board of directors and a body of shareholders. Doing so illustrates the possible private enforcement actions that may serve to sanction M&A advisor disloyalty. These actions are shown in Figure 1, which also depicts the tripartite relationship that forms when an M&A advisor is engaged for advice. Disaggregating the corporation in this way also recognizes the distinct role directors perform in M&A transactions, both in engaging M&A advisors and potentially in monitoring and influencing their conduct during a deal. In taking this approach, the analysis treats shareholders' interests as equivalent to those of the corporate enterprise, thereby addressing the analytic difficulty in removing the client enterprise from analysis when it is, according to the analysis in Part I, the party to which the fiduciary duties should be owed.[196]

191. *Id.* at 178–82.

192. The question whether victims may protect their interests by "pricing for disloyalty" is distinct from whether the accident or wrong is rightly characterized as unilateral or bilateral. For consideration of the former issue, see *supra* section I(E)(1). *See also infra* notes 212–14 and accompanying text.

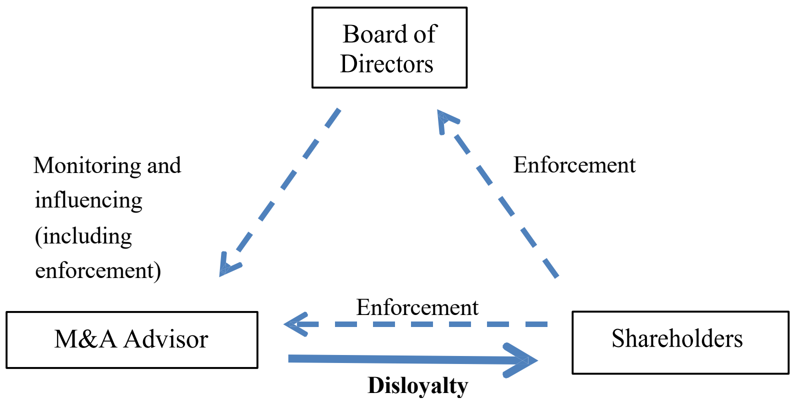
193. *See supra* notes 72–74 and accompanying text.

194. *See supra* subpart I(B) (defining conflicts of interest, real conflicts of interest, and apparent conflicts of interest).

195. *See* RESTATEMENT (SECOND) OF TORTS § 874 (AM. LAW INST. 1977).

196. This framework focuses attention on the potential roles performed by the primary actors able to constrain M&A advisors' conflicts of interest, namely directors and shareholders. It is admittedly narrow since, among other things, it overlooks other actors, including creditors, as well as the separate existence of the corporate "entity." See ERIC W. ORTS, BUSINESS PERSONS: A LEGAL THEORY OF THE FIRM 25–51, 62–71 (2013), for more complete account of the nature of business corporations, including a critique of conceptions that overlook the corporation as a distinct entity. The depiction here is consistent with conceiving of corporations as simply one form of "legal fiction[] which serve[s] as a nexus for . . . contracting relationships" to the extent that account focuses on actors associated with the corporation. Jensen & Meckling, *supra* note 131, at 310 (emphasis omitted). However, this Article rejects the view that relations among these actors are governed exclusively by contracts and thus also rejects an exclusively contractual—or contractarian—understanding of fiduciary duties. See *supra* notes 125–45 and accompanying text for conceptions of fiduciary duties adopted in this Article.

Figure 1: Potential private enforcement actions to deter M&A advisor disloyalty



It is useful to examine more closely the strength of the analogy with unilateral accidents. Recall the analogy between M&A advisors and injurers.[197] In important respects, an analogy also exists between, on the one hand, shareholders and, on the other hand, accident victims who are strangers to injurers (as opposed to accident victims who are customers of injurers).[198] The distinction between strangers and customers is noteworthy because treating shareholders as analogous to customers, and more specifically as customers able to accurately perceive the risks of disloyalty for individual M&A advisors, would produce important theoretical conclusions. In particular, liability rules would be unnecessary for accidents involving customers because market forces alone would lead injurers to act desirably.[199] However, shareholders are more akin to strangers than to customers. First, unlike customers, shareholders rarely, if ever, have contractual dealings with M&A advisors; instead, corporate directors (or their representatives) engage M&A advisors for service.[200] Second, little evidence indicates that

197. *See supra* notes 191–92 and accompanying text (discussing the unilateral-accidents analogy).

198. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 208–23.

199. Even in the absence of liability rules, clients will be able to pay less or go elsewhere in response to the perceived risks posed to customers. *See id.* at 212–14. If clients' perception of risks is imperfect, M&A advisors will not be led to act desirably in the absence of liability rules. Generally speaking, strict liability rules will lead clients to make appropriate decisions to purchase the relevant product or service, or not. *See id.* at 214–15. For more detailed discussion, see *supra* section I(E)(1). That discussion examined whether corporate clients—rather than shareholders—are able to accurately perceive the risks of investment banking disloyalty. In this Part, the corporate client is disaggregated, which suggests now that the victim is more appropriately treated as a stranger rather than as a client or customer.

200. In doing so, however, corporate directors act on behalf of the client corporation; they contract in the name of the corporation rather than in their personal capacities.

shareholders can accurately perceive the risks of disloyalty for individual advisors.[201] This analysis suggests the need for liability to induce M&A advisors, as injurers, to act desirably.

Nevertheless, certain factors complicate the analogy with unilateral accidents involving strangers. Unlike strangers, shareholders have relationships with other actors (directors) who do have contractual dealings with M&A advisors. If shareholders can shape how directors contract with M&A advisors, and thereby influence the risk of harm posed by these advisors, we might reject the analogy with unilateral accidents involving strangers or even reject the analogy with unilateral accidents altogether.[202] Shareholders might exert such influence over directors through charter and bylaw provisions. This complication relates to debates concerning state "competition" for incorporation in which scholars dispute whether shareholders can and do appoint directors under "optimal" contractual terms.[203] In these debates, those asserting the optimality of contracts point to directors' incentives to offer optimal charter and bylaw terms in order to maximize the price at which their shares sell to investors.[204] Opponents question these incentives, arguing that informational imperfections and externalities prevent shareholders from assuring that directors will choose optimal charter and bylaw terms and, furthermore, that no such hypothetical contracting mechanism exists at the midstream charter amendment stage.[205] In the M&A advisory context, there is real doubt as to whether shareholders have reliable information on the risks posed by M&A advisors and, even if they do, whether they would be willing

201. But even if shareholders are not strangers, and instead are akin to clients of injurers, the analysis in section I(E)(1) shows why market forces without liability rules would fail to force M&A advisors to act desirably. Though section I(E)(1) discusses the ability of *M&A clients* to perceive the risks of advisor disloyalty (because that discussion does not disaggregate the client corporation), it applies with equal or greater force to shareholders since shareholders are likely to have weaker perceptive capacity than directors (acting for M&A clients), because shareholders have no direct dealings with M&A advisors.

