RESPONSIBILITY OF INVESTMENT BANKERS TO SHAREHOLDERS

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Directors who recommend a merger or sale of a business without adequately informing themselves as to the fairness of the price may be liable in damages to shareholders for breach of the fiduciary duty of care.[1]

It is widely recognized that directors, seeking to avoid such liability, may satisfy a large portion of that duty by purchasing an opinion from an investment banker stating that the transaction is fair from a financial point of view.[2] Both statute and case law permit directors to rely on the banker's opinion in discharging their duty of care.[3]

Until lately, bankers have escaped responsibility to shareholders for negligently prepared fairness opinions. The few cases that have recently imposed liability have been widely criticized as having a questionable doctrinal basis. Thus, shareholders may find that no one is legally responsible to them and that they alone must suffer financial losses a banker's negligence causes.[4]

This Article proposes that investment bankers be held responsible to shareholders. As gatekeepers for corporate control transactions, investment bankers should be liable as delegates of the board, having the same fiduciary duties of care, candor, and loyalty that directors have, as well as a duty of skill.

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1. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

2. Robert J. Giuffra, Jr., Note, *Investment Bankers' Fairness Opinions in Corporate Control Transactions*, 96 YALE L.J. 119, 120-21 (1986).

3. *See, e.g.*, ALI PRINCIPLES OF CORPORATE GOVERNANCE § 4.02 (Tent. Draft No. 11 1991); REV. MODEL BUS. CORP. ACT § 8.30(b) (1984).

4. *See* Carol B. Haight, Note, *The Standard of Care Required of an Investment Banker to Minority Shareholders in a Cash-Out Merger:* Weinberger v. UOP, Inc., 8 DEL. J. CORP. L. 98, 110-11 (1983); Giuffra, *supra* note 2, at 131-32.

I. TWO CATEGORIES OF INVESTMENT BANKERS' FAIRNESS OPINIONS

Although *Smith v. Van Gorkom* expressly stated[5] that an investment banker fairness opinion is not necessary for directors to fulfill their duty of care, it has had the effect of making a fairness opinion standard operating procedure in most control transactions affecting shareholder interests.[6]

In some transactions, shareholders are given the opinion or its contents in proxy or information statements, with the expectation that they may or will rely on it to some extent. For example, when a parent corporation merges with a less than wholly owned subsidiary and pays cash in lieu of shares to the subsidiary's minority shareholders, and when the merger is conditioned upon approval of a majority of the minority, those shareholders may rely on a fairness decision to decide whether to approve the deal. Further, management buyouts (MBOs) of publicly held companies, similarly conditioned on minority shareholder approval, may rely on a fairness opinion's convincing minority shareholders to assent to the transaction.

In going-private transactions,[7] the Securities and Exchange Commission (SEC) requires a company to disclose the board's opinion whether the transaction is fair to shareholders.[8] Extensive disclosure of any investment banker's report is also required for other transactions involving similar conflicts of interest.[9] Practitioners report that the SEC staff recently has been requiring the same extensive disclosure concerning fairness opinions for arm's-length transactions, such as negotiated mergers with nonaffiliates.[10] The SEC's required disclosure includes a summary of the report, opinion, or appraisal, including: "the procedures followed; the findings and recommendations; the bases for and methods of arriving

5. *See* 488 A.2d at 876.

6. Lucian Arye Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27, 28.

7. A "going-private transaction," described in SEC Rule 13e-3, 17 C.F.R. § 240.13e-3 (1991), is generally a transaction that results in a company's shares' being no longer publicly traded on an exchange or on NASDAQ (the National Association of Securities Dealers Automated Quotation System).

8. 17 C.F.R. § 240.13e-100, Item 8 (1991).

9. 17 C.F.R. § 239.25, form S-4, Item 4(b) (1991); 17 C.F.R. § 240.14a-101, Item 14(a)(10) (1991).

10. *See* Memorandum of Wachtell, Lipton, Rosen & Katz, Fairness Opinions and "Blue Book" Analyses (Oct. 22, 1991) (on file with the author).

at such findings and recommendations; instructions received from the issuer or affiliate; and any limitation imposed by the issuer or affiliate on the scope of the investigation."[11]

This expanded disclosure may be expected to encourage skillful and careful work, but if the bankers fail to produce accurate fairness opinions, extending disclosure requirements to more transactions merely expands the universe of shareholders who rely on bankers' opinions to their detriment.

