Good Deals Gone Bad: Fiduciary Liabilities in Mergers and Acquisitions

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The first version of this article was published in the Orange County Business Journal.

With so much at stake in a merger or acquisition, it is critical for all involved to keep a weather eye on potential fiduciary liabilities.

Officers and directors (and sometimes majority shareholders) are in positions to control a company. Power has been delegated to them, in trust, and they are obligated under the law to act with loyalty and care. They must act with independence, good faith, and reasonable diligence in informing themselves of the facts before making a decision or taking an action. Officers and directors are fiduciaries of the company, and can be held liable for the harm that flows from any breach in their fiduciary duties.

As fiduciaries, officers and directors must put the company's interests over that of their own. However, in many merger and acquisitions scenarios, the interests of the minority owners are pitted against the interests of majority interests, and the interest of the management of the company is at war with the interests of the actual owners of the company. The issues usually revolve around how much value is going to be paid by the buyer for the company versus how much value the buyer is going to pay for the continued participation of management in the company after the sale.

A person who knowingly assists a fiduciary in committing a breach of trust may also become liable for all of the harm caused. A claim for aiding and abetting the breach of fiduciary duty arises in the absence of any direct duty to the plaintiff. It is a form of vicarious liability. The rational for imposing liability on such a person is to further deter wrongful conduct that could result in harm.

Section 876(b) of the Restatement (2nd) of Torts provides that a defendant is liable for harm resulting to a third person from the tortious conduct of another, if the defendant *knows* that the tortfeasor's conduct constitutes a breach of duty, and defendant gives substantial *assistance or encouragement* to the tortfeasor in such conduct. California has adopted this common law rule.

The law in Delaware, is similar. To state claim for aiding and abetting a breach of fiduciary duty in Delaware, the plaintiff must allege four elements: (i) the existence of a fiduciary relationship, (ii) a breach of the fiduciary's duty, (iii) knowing participation in that breach by the defendant, and (iv) damages caused by the breach.

The "knowledge" element of the claim essentially includes two components. The first component is the knowledge that the officer or director has a fiduciary duty. Most business people could not creditably deny that they know officers and directors are fiduciaries of their companies. The second component is the knowledge that the officer's or director's conduct constitutes a breach of fiduciary duty.

In the context of the purchase and sale of a company, the purchaser must be cautious in providing any extra benefits or perks to individuals on the target company's board or its executive officers to consummate the transaction. The purchaser could find itself liable for aiding and abetting the breach of a fiduciary duty.

The suspect benefits from the purchaser to one or more of the officers or directors of the target company usually appear as side deals, such as lucrative employment agreements, non-compete payments or stock options. Side agreements are not uncommon and do not necessarily create liability. But when a side agreement represents a large percentage of the total transaction value, or where a quid pro quo for the special treatment is acknowledged, an aiding and abetting claim is sure to follow.

Experienced lawyers frequently use "fairness opinions" from investment bankers and other techniques that offer some protection against these claims.

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