202. If senior executives, rather than directors, engage an M&A advisor for advice, they will do so under the direction and control of directors.

203. For discussion, see, for example, Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1825 (1989) (arguing that informational imperfections and externalities hinder the production of a corporate contract); Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1396 (1989) [hereinafter Bebchuk, *Debate*] (describing the debates over contractual freedom in the charter amendment stage and in the initial charter).

204. That is, the price for which shares initially sell will reflect the provisions of the initial contract between directors and shareholders. Efficient or optimal terms will be chosen in that contract since any inefficient term will be reflected in the price at which the shares sell. For a description of the argument, see Bebchuk, *Debate*, *supra* note 203, at 1404–08.

205. *Id.* at 1403–08.

to act on that information.[206] Having noted these potential limitations, this Part proceeds to apply optimal deterrence theory to assess how well certain liability rules would deter M&A advisor disloyalty.[207]

B. Liability of M&A Advisors: A Simple Regime

Under a simple regime, M&A advisors (the injurers) face liability for acting disloyally toward shareholders. As discussed above, disloyalty here refers not to M&A advisors' conflicts generally, but instead to their real conflicts—those that cause net harm to clients. In practice, a rule imposing liability on M&A advisors for disloyalty towards their clients would find expression in a fiduciary duty requiring them to act loyally in the absence of

206. *See* Alan O. Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231, 1257 (1984) (observing that voluntary creditors—analogous to shareholders in this context—may not have a relevant source of information about the risks posed by potential wrongdoers or may choose to ignore such information).

207. Other factors potentially complicate the strength of the analogy with unilateral accidents. One concerns the remedy for breach of fiduciary duty, which may be set to strip the fiduciary of its gain, rather than set equal to the social loss. Optimal deterrence theory, however, posits that the remedy for wrongdoing should equal the social harm. The extent, and thus the significance of this distinction, is uncertain. This is because remedies for breach of fiduciary duties vary widely; since breach of fiduciary duty is a tort, remedies include damages calculated on a tort basis. *See* RESTATEMENT (SECOND) OF TORTS § 874 cmt. B (AM. LAW INST. 1977) (discussing the various remedies associated with a breach of fiduciary duty). See DeMott, *supra* note 126, at 927–31, for a discussion of the remedial consequences of a violation of fiduciary duty. Moreover, even if a fiduciary remedy is calculated on a gain-stripping basis, it is uncertain precisely how that measure compares with a remedy set equal to social loss; there is little reason to regard one as systematically more or less than the other. Despite these limitations, deterrence theory helps organize thinking of how various legal rules influence the incentives of potential wrongdoers and may thereby deter wrongs.

informed client consent.[208] A simple regime would impose potential liability on M&A advisors only, rather than also on corporate directors.[209]

According to the framework developed above, an M&A advisor would be effectively deterred from acting disloyally toward a client's shareholders if it expected to face liability equal to the social cost of the harm its disloyalty imposed on shareholders. As Steven Shavell has demonstrated for unilateral accidents, both strict liability and fault-based liability would achieve this result, since both rules would lead an injurer to take precautions to minimize the total social costs it created.[210] Only strict liability, however, would also lead an injurer to engage in desirable activity levels, by forcing it to weigh the total social costs of increasingly engaging in the activity.[211] Since the simple regime contemplated here would hold an M&A advisor liable for disloyalty irrespective of its efforts to minimize the risk of disloyalty (that is, regardless of its fault), it would seem to hold much promise in deterring an M&A advisor's disloyalty.

Now consider obstacles this simple regime would confront. As a doctrinal matter, the fiduciary duty envisaged here—one *enforced* by shareholders—might be a duty *owed to* shareholders directly or to the corporate enterprise itself. Consider first a duty owed to shareholders directly. Such a

208. Compare the rules or duties described above: a rule holding an M&A advisor liable for disloyalty toward its client and a fiduciary duty requiring loyalty (or forbidding conflicts of interest) in the absence of a client's informed consent. The former rule is suggested by the framework for analysis above (which analogizes an M&A advisor's disloyalty with injurer harm in a unilateral accident). The latter rule, encompassing conventional formulations of the fiduciary duty of loyalty, is suggested by the analysis in Part I. *See supra* notes 125–37 and accompanying text (discussing various views with respect to the fiduciary duty of loyalty). These rules are generally equivalent if a client consents only to apparent conflicts, that is, to those conflicts that cause no net client harm; the fiduciary duty then effectively forbids only conflicts causing client harm, that is, it forbids disloyalty. *See supra* notes 72–73 and accompanying text (explaining why some conflicts may not cause harm). However, this equivalence breaks down in either or both of two cases: first, if a client consents to a conflict that causes harm; and second, if a client fails to consent to a conflict that causes no harm. The former case may reflect agency costs on the part of those consenting for the client. The latter reflects the cautious approach adopted by fiduciary doctrine, which recognizes the difficulty and occasional impossibility of determining whether a conflict creates harm (compromised advice is virtually impossible to detect, especially if accompanied by assurances by the fiduciary to the contrary) and thus bans conflicts whether real or apparent, relieving the fiduciary of even temptations for disloyalty. Nevertheless, to simplify the analysis the two rules or duties described in the text above are treated as equivalent.

209. Shareholder-initiated suits might be direct actions under which shareholders are seeking to enforce fiduciary duties directly owed to shareholders themselves; to enforce duties as third party beneficiaries under contracts entered into by their corporations; or to enforce duties owed to corporations in derivative actions.