In a second category of cases, the shareholders are not informed of the banker's opinion, or, if they are, it is not a cause of shareholder action. Thus in an auction of the entire company, in which the board utilizes a fairness opinion only in deciding which of many competing offers to support, shareholders may either not receive or not rely on the opinion.[12]

II. CURRENT DOCTRINE AS TO BANKERS' LIABILITY FOR DEFECTIVE OPINIONS

A. Liability of the Banker to Shareholders When the Opinion is Addressed to Shareholders

The first class of cases, in which the opinion is communicated to shareholders who may directly rely on it, fits under the rubric of negligent misrepresentation. In these cases, the familiar question for liability is the required degree of relationship between the defendant who negligently utters a misrepresentation and the plaintiff who is injured by relying upon the representation: privity of contract, actual foreseeability, or reasonable foreseeability?

In New York, for physical torts, *MacPherson v. Buick Motor Co.*[13] toppled the citadel of privity in 1928, extending liability to all who are "reasonably foreseeable" victims of the negligent act or omission. But shortly thereafter, when the question arose whether an auditor was liable to persons who foreseeably relied on negligently audited financial statements, Chief Judge Cardozo refused to depart from the requirement of privity, or at least "near privity," as established in the prior decision of *Glanzer v. Shepard*.[14] Only those whose action was the "end and aim"[15]

11. *Id.*

12. For a compilation of additional illustrations see Bebchuk & Kahan, *supra* note 6.

13. 111 N.E. 1050 (N.Y. 1916).

14. Ultramares Corp. v. Touche, 174 N.E. 441, 448 (N.Y. 1931); Glanzer v. Shepard, 135 N.E. 275 (N.Y. 1922).

15. *Ultramares Corp.*, 174 N.E. at 445 (quoting Wolfskehl v. Western Union Tel. Co., 46 Hun. 542 (N.Y. 1887)).

of the negligent misrepresentation could recover for this pecuniary tort because to hold otherwise "may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class."[16]

More recently, the New York Court of Appeals, in *Credit Alliance Corp. v. Arthur Andersen & Co.*,[17] reiterated and further spelled out the privity or near-privity requirement for auditors' liability. In that opinion, the Court reviewed the near-privity requirement of *Glanzer*,[18] *Ultramares v. Touche*,[19] and a third decision, *White v. Guarente*,[20] in its decision to reaffirm that doctrine. The court would not hold defendant accountants liable to "noncontractual parties" unless certain criteria were satisfied.[21] First, an accountant must be aware that the financial reports were to be used for a particular purpose or purposes.[22] Second, he or she must know that the specific noncontractual party will rely on the information. Third, there must be some conduct between the accountant and noncontractual party that "link[s]" the parties together and that "evinces the accountants' understanding of . . . [the noncontractual party's] reliance."[23] The court expressly refused to overrule the policy arguments set forth in the earlier cases.[24]

Despite the settled state of New York law on auditors' liability to shareholders, yet another opinion provides a note of caution for cases involving others. In *Berkey v. Third Avenue Railway*, Judge Cardozo warned that metaphors are not to be relied upon blindly, as they are dangerous.[25] Even if an auditor may be held liable in New York to persons in near privity who rely on the auditor's misrepresentation, the same rule may not apply against an investment banker. Indeed, the recent *Bank of Kuwait*[26] case illustrates that point. There, a federal district court held that, given the unique facts that case presented, near privity with a lawyer was not enough to invoke liability—strict privity of con-

16. *Id.* at 444.
17. 483 N.E.2d 110 (N.Y. 1985).
18. Glanzer v. Shepard, 135 N.E. 275 (N.Y. 1922).
19. 174 N.E. 441 (N.Y. 1931). *See supra* text accompanying notes 14-16.
20. 372 N.E.2d 315 (N.Y. 1977).
21. *Credit Alliance Corp.*, 483 N.E.2d at 116.
22. *Id.* at 118.
23. *Id.*
24. *Id.* at 119. *See also supra* notes 12-19 and accompanying text.
25. 155 N.E. 58, 61 (N.Y. 1926).
26. United Bank of Kuwait PLC v. Enventure Energy Enhanced Oil Recovery Assoc., 755 F. Supp. 1195 (S.D.N.Y. 1989).

tract was necessary lest the attorney-client privilege be invaded.[27]

Nevertheless, a New York appellate court, in *Wells v. Shearson Lehman/American Express, Inc.*,[28] a case involving the Metromedia management buyout, held that privity was not required, and that near privity existed between the investment banker who issued a fairness opinion to the Metromedia board and the Metromedia shareholders, which was sufficient to hold the banker directly liable. The Metromedia board had published and distributed the fairness opinion to shareholders to persuade them to approve the MBO.[29] The bankers had opined that an MBO at a price of $1.1 billion was fair. However, just over one year later, management resold the assets of the corporation for over $4.5 billion, making a disconcerting $3.4 billion profit at the shareholders' expense. The Appellate Division found sufficient near privity because a special committee of the board, set up to protect shareholders, hired the bankers to aid in determining fairness and provided shareholders with the opinion. The court said that, in such circumstances, the bankers were aware that they were "retained to advise the shareholders."[30]

