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Corporate Governance Group

Client Alert

BEIJING FRANKFURT HONG KONG LONDON LOS ANGELES MUNICH NEW YORK SÃO PAULO SINGAPORE TOKYO WASHINGTON, DC

DELAWARE COURT REFUSES TO DISMISS AIDING AND ABETTING CLAIM AGAINST INVESTMENT BANK THAT RENDERED FAIRNESS OPINION IN SUPPORT OF M&A TRANSACTION

In *Shandler v. DLJ Merchant Banking, Inc.*,¹ the Delaware Court of Chancery recently refused to dismiss a claim that KeyBanc Capital Markets, Inc. aided and abetted directors and the majority shareholder of Insilco Technologies, Inc. in breaching their fiduciary duties through a self-dealing transaction. Although KeyBanc's engagement by Insilco was governed by Ohio law, which does not recognize aiding and abetting as a valid cause of action, the Court found that Delaware's interest trumped that of Ohio's in connection with a claim that a third party "was knowingly complicitous in a breach of fiduciary duty against a Delaware entity." This represents the first time, to our recollection, that the Court of Chancery has demonstrated a willingness to hold an investment bank liable for aiding and abetting a breach of fiduciary duty by a Delaware board of directors or controlling shareholder.

Background

Before its liquidation in bankruptcy in 2004, Insilco conducted business through "three primary independent operating divisions: (1) a specialized automotive components business called 'ThermaSys;' (2) a publishing business, which primarily printed and designed student yearbooks; and (3) a technology segment, split into four sub-units, that manufactured telecommunications and electrical components for, among other things, computer networking, digital telephones, and automobiles." In August 1998, the investment banking firm Donaldson, Lufkin & Jenrette² acquired, through various affiliated entities (jointly "DLJ"), 74% of Insilco's common stock in exchange for an investment of \$43 million. Soon thereafter, DLJ exercised its majority control by placing four individuals affiliated with DLJ on Insilco's seven-member board of directors.

¹ C.A. No. 4797-VCS (Del. Ch. July 26, 2010).

² Subsequently, DLJ was acquired by and became a part of Credit Suisse.

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The newly-constituted board then initiated a new business strategy focusing on Insilco's technology division. Consistent with this strategy, one of the DLJ-affiliated directors recommended to Insilco's CEO that the company sell ThermaSys for cash and use the proceeds to restructure its debt. Following up on this recommendation, Insilco's board "struck a preliminary bargain" to sell ThermaSys to another DLJ-controlled entity for \$147 million in cash.

Once the basic deal terms were agreed upon, James Ashton was added to the Insilco board and immediately designated as a single-person special committee to consider the fairness of the proposed transaction. Although the board's resolution establishing the committee recited Ashton's independence, it failed to mention that he had served as CEO of a DLJ portfolio company from 1995 to 1997. Within five days, Ashton ratified all prior actions taken by the board in connection with the sale of ThermaSys while apparently making no effort to negotiate better terms or to shop ThermaSys to other potential buyers. In concluding that the transaction was fair, Ashton relied on a fairness opinion provided by KeyBanc.

By early 2001, Insilco found itself in financial straits and, just before year-end, filed for Chapter 11 bankruptcy protection. Subsequently, Chad J. Shandler, who had been appointed as Creditor Trustee in connection with the bankruptcy with the power "to bring any causes of action belonging to Insilco," filed an action in the Court of Chancery alleging, among other things, that Insilco's board had breached its fiduciary duty of loyalty by authorizing the sale of ThermaSys to the DLJ affiliate for less than fair value and that DLJ, as "Insilco's controlling stockholder," caused the board "to engage in the same alleged misconduct." Shandler also sued KeyBanc, claiming that it "aided and abetted the breaches of fiduciary duty that occurred in connection with the ThermaSys transaction by knowingly placing too low of a value on ThermaSys and thereby painting the patina of fairness on an allegedly unfair transaction." Specifically, Shandler claimed that KeyBanc's fairness analysis "was flawed because it adopted an EBITDA multiple that was below the floor of the range of EBITDA multiples for automotive transactions during that time period," significantly reducing the estimation of a fair price. Shandler also pointed out that DLJ had retained KeyBanc to render an opinion that the ThermaSys transaction *was fair to DLJ* just three weeks before being retained to perform its fairness analysis on behalf of the special committee. And, seemingly to add insult to injury, Shandler noted that following the closing, Ashton was named by DLJ as chairman of the ThermaSys board and later as its CEO.