210. SHAVELL, FOUNDATIONS, *supra* note 147, at 179–81.

211. *Id.* at 194–98. The goal of optimizing activity levels would seem less relevant in the M&A advisory context where transactions are undertaken by most companies relatively rarely and it is not obvious that even the most acquisitive companies significantly increase the risk of disloyalty by M&A advisors by engaging in the number of transactions they do.

duty has not been recognized at law or in equity, at least not in Delaware;[212] its imposition might thus undermine the coherence of the law. Such a duty would also face practical difficulties: by itself, it would provide no practical means for shareholders to receive full information about conflicts and to consent to them in the midst of a deal. A mechanism for consent to conflicts is important because, as classically articulated, the fiduciary duty requires loyalty in the absence of informed client consent.[213] Yet to require consent from shareholders during a deal is to risk disclosing otherwise nonpublic deal talks and potentially to fall victim to the collective action problems that afflict shareholders. Consent might instead be given by directors, or those under their authority, but then the effectiveness of the simple regime would hinge on directors' conduct; were they too willing to acquiesce to an M&A advisor's request for consent, they would undermine the protection the regime offered shareholders. Additionally, a duty owed to shareholders directly is potentially vulnerable to contractual variation by directors.[214] Accordingly,

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212. *See* Joyce v. Morgan Stanley & Co., 538 F.3d 797, 801–02 (7th Cir. 2008) (rejecting a claim that an M&A advisor owed a fiduciary duty to shareholders of its corporate client where the engagement letter stated that the M&A advisor was working only for the client); *In re* Shoe-Town, Inc. Stockholders Litig., No. 9483, 1990 WL 13475, at *6–7 (Del. Ch. Feb. 12, 1990) (finding that an M&A advisor engaged by management to provide a fairness opinion for the challenged transaction owed no fiduciary duty to shareholders); Young v. Goldman Sachs & Co., No. 08 CH 28542, 2009 WL 247626 (Ill. Cir. Ct. Jan. 13, 2009) (finding that an M&A advisor owed no fiduciary duties to the shareholders of its corporate client); Bratton & Wachter, *supra* note 13, at 33 (concluding that "[u]nder Delaware's default rule, bankers owe no duties to shareholders and shareholders accordingly have no direct action against a banker"). *But see* Baker v. Goldman Sachs & Co., 656 F. Supp. 2d 226, 236–37 (D. Mass. 2009) (finding sufficient facts to support the existence of a fiduciary relationship between an M&A advisor and shareholders of its corporate client where the shareholders "were the central players in the transaction, not mere bystanders as in the typical shareholder suit").

213. *See supra* notes 144–45 and accompanying text.

214. Although detailed examination is outside the scope of this Article, the better view is that provisions purporting to disclaim the existence of a fiduciary relationship may fail to have that effect. Rather, the question whether a fiduciary relationship exists depends on the presence or not of indicia of such relationships. Because the "ongoing conduct between parties may give rise to a fiduciary relationship," courts will examine factors other than the parties' contract, including postcontractual dealings between the parties. Wiener v. Lazard Freres & Co., 672 N.Y.S.2d 8, 14 (N.Y. App. Div. 1998). In the case of agency relationships specifically, the *Restatement (Third) of Agency* asserts that "[a]n agency relationship arises only when the elements stated in § 1.01 are present" and further that "[w]hether a relationship is characterized as agency in an agreement between parties . . . is not controlling." RESTATEMENT (THIRD) OF AGENCY § 1.02 (AM. LAW INST. 2005). It logically follows that the express disclaimer of an agency relationship by parties is not controlling. For further discussion of the effect of parties' own characterization of their relationship on the existence of an agency relationship, see generally Tuch, *Disclaiming Loyalty*, *supra* note 13, at 216–21; Deborah A Demott, *Defining Agency and Its Scope (II)*, *in* COMPARATIVE CONTRACT LAW: BRITISH AND AMERICAN PERSPECTIVES 396 (Larry A Dimatteo & Martin Hogg eds., 2016). A related question concerns the effect of such disclaimers when agency law is not the basis of any fiduciary duties that arise. Even outside the agency context, it is also far from certain that a fiduciary disclaimer would be effective to prevent fiduciary duties from arising. *See, e.g.*, Ha-Lo Indus., Inc. v. Credit Suisse First Bos., Corp., No. 04 C 3163, 2005 WL 2592495, at *5–6 (N.D. Ill. Oct. 12, 2005) (denying a motion for summary judgment that argued that a clause in an engagement letter disclaiming a fiduciary duty between a bank and its M&A client prevented the bank from owing

the deterrent effect of a fiduciary duty owed to shareholders would potentially hinge, in practice, on the conduct of directors.

A fiduciary duty may also be owed to the corporate client. This duty might be enforced by shareholders suing derivatively on the company's behalf.[215] While this duty is doctrinally sound,[216] its deterrent force also hinges on directors' conduct, since directors exert significant influence over the derivative suit, severely restricting shareholders' ability to use this device.[217]

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fiduciary duties to its client). The notion that attempts to contractually exclude or limit liability may be ineffective is not unique to fiduciary law. Under New York law, for instance, attempts by sophisticated commercial parties to limit liability for gross negligence are ineffective. *See* Colnaghi, U.S.A., Ltd. v. Jewelers Prot. Servs., 611 N.E.2d 282, 283–84 (1993) ("Public policy . . . forbids a party's attempt to escape liability, through a contractual clause, for damages occasioned by 'grossly negligent conduct.'"); *supra* note 137 and accompanying text.

215. Shareholders might also bring enforcement action as third-party beneficiaries of a contract between an M&A advisor and its corporate client, although the weight of authority stands against these actions except in exceptional circumstances. *Compare Young*, 2009 WL 247626 (rejecting the claim that shareholders of an M&A advisor's corporate client were third-party beneficiaries of the client and asserting that "[a]ny duty on the part of [the M&A advisor] ran to the corporation, not to the individual stockholders"), *with Baker*, 656 F. Supp. 2d at 234–35 (finding that a shareholder of an M&A advisor's corporate client was a third-party beneficiary of an engagement letter where *express terms* of the letter showed a clear intent to benefit that shareholder).

216. The analysis in Part I supports a fiduciary duty owed by M&A advisors to the corporate entity (the client), rather than to shareholders. Such a duty is consonant with legal doctrine. *See, e.g.*, *In re* Daisy Sys. Corp., 97 F.3d 1171, 1178 (9th Cir. 1996) (rejecting an M&A advisor's claim that "the relationship between an investment banker and the banker's [corporate] client is not a fiduciary relationship as a matter of law," treating that relationship as depending on the facts and circumstances at issue, and finding that a fiduciary relationship may have existed between the M&A advisor and its client); Am. Tissue, Inc. v. Donaldson, Lufkin & Jenrette Sec. Corp., 351 F. Supp. 2d 79, 102 (S.D.N.Y. 2004) (stating that the relationship between an M&A advisor and its corporate client may be fiduciary even where no formal agency relationship exists, observing that New York courts have found such relationships to be fiduciary, and finding that the M&A advisor in question "owed a fiduciary duty to [its corporate client] in its capacities as investment banker and financial advisor"); Official Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Sec. Corp., No. 00 Civ. 8688(WHP), 2002 WL 362794, at *9 (S.D.N.Y. Mar. 6, 2002) (finding sufficient facts to support the existence of a fiduciary relationship between an M&A advisor and its corporate client); Gen. Acquisition, Inc. v. GenCorp Inc., 766 F. Supp. 1460, 1473 (S.D. Ohio 1990) (finding sufficient facts to show that an M&A advisor was an agent of its corporate client with respect to a proposed acquisition and to support the imposition of a de facto fiduciary duty on the M&A advisor for the benefit of that client); Frydman & Co. v. Credit Suisse First Bos. Corp., 708 N.Y.S.2d 77, 79 (N.Y. App. Div. 2000) (reversing dismissal of breach of fiduciary duty claim by a corporate client against its M&A advisor).