Although *Wells* does not say that the special committee acted as an agent of the shareholders, some have so read it. Such a reading would seem inappropriate. The court there merely applied the familiar near-privity rule, consistent with the *Ultramares-Credit Alliance* line of cases that New York courts previously had decided.[31]

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27. *Id.* at 1200-04. In *United Bank of Kuwait*, the court thought that if the borrower client had requested its lawyer to deliver the opinion to the lender, the lawyer would be liable to the lender when it made its loan in reliance on the opinion. But because, in fact, the *lender* made the request of the lawyer, the lawyer was immune for lack of privity of contract. *Id.* at 1204.

28. 514 N.Y.S.2d 1 (App. Div. 1987), *rev'd on other grounds*, 526 N.E.2d 8 (N.Y. 1988).

29. *Id.* at 2.

30. *Id.*

31. The court's somewhat confusing language should be read with the *Glanzer-Ultramares-Credit Alliance* near-privity concept in mind. Like the bean-weigher in *Glanzer*, who gave his weight certificate to the buyer at the behest of the seller and who therefore was held to be responsible to the buyer, the banker who renders an opinion to shareholders at the request of the board should be liable to the shareholders:

> Shearson Lehman and Bear Stearns make the untenable assertion that they represented the officers and therefore were not in privity to the shareholders. The officers, however, created a committee whose purpose was to serve the shareholders by determining the fairness of the buyout. The committee hired Shearson Lehman and Bear Stearns. Anybody hired by the committee, aiding in its endeavor, was actually retained to advise the shareholders. Assuming Ms. Wells' complaint is true, and assuming Shearson Lehman and Bear Stearns were aware (as they must have been) that their opinion would be used to help shareholders decide on the fairness of Metromedia's stock offer, they can be liable to the shareholders.

Id.

Thus, unlike the indeterminate class of lenders without standing to sue auditors in *Ultramares* and *Credit Alliance*, the shareholders of a corporation are a determinate class when the claimed injury involves a shareholder vote. Likewise, the banker's liability does not extend indeterminately since the vote is at a point certain in time. Neither is the amount indeterminate. Hence the policy bases of *Ultramares* do not apply to immunize the bankers. Furthermore, unlike auditors' opinions, which generally have various uses, in cases like *Wells* the opinion, as a primary purpose or "end and aim," seeks to induce the shareholders to approve the buyout. If it does not serve that function well, it has no other social utility. The policy goal of eliminating carelessly prepared fairness opinions would be well served by imposing liability on the banker.

Other jurisdictions have extended liability for negligent misrepresentation by some professionals beyond near privity to encompass persons whose injuries from the misrepresentation are "actually foreseeable." The *Restatement of Torts (Second)* takes this view.[32]

A good modern case-law exposition supporting the actual foreseeability standard is *H. Rosenblum, Inc. v. Adler*,[33] an auditor's liability case like *Ultramares* in which the auditor was not in near privity with the plaintiffs. The plaintiffs in *Rosenblum* sold their business to Giant Stores for common stock, having relied on false financial statements. The plaintiffs alleged that Touche Ross had negligently audited and reported on these statements.

The court explained in part IV of its opinion that policy grounds required weighing several factors, resulting in departure from the *Ul-*

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(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

RESTATEMENT (SECOND) OF TORTS § 552 (1965).

33. 461 A.2d 138 (N.J. 1983).

tramares near-privity requirement in favor of the *Restatement*'s actual foreseeability rule:

> . . . policy considerations involve balancing of several factors: "the burden [that the suggested duty] would put on defendant's activity; . . . the risk and the burden to plaintiff; the respective availability and cost of insurance to the two parties; the prevalence of insurance in fact; the desirability and effectiveness of putting the pressure to insure on one rather than the other, and the like."[34]

As to Judge Cardozo's policy concern for indeterminate liability, the court pointed out the well-recognized facts that section 11 of the 1933 Securities Act[35] had long since overturned the privity rule of *Ultramares* for misrepresentations in 1933-Act registration statements and that accounting firms had been able to insure against the loss in that situation. The court stated that this real-world-experiential test disproved Judge Cardozo's fears of ruinous liability.

Another case adopting the *Restatement (Second)* view is based on the tort-law principle that imposes liability on the party deemed to be the most efficient distributor of the loss.[36] The other pre-1983 cases on both sides are cited in *Credit Alliance*.

The only other reported judicial development beyond the *Wells* case that involves investment bankers' fairness opinions relied on by shareholders involves a unique state of affairs in Delaware.