KeyBanc moved to dismiss the aiding and abetting claim partly on the ground that its engagement with Insilco was governed by Ohio law, which does not recognize such a claim. After refusing to dismiss breach of fiduciary duty claims against both DLJ and various DLJ-affiliated Insilco directors in connection with the ThermaSys transaction, the Court concluded that Shandler also had sufficiently pled a claim against KeyBanc for aiding and abetting DLJ and the Insilco directors in breaching those fiduciary duties.³

The Court's Analysis

In rejecting KeyBanc's choice of law defense, Vice Chancellor Strine balanced the interests of Delaware in Shandler's aiding and abetting claim against those of Ohio. The Vice Chancellor noted that "KeyBanc's only argument as to why Ohio law applies is that its contract with Insilco provided for Ohio law to apply." He found this justification to be insufficient, stating that "the mere fact that any contractual or malpractice obligations KeyBanc owed to Insilco were governed by Ohio law does not give Ohio a stronger interest ... [than] Delaware

³ At the same time, the Court dismissed a professional malpractice claim brought by Shandler against KeyBanc and ruled that the aiding and abetting claim was not barred by the applicable statute of limitations.

as to an aiding and abetting claim.” Because “our law recognizes aiding and abetting claims” and Shandler’s complaint “clearly states” a claim that KeyBanc aided and abetted a breach of fiduciary duties against a *Delaware* corporation, Vice Chancellor Strine concluded that “Delaware’s interest is paramount.” On this basis, KeyBanc’s motion to dismiss was denied.

Conclusion

Vice Chancellor Strine’s refusal to dismiss the aiding and abetting claim against KeyBanc in *Shandler v. DLJ Merchant Banking, Inc.* sets the stage for the possibility that, under the right circumstances, an investment bank may be found liable for aiding and abetting a breach of fiduciary duty by directors or a controlling shareholder of a Delaware corporation. Even though, following a trial on the merits, KeyBanc may be found not to have liability to Insilco’s bankruptcy estate, this ruling should nevertheless send a cautionary note to financial advisors of the need to consider all potential conflicts of interest when accepting an engagement and to be diligent in their efforts to provide truly independent financial advice in connection with M&A transactions in general, and particularly those involving affiliated entities with minority shareholders.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root	+86-10-5969-2777	aroot@milbank.com
Edward Sun	+86-10-5969-2772	esun@milbank.com

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main, Germany
Norbert Rieger

+49-89-25559-3620	nrieger@milbank.com
-------------------	---------------------

Hong Kong

3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root	+852-2971-4842	aroot@milbank.com
Joshua Zimmerman	+852-2971-4811	jzimmerman@milbank.com

London

10 Gresham Street
London EC2V 7JD, England

Stuart Harray	+44-20-7615-3083	sharray@milbank.com
Thomas Siebens	+44-20-7615-3034	tsiebens@milbank.com

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017

Ken Baronsky	+1-213-892-4333	kbaronsky@milbank.com
Neil Wertlieb	+1-213-892-4410	nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhoeft)
80539 Munich, Germany

Peter Nussbaum	+49-89-25559-3636	pnussbaum@milbank.com
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New York

One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman	+1-212-530-5149	sedelman@milbank.com
Roland Hlawaty	+1-212-530-5735	rhlawaty@milbank.com
Thomas Janson	+1-212-530-5921	tjanson@milbank.com
Robert Reder	+1-212-530-5680	rreder@milbank.com
Alan Stone	+1-212-530-5285	astone@milbank.com
Douglas Tanner	+1-212-530-5505	dtanner@milbank.com

São Paulo

Av. Paulista 1079, 8th Floor
São Paulo, SP
Brazil

Andrew Janszky	+55-11-2787-6282	ajanszky@milbank.com
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Singapore

30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans	+65-6428-2555	dzemans@milbank.com
Naomi Ishikawa	+65-6428-2525	nishikawa@milbank.com

Tokyo

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Darrel Holstein	+813-5410-2841	dholstein@milbank.com
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Washington, DC

International Square Building, 1850 K Street, NW
Suite 1100

Washington, DC 20006		
Glenn Gerstell	+1-202-835-7585	gerstell@milbank.com