217. *See generally* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 46–47 (2004). In particular, directors may decline to pursue any "demand" for suit by shareholders, a decision courts will respect provided the board's decision was not wrongful. Zapata Corp. v. Maldonado, 430 A.2d 779, 783 (Del. 1981). If shareholders succeed in claiming that "demand" was "excused," which is no easy task, the board may establish a special litigation committee of independent directors to examine whether to continue the matter; courts will defer to the committee's decision provided certain procedural criteria are met, although courts reserve discretion to second-guess the committee's decision. *Id.* at 788–89.

Directors rarely enforce fiduciary duties against their M&A advisors, despite legal doctrine suggesting the fiduciary character of the M&A advisor's role.[218] This is a remarkable feature of banker–client relations given the risk of M&A advisor conflicts created by banks' organizational structures.[219] Directors have been known to give informed consent to advisor conflicts during deals, even in the absence of any apparent corporate benefit of doing so.[220] And directors execute engagement letters with M&A advisors that purport to disclaim fiduciary duties altogether, whether owed to shareholders directly or to the corporate client, and otherwise limit advisors' liability for conflicts.[221] Although the legal effect of these provisions remains contested,[222] they attempt to reduce directors' and shareholders' capacity to hold M&A advisors accountable for disloyalty to the extent possible. To the degree they do, they also weaken market forces, including potential damage to M&A advisors' reputations, since market forces operate most effectively when disloyalty is established, rather than when it is simply alleged or suspected.

The reasons for directors' permissive approach toward M&A advisors are complex but also fundamental to understanding the likely deterrent force of regimes that hinge on directors' conduct. The interests of senior managers naturally diverge from those of shareholders,[223] a divergence that is likely more pronounced in the M&A context than in others, because these deals threaten senior managers with removal from office.[224] This divergence is one

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218. Many of these cases were brought by Chapter 11 trustees or bankruptcy debtors-in-possession. *See supra* note 216.

219. *See supra* subpart I(B).

220. *See, e.g.*, *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 825–26 (Del. Ch. 2011) (criticizing directors' decision to permit an M&A advisor to provide buy-side financing).

221. *See supra* note 79. As to the likely effect of fiduciary disclaimers, *see supra* note 214. As to the relevance of disclaimers to characterizing M&A advisors as fiduciaries, see *supra* notes 156–58.

222. *See supra* note 214.

223. As to this divergence of interests, see ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 119–25 (1932) (explaining the divergence of interests between corporate management and widely dispersed shareholders). For important recent contributions and assessments of strands of the literature, see generally William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737 (2001); Jennifer G. Hill, *Then and Now: Professor Berle and the Unpredictable Shareholder*, 33 SEATTLE U. L. REV. 1005 (2010). Even though the corporate shareholder base is more concentrated as the result of institutional ownership of securities, agency costs continue to exist between corporate managers and shareholders. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 864–65 (2013) (questioning the canonical Berle–Means account of dispersed share ownership and describing the rise of concentrated institutional share ownership).

224. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (referring to "the omnipresent specter that a board [of directors] may be acting primarily in its own interests, rather than those of the corporation and its shareholders"); *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 439 (Del. Ch. 2012) ("[T]he potential sale of a corporation has enormous implications

that major investment banks have exacerbated in various contexts, including by offering opportunities to managers in their personal capacities to gain favor with them.[225] Outside directors may fail to effectively control this divergence of interests because senior managers—who typically appoint M&A advisors—dominate the boards of many publicly held companies.[226] As Professors Lucian Bebchuk and Jesse Fried have argued, directors have a host of financial and nonfinancial incentives to favor senior managers, including the desire to bolster directors' prospects for renomination to the board, over which chief executive officers typically exert strong influence.[227] The "genteel pressures of camaraderie and community between [directors] and officers" also play a role.[228] In the M&A context, managers' power and influence over directors is manifested in the gratuitous payments—approved by directors—and acquirer-paid sweeteners that target-company managers often receive when their corporations are acquired.[229]

Directors may also avoid holding M&A advisors to account when to do so would cast their own performance in a negative light, revealing their oversight weaknesses and exposing them to reputational damage or potential liability.[230] It is also conceivable that many directors simply trust their investment bankers—perhaps the result of bankers' efforts to cultivate trust[231]—and thus are not as skeptical of bankers' conduct as they otherwise might be.

Other forces may also explain M&A advisors' limited accountability for conflicts. First, buyers may be reluctant to pursue past wrongs to target companies. Commentators explain that

> [i]f a transaction fails [to close], it is hard to envision damages [for M&A advisors' conflicts]; if a transaction succeeds, it is similarly difficult to envision the successor counterparty to the engagement

for corporate managers and advisors, and a range of human motivations, including but by no means limited to greed, can inspire fiduciaries and their advisors to be less than faithful . . . .").

225. *See supra* notes 164–66 and accompanying text.

226. *See* BEBCHUK & FRIED, *supra* note 217, at 23–44 (arguing that directors have financial and other incentives to favor senior managers, giving rise to managerial power over directors).

227. *Id.*

228. John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35, 66 (2014) ("[Directors] face more genteel pressures of camaraderie and community between themselves and officers, which may have a subtly corrosive effect on their ability to monitor and exert oversight."); *see also* BEBCHUK & FRIED, *supra* note 217, at 31–34 (discussing social and psychological factors leading directors to favor senior managers).

229. *See* BEBCHUK & FRIED, *supra* note 217, at 89–92.

230. When directors are misled by the self-interested conduct of their M&A advisors, directors may be found to have breached their own fiduciary duties to the corporations they manage. *See infra* subpart III(A).

231. *See* Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CALIF. L. REV. 627, 671–76 (1996) (arguing that institutional customers may trust their broker–dealers, justifying the imposition of heightened standards of conduct on broker–dealers).