Weinberger v. UOP[37] was a shareholders' class action for unfairness in a take-out merger by a parent corporation. The original defendants were the parent corporation and Lehman Brothers, the investment banker that had passed on the fairness of the price to be paid to the subsidiary's minority shareholders. The claim against Lehman Brothers rested on an alleged conspiracy with the parent corporation to fix too low a price and on a breach of fiduciary duty to the minority shareholders. After a full trial, Vice Chancellor Brown found that (1) there was no conspiracy, because the plaintiffs proved neither (a) an overt combination nor (b) damages; and (2) a banker does not owe minority shareholders the same

34. *Id.* at 147 (quoting 2 FOWLER V. HARPER & FLEMING JAMES, JR., LAW OF TORTS § 18.6, at 1052 (1956).

35. 15 U.S.C. § 77k (1988).

36. Rusch Factors, Inc. v. Levin, 284 F. Supp. 85, 91 (D.R.I. 1968).

37. Weinberger v. UOP, Inc., 409 A.2d 1262 (Del. Ch. 1979); Weinberger v. UOP, Inc., 426 A.2d 1333 (Del. Ch. 1981); Weinberger v. UOP, Inc., No. 58,1981 (Feb. 9, 1982), *withdrawn and replaced*, 457 A.2d 701 (Del. 1983) (en banc). The several opinions and a comment on them are collected in Haight, *supra* note 4.

fiduciary duty of entire fairness that the majority shareholder owes them.[38]

In an opinion of the Delaware Supreme Court, later withdrawn on rehearing, Justices McNeilly and Quillen, as the majority, affirmed:

> As to Lehman Brothers, we find no basis to upset the findings and conclusions of the Vice Chancellor. Nor do we find it fruitful in the present context to characterize the relationship between Lehman Brothers and UOP, and the UOP minority, as anything but contractual. The contract obviously created a duty, *including a duty to the minority*, but there is no basis for liability in the present record, given the conclusions of the trier of fact. Because of its general expertise and financial insight as UOP's investment banker for many years, Lehman Brothers was employed to render a fairness opinion for the immediate benefit of the members of UOP's Board of Directors who were scheduled to meet five days from the date of employment. The working team of Lehman Brothers submitted its report to the Board within the time allotted, thereupon fulfilling its duties and obligations under the agreed upon contractual terms.[39]

Thus, Justices McNeilly and Quillen were of the view that the Vice Chancellor was correct in finding both a lack of evidence of a conspiracy and no fiduciary duty of entire fairness owing from Lehman Brothers to the minority shareholders, although it did owe a "contractual" duty to the minority.

Justice Duffy, dissenting, evidently realized that the plaintiffs had miscast their argument and the alleged breach of duty was a breach of Lehman Brothers' duty of care in preparing the fairness opinion issued to the minority shareholders. Further, he opined that in Delaware the *Restatement* approach, eschewing the near-privity requirement in favor of actual foreseeability, would give the minority shareholders standing to sue.

However, as noted, these opinions were withdrawn on reargument, and when the plaintiff dropped the claims against Lehman Brothers to assure that Justice Herrmann would not be disqualified,[40] the case against Lehman Brothers was mooted.

It would appear from these opinions that Delaware courts reasonably may be expected to apply Justice Duffy's opinion in a case of negligent

38. Weinberger v. UOP, Inc., 426 A.2d 1333, 1348 (Del. Ch. 1981).

39. Weinberger v. UOP, Inc., No. 58,1981, slip op. at 13 (Del. Feb. 9, 1982) (emphasis in original). *See* Haight, *supra* note 4, at 162-63.

40. It appears that Justice Herrmann's son was employed by the law firm representing the bankers. *See* Haight, *supra* note 4, at 100 n.18.

misrepresentation to shareholders by a banker, at least if the complaint is properly cast.

In any event, *Wells* stands for the proposition that, even under the narrower near-privity requirement, an investment banker is liable to shareholders, an actually foreseeable class of possible litigants relying on the fairness opinion. Thus, either the New York or the Delaware standard gives standing to such shareholders.

Incidentally, it must be noted that any misrepresentations in a disclosure may impose liability under the federal securities laws' antifraud provisions. Since this Article is concerned with negligence liability under state law, the federal law is beyond its scope. However, without exploring the technical complexities, it may be noted that for many transactions in which fairness opinions are commonly used, 1933 Act registration is required.[41] These transactions include certain mergers and acquisitions that use a "wrap-around" prospectus-proxy statement.[42] Bankers in these deals may be liable as "experts" under section 11 of the Securities Act of 1933[43] unless they establish a "due diligence" defense, something of a negligence standard with the burden of proof on the defense. Bankers could also be exposed to potential liability as aiders and abettors of SEC Rule 10b-5 or proxy violations,[44] but scienter (including recklessness) is required to invoke these liabilities.[45] Bankers may also be liable as principals under either 10b-5 or the proxy rules; in cases involving the proxy rules, the appellate courts are split as to whether such ancillary parties' mere negligence is actionable.[46] Hence, to some extent negligence liability exists under federal law.