> letter (i.e., the acquirer who likely would have benefited from the conflict) going after the [M&A] advisor for breach of contract.[232]

Second, a proposed deal may be better than no deal, even if it is compromised by M&A advisor disloyalty and thus not as good as it might be.[233] Target company directors would then have little incentive to hold their M&A advisors to account since doing so may undermine the deal, potentially scaring off the buyer, and may reflect unfavorably on the directors' own performance.

Some commentators suggest that directors have few practical options when they discover disloyalty by an M&A advisor. The "most practical action" will be to "hire a new financial advisor."[234] If that course is infeasible—and one could imagine many reasons it might be, including the danger of undermining the deal or having inadequate time to acquaint a new advisor with the transaction—directors' most practical course, according to these commentators, will be to take no action at all and simply "swallow the risk."[235] Here, that risk is client harm.

Rigidities in the legal services market may also contribute to directors' reluctance to hold M&A advisors accountable. The legal counsel to which directors turn for M&A advice are often also the most active legal advisors to M&A advisors. (M&A advisors, like their clients, retain law firms for advice on deals.) Law firms rarely, if ever, simultaneously counsel a deal principal and its M&A advisor in a single transaction. Nevertheless, when M&A advisor disloyalty is suspected or established, law firms' strong links to M&A advisors create incentives for them to advise principals (their clients) against formal enforcement (through lawsuits) and in favor of less confrontational approaches.[236] Even legal advisors that do not counsel M&A

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232. Eric S. Klinger-Wilensky & Nathan P. Emeritz, *Financial Advisor Engagement Letters: Post*-Rural/Metro *Thoughts and Observations*, 71 BUS. LAW. 53, 56 (2015).

233. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 450–51 (Del. Ch. 2012) ("The negotiation process and deal dance present ample opportunities for insiders to forge deals that, while 'good' for stockholders, are not 'as good' as they could have been . . . ."). In effect, the presence of a conflicted advisor may be "bundled" with a desirable deal and presented to shareholders on a take-it-or-leave-it basis, making it rational for shareholders to accept the deal, even where they would not otherwise approve of the advisor's conduct. *See generally* Brian Broughman, *CEO Side-Payments in Mergers and Acquisitions* (Ind. Univ. Legal Studies Research Paper No. 313, 2016), http://ssrn.com/abstract=2584699 [https://perma.cc/GZL7-KQ69] (proposing a theory of bundling to explain rent extraction by CEOs through merger side payments).

234. Klinger-Wilensky & Emeritz, *supra* note 232, at 71–72.

235. *Id.* at 72 ("At that time [when negotiating an acquisition agreement at the end of the process], it may not be feasible to hire a new financial advisor and, despite the frustration, the client may have to swallow the risk.").

236. In 2014, among the top-ten-ranked legal advisors to M&A principals, seven firms were also highly active in representing M&A advisors. For example, in 2014 Sullivan & Cromwell LLP reportedly advised M&A principals on fifty-four deals valued collectively at $295 billion and also advised M&A advisors on twenty-seven deals valued at $175 billion. *2015 Corporate Scorecard*, AM. LAW. (Mar. 30, 2015), http://www.americanlawyer.com/home/id=1395154455727/2015-Corporate-Scorecard-?mcode=1202615710885&curindex=1 [http://perma.cc/67QS-KPTM]

advisors on deals will typically counsel investment banks in a wide range of other matters, creating similar incentives against robust enforcement of M&A advisor disloyalty. Rigidities in the investment banking market, which gives rise to relatively few expert M&A advisors, may also deter clients from challenging them, although this possibility is difficult to confirm.

The upshot: once we recognize the role of directors and the nature of M&A deals, obstacles to effective deterrence of advisor conflicts become apparent. A simple regime permitting shareholders to enforce fiduciary duties against M&A advisors would hinge ultimately on directors' own conduct, and multiple factors undermine the incentives and practicality of directors holding M&A advisors to account for disloyalty.

Of course, one might address this low probability of sanction by ratcheting up the magnitude of sanctions on M&A advisors for disloyalty, thereby potentially offsetting the risk of them escaping suit.[237] While justified by optimal deterrence theory, the magnitude of sanctions for M&A advisors in private suits is practically limited because traditional remedies for breach of fiduciary duty provide no real scope for increasing damages to compensate for a low probability of sanction. Notions of fairness requiring sanctions in proportion to the relevant wrongdoing may also undermine the possibility of ratcheting up sanctions.[238] Moreover, in theory at least, increasing sanctions raises the prospect that the wrongdoer will simply have insufficient assets to satisfy the sanctions imposed.[239]

It is no answer to these concerns about a simple regime to suggest stripping directors of their power to consent to conflicts or banning them from relieving M&A advisors of fiduciary liability. The mechanism of informed consent, in particular, is central to fiduciary doctrine.[240] Yet to give consent, a client must act through its representatives, both because giving them decision rights helps address the collective action problems shareholders would face in consenting to conflicts and because directors are likely to be better placed than shareholders to determine which conflicts may benefit the client (and should thus be permitted).

(ranking law firms under the separate categories of "M&A: Principal Representations" and "M&A: Financial Adviser Representations").

237. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 230, 244 (suggesting that damages be increased above expected losses to restore appropriate incentives for injurers where injurers are likely to escape suit).

238. *See id.* at 483 ("[T]here may be resistance to inflating sanctions on grounds of fairness; the notion that the magnitude of sanctions should be proportional to the gravity of a bad act is a widely held notion of fairness . . . .").

239. *See id.* at 484 (discussing the effects of the wealth of actors facing sanctions).

240. This mechanism is also desirable because it recognizes that not all conflicts harm clients. For further discussion, see *supra* notes 72–73 and accompanying text.

C. *Liability of Corporate Directors*

Other private enforcement measures are available to deter M&A advisor disloyalty, as depicted in Figure 1. Deterrence theory conventionally looks first to the possibility of ratcheting up sanctions—a possibility dismissed above.[241] Under certain conditions, it also looks to imposing liability on actors other than injurers. It often does so in relationships between an economic principal and agent where the principal has the capacity to monitor and influence the agent's conduct.[242] The archetypical relationship is that between a firm, or enterprise, and its employee. Such liability is often referred to as enterprise liability or, when liability is strict rather than fault-based, as vicarious liability. In the current context, directors are obvious targets of liability because of their potential capacity to monitor and influence M&A advisor disloyalty, such as by specifying the terms of engagement and by taking action against deviant behavior.

Consider the conventional justifications, or basic conditions, for imposing liability on an ecomonic principal (here, the board of directors) for wrongs of its economic agent (here, the M&A advisor).[243] First, a simple liability regime (one imposing liability only on the agent) must give the agent inadequate incentives to act loyally and thus ineffectively deter wrongdoing.[244] This condition is typically satisfied when the agent has insufficient assets to pay for prospective liability and is therefore judgment proof.[245]

Second, the principal must have the capacity to monitor and influence the agent's conduct, a condition often satisfied by enterprises whose relationship with agents is that of employment.[246] By monitoring and influencing the agent's conduct, the principal may deter wrongdoing, decreasing its own

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241. *See supra* note 237–39 and accompanying text.

242. As to this literature, see generally SHAVELL, FOUNDATIONS, *supra* note 147, at 207–14; Arlen, *supra* note 188, at 154; Shavell, *Strict Liability*, *supra* note 147, at 1, 5, 16–17.

243. *See, e.g.*, SHAVELL, FOUNDATIONS, *supra* note 147, at 233–36 (examining vicarious liability); Reinier H. Kraakman, *Vicarious and Corporate Civil Liability*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS: TORT LAW AND ECONOMICS 134, 134–36 (Micahel Faure ed., 2d ed. 2009). An additional condition is that the agent and principal must not be able to costlessly shift liability between themselves by agreement—a condition reflecting the Coasian insight that voluntarily bargaining parties will reach a mutually beneficial—and thus, efficient—agreement where the opportunity exists for them to do so, provided their legal rights are well-defined. If the parties may costlessly shift liability, they could bargain to an efficient result without the need for a rule imposing liability on the principal. *See* Sykes, *supra* note 206, at 1240 & n.29 (examining the Coase theorem in the context of vicarious liability). Though directors do bargain with M&A advisors over the terms of engagement letters, they do so on behalf of the corporate client, not in their personal capacities. Existing market practices may therefore impede the parties from bargaining to reach a mutually beneficial agreement.

244. Enterprise liability (or, more specifically, vicarious liability) is cited as a solution to the agent's inadequate incentives to reduce risk. *See, e.g.*, SHAVELL, FOUNDATIONS, *supra* note 147, at 231–32.

245. *See, e.g.*, *id.* at 230–32.

246. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 233.

potential liability.[247] Third, and finally, the principal must not have diluted or inadequate incentives, but rather must have the resources to meet any prospective liability;[248] otherwise, imposing liability on it may not lead it to desirably monitor and influence the agent's conduct.

While these conditions are not satisfied in the conventional way in the M&A advisory context, they may nevertheless be plausibly established. The simple liability regime underdeters M&A advisor disloyalty (satisfying the first condition),[249] but the reason relates to the obstacles to enforcement discussed above, rather than to M&A advisors' asset insufficiency. M&A advisors do not realistically face wealth constraints, a factor typically militating against imposing enterprise liability.[250] Nevertheless, while the asset insufficiency problem is distinguishable from the obstacles discussed here, they are analytically identical in a critical respect: both dull the incentives of injurers to act desirably, leaving wrongs underdeterred.[251] Moreover, the measure typically used to address a low probability of sanction—increasing the magnitude of the sanction—is not reasonably available here, providing an opening for enterprise liability.

As for the second condition, directors' capacity to monitor and influence M&A advisors' conduct during a deal is surely more limited than that of many employers, especially employers of lower-level employees whose conduct can be closely monitored and controlled. As discussed in subpart I(D), many directors lack expertise and experience in M&A deals *relative to* M&A advisors, limiting their ability to judge the merits of their advisors' advice and other conduct. They delegate discretion to their M&A advisors, tasking them with acting on the enterprise's behalf. Directors lack full control over their M&A advisors and cannot monitor so actively as to render fiduciary duties unnecessary. But can they nevertheless monitor and influence M&A advisors' conduct sufficiently to justify imposing liability on directors for

247. *See id.* at 233–36; Kraakman, *supra* note 243, at 135–37.

248. *See* Kraakman, *supra* note 243, at 135 (discussing vicarious liability and treating the principal as able to satisfy any prospective liability); *see also* SHAVELL, FOUNDATIONS, *supra* note 147, at 532 ("Deterrence works . . . only when the sanctions can actually be applied. (If the person is judgment proof and the sanction is monetary, the sanction cannot be applied . . . .)").

249. *See supra* subpart II(B).

250. *See* Kraakman, *supra* note 243, at 137–38 (discussing factors militating against vicarious liability).

251. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 230–31 (describing injurers' asset insufficiency as dulling their incentives to reduce risk); Kraakman, *supra* note 243, at 135–36 (explaining the incentives created by the presence or absence of a vicarious liability regime); Sykes, *supra* note 206, at 1239–41 (discussing the effects of personal and vicarious liability on the behavior of principals and agents). As to the possibility that tortfeasors' damages would be increased to offset the risk of them escaping suit, see *supra* notes 237–39 and accompanying text.

advisor conflicts? Critically, imposing liability on secondary actors is premised on them having some capacity to influence primary actors, rather than having complete control over those actors.[252]

Directors may monitor and influence their M&A advisors in limited but notable respects. In examining the directors' ability to monitor M&A advisors during a deal, it is useful to draw a distinction suggested by Professors Jennifer Arlen and Reinier Kraakman in the context of corporate crime.[253] In so doing, we see that directors may employ various measures to monitor and influence—or to police—and may do so either before or after they discover any wrongdoing by their M&A advisors.[254] Beforehand, directors may set clear expectations of loyalty, for example by ensuring engagement letters reflect the expected standards of loyalty. The importance of this measure cannot be overstated given the capacity of directors to undermine the fiduciary protections available to shareholders. During a deal, they may be alert to factors potentially skewing an advisor's incentives and probe any suspected disloyalty. Before giving informed consent to a conflict, they may understand the attendant risks and benefits and narrowly tailor any consent to minimize possible harm.

If they learn of or suspect disloyalty, directors may use other measures. They may investigate M&A advisors, with help from independent counsel if necessary. They may hold M&A advisors accountable for disloyalty, including for any disloyalty beyond the scope of informed consent directors have given. These various measures require directors to act somewhat skeptically toward their M&A advisors, rather than blindly trusting them or unquestioningly acquiescing to their requests. Though limited and falling short of full control, these *ex ante* and *ex post* measures (that is, policing efforts both before and after the discovery of any disloyalty) may deter disloyalty, suggesting the desirability of imposing liability on directors to create incentives for them to use these measures.