Most likely, as a primary claim plaintiffs will continue to press for

41. Form S-4 is required for certain transactions that both constitute an offering of securities and require a shareholders' vote and a necessary proxy solicitation.

42. LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 293-94 (2d ed. 1988).

43. 15 U.S.C. § 77k(a) (1988).

44. 17 C.F.R. § 240.10b-5 (1991).

45. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). For a view that recklessness is sufficient to invoke liability, see also IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980); McLean v. Alexander, 599 F.2d 1190 (3d Cir. 1979); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033 (7th Cir. 1977).

46. *See* Herskovitz v. Nutri/System, Inc., 857 F.2d 179, 190 (3d Cir. 1988) (mere negligence sufficient to impose liability on investment banker under proxy rules), *cert. denied*, 489 U.S. 1054, 1060 (1989); Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 428 (6th Cir. 1980) (scienter required for auditor's liability); Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1301 (2d Cir. 1973) (intimating that although negligence is enough for principals, scienter must be shown for ancillary defendants).

state-law negligence liability, as in *Wells*. Of course the SEC's expansion of disclosure requirements for fairness opinions will, to the extent bankers fail to exercise due care, expand their exposure for negligence under both state and federal law.

B. Bankers' Liability When the Opinion is Rendered Solely to the Board or a Committee Thereof

The more challenging problem lies in finding a suitable doctrine for imposing liability on bankers for the fairness opinions in the second category of cases—when only the board of directors uses and relies on the banker's opinion in exercising its business judgment. In these cases, there is no misrepresentation to the shareholders and the law of negligent misrepresentation is not apropos.

In a case arising from the RJR Nabisco auction between management—led by Ross Johnson—and Kohlberg Kravis Roberts (KKR), *Schneider v. Lazard Freres & Co.*,[47] the plaintiff claimed, in a New York forum, that the investment bankers negligently injured the shareholders in opining that two bids were "substantially equivalent from a financial point of view."[48] The plaintiffs alleged that management's bid was higher than the KKR bid, which the board nevertheless accepted based on that opinion. Alternatively, they alleged that, even if the KKR bid were higher, further bidding should have occurred. The New York Appellate Division upheld the claim as a matter of New York law on the novel theory that the special committee of the board conducting the auction was, in fact, an agent for the shareholders who had contracted with a sub-agent, the banker. Hence, the banker was also an agent of the shareholders answerable to them as a fiduciary for failing to act with due care. The court rejected the claim that this was a matter of Delaware corporate law under which the board, not the shareholders, would alone have management of the affairs of the corporation.[49]

Manifestly, the court's characterization of the *question* as being one of agency as opposed to corporate law is actually a rhetorical device for supporting the *holding* that the special committee was an agent of the shareholders and that the banker was a sub-agent of the shareholders. This clearly violates the generally accepted conception of the board of

47. 552 N.Y.S.2d 571 (App. Div. 1990).
48. *Id.* at 572.
49. *Id.* at 575.

directors as a *sui generis* fiduciary of the shareholders not subject to their control absent a special contract.[50] Further, the use of this agency theory also freed the court from the constraint of Delaware law, which would have applied under the corporate choice-of-law rule for internal affairs.[51]

The *Schneider* opinion has been criticized, perhaps rightly, for its break with convention.[52] One would expect this criticism to be sufficient for Delaware to reject the case's sub-agency theory, because the Delaware Supreme Court has made clear its view that the internal-affairs doctrine is nearly sacrosanct and may even have federal constitutional dimensions.[53] Thus, it is generally held that choice-of-law questions concerning, for example, shareholder voting rights, are matters of internal corporate affairs, regulated by the law of the state of incorporation.[54]

However, the *Schneider* sub-agency rationale is expressly limited to a sale of control of the business. In the court's words, the purpose of the banker's opinion "was to advise the shareholders with respect to a transaction that contemplated RJR's demise and whose end and aim was to obtain for the shareholders the highest possible price for their stock."[55] Thus the "sale of the control of a corporation is not corporate business of the type governed by traditional principles of corporate governance, and . . . the Special Committee stood in a relationship to the shareholders different from that which normally obtains between a corporation's board and shareholders."[56]

This was not a wholly novel doctrine, except as it was applied in the context of a publicly held corporation. In another well-known New York case involving a close corporation, the court permitted a deviation from the corporate norm vesting power to manage the business in direc-

50. *See, e.g.*, N.Y. BUS. CORP. LAW § 620(b) (McKinney 1990) (authorizing contracts to take power to manage from the directors and place it in the shareholders); DEL. CODE ANN. tit. 8, § 350 (1991) (same).

51. *See* John C. Coffee, Jr., *New York's New Doctrine of Constructive Privity*, N.Y. L.J., Jan. 25, 1990, at 5.

52. *Id.* at 6; Edward Brodsky, *Investment Banker Liability to Shareholders,* N.Y. L.J., May 3, 1990, at 3.

53. In McDermott, Inc. v. Lewis, 531 A.2d 206, 216 (Del. 1987), the Delaware Supreme Court held that the internal-affairs rule applied to a question of the right to vote shares and further stated that the rule has important constitutional underpinnings in the Due Process, Commerce, and Full Faith and Credit clauses. The court also strongly disapproved of a Second Circuit opinion, Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 261 (2d Cir. 1984), which had applied New York law to a Panamanian corporation.

54. *See, e.g.*, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987).

55. *Schneider*, 552 N.Y.S.2d at 575.

56. *Id.*

tors on the same ground that a corporate life threatening transaction was at issue.[57]

By the same token, if *Schneider* is sound, many other corporate-control transactions would also not be mere matters of the internal affairs of a corporation. In *Edgar v. MITE*,[58] for example, the Supreme Court held that tender offer invitations by bidders to shareholders are not internal affairs regulated by the law of the state of incorporation.

Thus, control transactions ending in a sale of shares that terminates shareholder interests, such as MBOs and going-private transactions, could easily fit within the *Schneider* rationale. *Schneider* would seem equally applicable to a cash-out merger or a total liquidation.

But what of liability to shareholders for fairness opinions delivered to a board in a run-of-the-mill, non-cash-out merger when the opinion is not communicated to shareholders, but instead is used by a board to satisfy its duty to be informed under *Smith v. Van Gorkom*?[59] Clearly this is traditional internal-affairs law to which *Schneider* cannot apply. And, of course, *CTS Corp. v. Dynamics Corp.*[60] would seem to preclude treatment of ordinary mergers as anything other than matters of corporate law. *Amanda Acquisition Corp. v. Universal Foods, Corp.*,[61] which upheld the Wisconsin merger moratorium statute, made clear that mergers are classic cases of intra-corporate regulation and confirmed that, although tender offers are not internal-affairs matters, voting-rights questions are.

Thus, *Schneider* is poor precedent, both because of its aberrant refusal to follow well-settled concepts of the relationship of directors to shareholders and because, to the extent its policy is sound, its doctrine fails to reach many of the cases in which directors use bankers' opinions to immunize themselves. It would seem that *Schneider*, in stretching the law beyond generally accepted norms, falls short in implementing its policy. Policy thus cries for a more straightforward doctrinal basis for holding bankers to a duty of care to shareholders in all of these cases. There is an elegant basis—the "temporary insider" concept developed in Rule 10b-5 insider-trading cases.

57. Application of Vogel, 268 N.Y.S.2d 237 (App. Div. 1966), *aff'd*, 224 N.E.2d 738 (N.Y. 1967).

58. Edgar v. MITE Corp., 457 U.S. 624, 645 (1982).

59. 488 A.2d 858 (Del. 1985).

60. 481 U.S. 69 (1987).

61. 877 F.2d 496 (7th Cir. 1989).

C. *Bankers as Temporary Insiders Having the Same Fiduciary Duties as Directors*

If a banker in the course of her consultation learns material inside information with respect to the corporation and trades in its shares, dicta in the *Dirks* case may hold her liable to shareholders as a "temporary insider" who breached her fiduciary duty to the person on the other side of the trade.[62] *Dirks* purported neither to establish a novel fiduciary duty analysis nor to articulate an exclusively federal concept of fiduciary duty. It was merely determining that traditional fiduciary duties exist between investment bankers and shareholders of their clients.[63] The Court obviously conceived of this duty as arising from common-law traditions. Hence it is not a radical departure from accepted norms to rule that an investment banker in such circumstances is a temporary fiduciary, owing not only the fiduciary duty to abstain from insider trading with shareholders, but also other fiduciary duties of "permanent" insiders like directors and officers—such as a duty of care to shareholders.

Indeed, the Delaware Supreme Court has embraced a temporary insider concept for investment bankers, albeit without the nickname. Justice Moore held, in *Mills Acquisition Co. v. MacMillan, Inc.*,[64] that an investment banker owes a fiduciary duty of candor to the full board equal to that of a corporate director or officer.[65] Indeed, *MacMillan* may be read to hold that bankers owe a fiduciary duty of candor identical to that of officers and directors. The court, referring to the investment banker involved, said: "As the duty of candor is one of the elementary principles of fair dealing, Delaware law imposes this unremitting obligation not only on officers and directors, but *also upon those who are privy to material information obtained in the course of representing corporate interests*."[66]

The court could have intended that the banker would be liable for the breach only as an aider and abettor. This possibility exists because at the end of the paragraph containing the language quoted above, the court

62. Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983).