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252. The better able principals are to monitor and influence an agent's conduct, the more attractive enterprise liability becomes, but even limited monitoring can deter disloyalty. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 234 ("The advantage [of vicarious liability] will . . . be greater the better able the principal is to control the agent's behavior."); Kraakman, *supra* note 243, at 135 ("[T]he likely efficiency of vicarious liability increases with the ability of principals to monitor and control agent risk-taking.").

253. *See* Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 706–07 (1997) (discussing the effects of corporate policing measures).

254. *Id.* Policing measures are practical techniques that increase the probability of detection and sanction. *See* Arlen, *supra* note 188, at 165–66 (describing corporate policing measures). Professor Arlen also refers to prevention measures, which are measures economic principals may use to lower the expected benefits of wrongdoing. These measures are apposite in the employer–employee context since employers "directly influence the degree to which their employees can expect to benefit from crime" through their employment policies. *Id.* at 165. In contrast, directors do not have such direct influence over the extent to which investment banks expect to benefit from disloyalty.

Consider next the capacity of directors to satisfy any prospective liability imposed on them, the third condition. The facts here depart again from the conventional case because directors, though often wealthy, have limited assets, diminishing the prospect that they will bear in full the liability imposed on them. Contributing to this concern is the possibility of directors strategically "judgment proofing" their resources, further limiting the deterrent effect of rules imposing liability on them as secondary actors. On the other hand, as risk-averse and reputation-conscious individuals, directors may be sensitive to the threat of a small sanction or even to low probabilities of sanction. If so, then they may be effectively deterred, despite their limited assets. These factors are difficult to weigh, but may well create adequate incentives for directors to monitor and influence their M&A advisors.

Other factors potentially complicate the analysis. Regulatory oversight is an alternative to directorial liability, but there are reasons to consider directors better able than regulators to deter M&A advisors' conflicts—other than particular hard-to-detect conflicts—since much of the M&A deal process unfolds rapidly and is not known to regulators in real-time, and directors typically have closer access to M&A advisors than do regulators (or shareholders), suggesting directorial liability may be superior in important respects to public enforcement by regulators.

In short, the case for directorial liability does not stand on all fours with the paradigmatic case for enterprise liability, but may be plausibly made out. While not wealth constrained, M&A advisors face inadequate incentives to deter disloyalty under a simple liability regime. While directors are asset constrained, they face liability to the extent that their often considerable assets and their risk aversion may lead them to bear in full any liability imposed on them, potentially creating adequate incentives for them to monitor and influence their M&A advisors. Though their capacity to do so is necessarily limited, they can monitor and influence their advisors in important respects, particularly at the outset of the advisory relationship and after learning of any disloyalty. Nevertheless, whether a regime imposing liability on M&A advisors as well as directors would yield too much or too little deterrence is impossible to predict.[255]

If directorial liability for M&A advisor disloyalty is desirable, should such liability be strict (as in vicarious liability) or fault based? Jennifer Arlen demonstrates the potential danger of imposing strict liability in these circumstances where misconduct is difficult to detect.[256] Applied to the M&A advisory context, Professor Arlen's reasoning suggests that imposing

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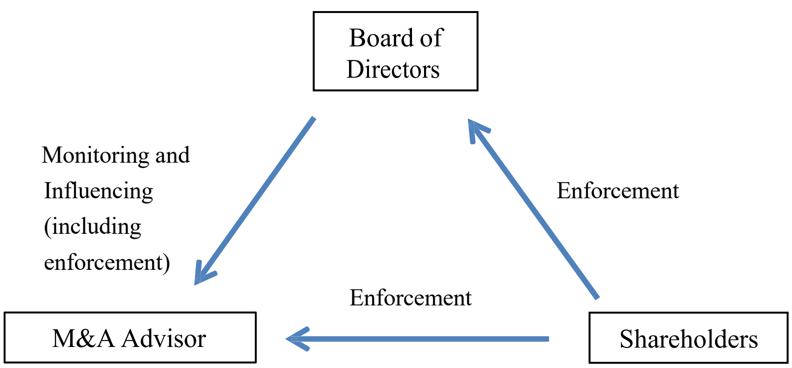
255. Another consideration is the increased administrative costs of enlarging the range of possible defendants by imposing liability on directors. *See* SHAVELL, ACCIDENT LAW, *supra* note 186, at 174 (discussing the administrative costs resulting from the imposition of vicarious liability).

256. Arlen, *supra* note 188, at 172–85 (discussing the desirability of duty-based liability over strict liability in corporate criminal law).

strict liability on directors for M&A advisor disloyalty may produce perverse results. Under a strict liability regime, directors who police effectively—including by undertaking the *ex post* policing measures of investigating and prosecuting disloyalty—may invite liability since those measures may disclose misconduct that would not otherwise come to light. They would then face a higher expected liability by policing effectively than they would if they didn't, which would discourage effective policing.[257] This concern would seem salient in the M&A advisory context where conflicts may escape detection without directors' monitoring. A regime of fault-based liability for directors overcomes this potential problem when fault is keyed to the quality of both their *ex ante* and their *ex post* policing efforts.[258] Directors would then be relieved of liability where they engaged in such policing efforts, even if they ultimately failed to avert the M&A advisor's misconduct. Figure 2 visually illustrates this liability regime.

Figure 2: Suggested private enforcement actions to deter M&A advisor disloyalty



While the analysis here does not lead to a single, straightforward prescription, it suggests the desirability of liability rules akin to primary and enterprise tort liability. More specifically, it suggests that a simple regime in which M&A advisors alone faced liability would ineffectively deter M&A advisor disloyalty. Such a regime holds M&A advisors liable to shareholders for disloyally serving client interests in the absence of client consent.[259]

257. *See id.* at 183–84.

258. *See id.* at 178–81 (suggesting that duty-based corporate liability creates optimal incentives to engage in policing activities). Arlen argues for a multi-tiered, duty-based liability regime under which firms face liability for failing to discharge three duties (regarding three facets of policing). *Id.* at 184–85. The present analysis avoids the tiered approach since sanctions arising from breach of fiduciary duties are not as susceptible to increments as sanctions in the regime Arlen considers.

259. The underlying duty of M&A advisors could be owed either to the corporate client, to shareholders generally, or to both.

Further deterrence would be required, and the ability of directors to monitor and influence M&A advisors in important, though necessarily limited, respects suggests the wisdom of imposing directorial liability, although the justification is nonstandard. If directorial liability is imposed, theory supports imposing fault-based liability, rather than strict liability. By design, such a regime would create incentives for directors to monitor and influence M&A advisors, effectively transmitting liability to M&A advisors through various *ex ante* and *ex post* measures, thereby helping deter advisor disloyalty toward shareholders.