63. *See also* United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (containing extensive discussions, in both the majority opinion and Judge Winter's dissent, of fiduciary duties, expressly drawing on state common-law concepts to implement Rule 10b-5), *petition for cert. filed*, 60 U.S.L.W. 3500 (U.S. Jan. 1, 1992) (No. 91-1085).

64. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1988).

65. *Id.* at 1283.

66. *Id.* (emphasis added).

cited *Penn Mart Realty Co. v. Becker*,[67] a case applying the aider-and-abettor concept.

However, one might instead note that this Delphic paragraph is, in keeping with the traditions of the development of the common law, a purposely ambiguous statement. A traditionalist might assert that the paragraph is unremarkable and merely states that anyone, including a banker, may be held liable for aiding and abetting a fiduciary in a breach of trust. On the other hand, to sustain the thesis of this Article it is necessary to establish that the court was propounding, as alternative grounds, direct liability of the banker as a principal and vicarious liability as an aider and abettor.

In support of this view, it should be noted that the quoted sentence speaks clearly in terms of imposing a direct duty of candor on the banker, not of vicarious liability for assisting the directors. Further, one cannot help but believe that *MacMillan* is at least a trial balloon because of the evident impatience of the court with the level of performance of the banker there. Other courts have expressed similar concern.[68]

The theory remains valid whether or not it has been endorsed by the Delaware Supreme Court. However, it must be noted that two Delaware Chancery Court opinions have rejected the notion that bankers are fiduciaries of shareholders.

One of these, the Vice Chancellor's opinion in *Weinberger*, is not an imposing obstacle in finding bankers fiduciaries of shareholders because it rests solely on the ground that the court found no precedent to follow.[69]

In Re Shoe-Town, however, a going-private case, did consider the issue and stands squarely opposed to this Article's thesis.[70] The Vice Chancellor, writing prior to the Appellate Division opinion in *Schneider*, easily distinguished *Wells* on the ground that the banker there was hired by the special committee expressly to determine fairness for the benefit of shareholders, while the banker's opinion in *Shoe-Town* was obtained solely for the purpose of discharging the board's *Van Gorkom* duties.[71]

67. 298 A.2d 349, 351 (Del. Ch. 1972) (applying the aider-and-abettor concept to breaches of corporate fiduciary duties).

68. *See, e.g.*, Herskovitz v. Nutri/System, Inc., 857 F.2d 179 (3d Cir. 1988), *cert. denied*, 489 U.S. 1054, 1060 (1989).

69. Weinberger v. UOP, Inc., 426 A.2d 1333, 1348 (Del. Ch. 1981).

70. 1990 Del. Ch. LEXIS 14, at *17-22 (Del. Ch. Feb. 12, 1990).

71. *Id.* at *20-21.

Schneider was then on appeal, and the Vice Chancellor unfortunately did not see fit to cite or distinguish the trial judge's opinion. A further shortcoming of *Shoe-Town* is its failure to note the temporary insider concept of *Dirks* and the dictum in *MacMillan*. *Shoe-Town* also fails to consider a policy basis for excluding bankers from responsibility for lack of care.[72] Since it is a trial court decision, and given its shortcomings, it may not be the final word in Delaware and should not be very compelling precedent elsewhere.

Any consideration of the issue should take into account the close analogy of investment bankers to corporate officers who, although not directors, are deemed fiduciaries not only of the corporation, but also of the shareholders. Note the closely parallel status: both are agents of the corporation, albeit one is servant and the other an independent contractor, and neither is directly appointed by, or subject to, the control of the shareholders. Officers are deemed fiduciaries of shareholders by virtue of their superior power to affect shareholder interests. Investment bankers, when their fairness opinions are sought, are even more powerful in affecting shareholder interests. Thus, a traditional basis for imposing a fiduciary duty is present in all its glory in such engagements of bankers.

Clearly, the legal purpose of the fairness opinion is to protect the shareholders from an unfair transaction. It does not propose to protect directors, although it may help the directors discharge their duty to inform themselves. For this reason, it seems clear that shareholders have the exclusive interest in the banker's opinion. Hence, the banker's duty of care should run to shareholders.