D. Caveats and Extensions

If directorial liability is desirable, why should it not substitute for the simple regime rather than supplement it? Shareholders could hold directors liable, leaving it to directors to sanction M&A advisors as appropriate, rather than also subjecting M&A advisors to liability in shareholder suits. There is no easy answer. In the regime depicted in Figure 2, effective deterrence of M&A advisor disloyalty will generally be achieved, the analysis suggests, when the *combined* liability imposed on principals and agents (here, on directors and M&A advisors) equals the social cost of the harm imposed by the agents (the M&A advisors).[260] It is unclear whether imposing liability on directors alone would achieve effective deterrence. Given the capacity of directors to subvert the effect of shareholder suits against M&A advisors, a regime subjecting both directors and M&A advisors to potential liability (at the suit of shareholders) is considered desirable. The underlying duty of M&A advisors could be owed either to the corporate client or to shareholders generally, or to both.[261]

If further deterrence were needed, other measures could be considered. One such measure would involve imposing criminal liability on M&A advisors for disloyalty toward their M&A clients.[262] Imposing criminal sanctions would compensate for the low probability of sanction and perhaps bring the regime closer to optimal deterrence. But corporations cannot be imprisoned, removing the oft-cited benefit of imposing criminal liability.[263] Moreover, this measure would be politically unpalatable, as recent experience of proposals to criminalize certain banking behavior has demon-

260. *See* Daniel R. Fischel & Alan O. Sykes, *Corporate Crime*, 25 J. LEGAL STUD. 319, 327 (1996) ("[A] standard result in the literature on vicarious tort liability is that appropriate levels of deterrence will be achieved when the combined liability imposed on firms and their employees is equal to the social cost of harm caused by the employees." (citing Alan Sykes, *An Efficiency Analysis of Vicarious Liability Under the Law of Agency*, 91 YALE L.J. 168 (1981))).

261. *See supra* subpart II(B) (discussing M&A advisors' liability).

262. *See* SHAVELL, FOUNDATIONS, *supra* note 147, at 231–32 (suggesting criminal liability where other measures, including private liability and regulation, are inadequate).

263. *But see id.* at 543–47 (explaining the use of criminal law sanctions to deter conduct that cannot be adequately dettered by monetary sanctions alone).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

* * *

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

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

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

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

III. valuating Existing Law

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

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

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

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

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

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

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

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

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

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

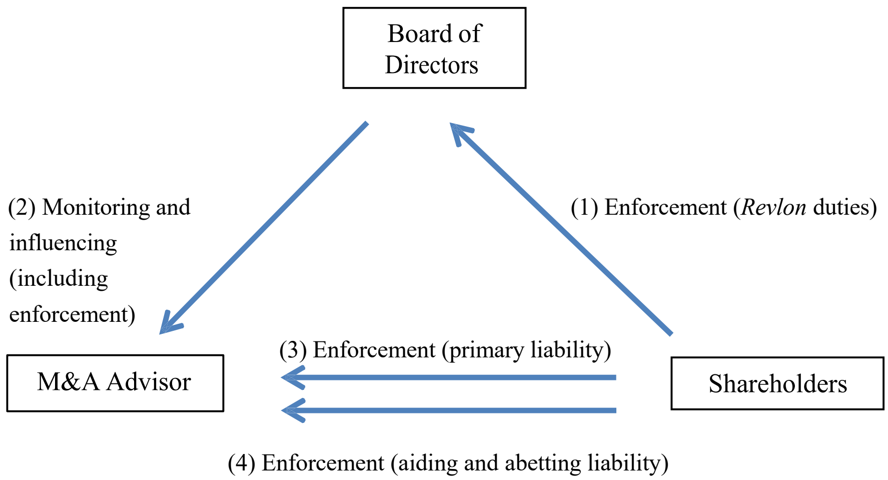
A. How Delaware Law Conforms

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

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

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

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



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

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

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

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

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

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

289. *Id.*

290. *Id.*

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

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

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

291. *Id.*

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

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

294. *Id.* at 818–19.

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

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

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

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

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

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

298. *Id.* at 817, 833–34.

299. *Id.* at 835.

300. *Id.*

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

302. *Id.* at 435–36.

303. *Id.* at 434.

304. *Id.* at 442.

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

306. *Id.* at 440.

307. *Id.* at 442.

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

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

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

309. *Id.* at 442.

310. *Id.* at 434.

311. *Id.*

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

313. *Id.*

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

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

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

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

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

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

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

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

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

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

318. *Id.* at 835.

319. *Id.* at 828.

320. *Id.* at 854.

321. *Id.* at 855.

322. *Id.* at 856.

323. *Id.* at 839.

324. *Id.*

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

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

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

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

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

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

326. *Id.* at 845.

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

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

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

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

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

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

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

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

331. *Id.* at 854–55.

332. *Id.* at 854.

333. *Id.* at 855.

334. *Id.*

335. *Id.*

336. *Id.*

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

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

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

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

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

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

340. *RBC Capital Mkts.*, 129 A.3d at 865 n.191 ("[T]he role of a financial advisor is primarily contractual in nature, is typically negotiated between sophisticated parties, and can vary based upon a myriad of factors.").

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

342. *Id.* at 855.

343. *Id.*

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

B. *How Delaware Law Fails to Conform*

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

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

345. *RBC Capital Mkts.*, 129 A.3d at 855 ("Here, the Engagement Letter expressly permitted [the M&A advisor] to explore staple financing. But, this permissive language was general in nature and disclosed none of the conflicts that ultimately emerged.").

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

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

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

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

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

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

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

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

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

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

353. *Id.* at 450–51.

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

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

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

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

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

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

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

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

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

C. *How Delaware Law Should Develop*

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

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

359. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 866 (Del. 2015); *see also* Lyman Johnson, *The Reconfiguring of Revlon*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 18–19 (S. Davidoff Solomon & C. Hill eds., forthcoming), http://ssrn.com/abstract=2654008 [https://perma.cc/8WAF-YAEZ] (describing aiding and abetting liability for M&A advisors as "rare" because of the requirement for "knowing participation").

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

372. *Id.*

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

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

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

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

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

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

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

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

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

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

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

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

IV. Other Implications

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

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

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

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

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

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

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

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

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

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

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

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

388. *Id.*

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

390. *Id.* at 54.

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

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

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

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

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

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

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

395. *Id.* at 902–16.

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

Conclusion

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

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