We still need to consider whether more than precedent and logic call for finding bankers to be in a fiduciary relationship to shareholders. We must ask whether such a finding would be sound on policy grounds, a question to which we shortly turn. But before that, consider the other virtues of such a rule:

(a) It restores the shareholders' right to have someone responsible for exercising due care for the financial fairness aspect of the board's duty;

(b) It makes the duty a matter of internal affairs again, with the law of the state of incorporation controlling, thereby eliminating the uncertainty of law depending on the forum;

72. *Shoe-Town* did hold that the plaintiff had validly asserted that the banker had aided and abetted the directors in their own alleged breach of fiduciary duties. But this Article takes that proposition as established.

(c) Unlike *Schneider*, which is limited to cases of "corporate demise," it covers all cases in which directors delegate a task to bankers;
(d) It comports with the reality that the banker is usually a member of a collectively acting team that includes officers or directors; and
(e) It comports with the further reality that bankers are often in a control position with their expertise, superior access to information because of their staff facilities, and the confidence and trust placed in them.

Bankers are thus quintessential fiduciaries.

Are the traditional bases for fiduciary status vis-á-vis shareholders applicable to investment bankers when they advise the board or a committee thereof? If directors are fiduciaries who delegate a part of their responsibility to bankers and are thereby excused from responsibility even if the delegate is negligent, the delegate should be deemed to have been substituted for the directors. Thus some of the same factors making the directors fiduciaries of shareholders are present here. These include reliance on the banker as well as dominance and de facto control over the transaction—i.e., the process of determining fairness from a financial point of view.[73] Further, like the harbor pilot who is given temporary control over a ship, the investment banker is in control, superior even to the target's management.

From another point of view, since it is unquestioned that the investment banker is a fiduciary to the corporation, and since, at least in a control transaction, the real parties in interest are shareholders, in such deals the corporate fiction should be ignored, thereby making the duty run directly to shareholders. In a further sense, the shareholders are third-party beneficiaries of the contract between banker and issuer and should be allowed to enforce the duty of care arising from that relationship.[74]

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73. "Reliance and de facto control and dominance . . . are at the heart of the fiduciary relationship." United States v. Margsotta, 688 F.2d 108, 125 (2d Cir. 1982), *cited in* United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991).

74. In Kenney v. Wong Len, 128 A. 343 (N.H. 1925), the court pointed out that the duty of care arises from the contractual *relationship*, not from the contract itself:

> The obligation to use due care in the performance of a contract arises from the relation the contract creates, and is independent rather than a part of it. For practical purposes it is usually not of much consequence whether the breach of the duty is called a tort or a breach of an implied term of the contract, and the law is more or less indifferent whether action is brought in tort or assumpsit. But that the obligation arises from the relation and not as an implied term of the contract is shown by the refusal of the law to permit express terms to nullify the effect of the obligation.

Id. at 349. Investment-banking experts, given their contractual obligation to provide expert advice to minority shareholders, their exclusive access to information unknown to the shareholders, and

Hence, there are sound doctrinal bases in corporate law for state courts to hold bankers liable to shareholders for negligence when assisting directors. The question is, should that liability be imposed as a matter of sound policy? Part III addresses this policy question.

III. GATEKEEPER LIABILITY FOR INVESTMENT BANKERS' OPINIONS

As we have seen, in some transactions shareholders rely directly on bankers' fairness opinions, and in other cases, such as *Schneider*, although the shareholders do not so rely, their wealth is directly affected by the directors' reliance on the opinions. Hence, unreliable bankers' opinions are not desirable and can injure shareholders.

Some simply conclude that bankers' opinions should be banned. In part, this suggestion stems from the previously mentioned observation that directors often obtain and rely on fairness opinions merely to insulate themselves from liability for breach of duty. Of course, in such cases the shareholders are left without recourse. These results suggest that banishing the bankers would place the responsibility squarely on the directors' shoulders, where it belongs.

There are two obvious responses to such a suggestion. First, the directors often are not sufficiently skilled or equipped with staff and facilities to perform these valuation studies while the bankers are.

Second, the difficulty caused by excusing directors could be alleviated by several other means without losing the skill and resources of the bankers. These alternatives include:

(a) Not excusing directors even for good faith, justifiable reliance on the bankers' opinion; and
(b) Excusing the directors if reliance is in good faith and justifiable, but substituting liability on the bankers for lack of care.

Measure (b) is more acceptable than measure (a), which would require reversal of the established policy of permitting reliance by directors on experts. Further, to the extent liability *is* visited on bankers, one may expect improvements in the quality of opinions because of the deterrent effects.

Making bankers liable for culpable acts of course would be a familiar

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their knowledge that the shareholders depend on them (*see* Denison Mines, Ltd. v. Fibreboard Corp., 388 F. Supp. 812, 821 (D. Del. 1974)), seem to be closely akin to the two bank clerks in Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972), who were held to be fiduciaries and therefore to have an affirmative duty to disclose *values* of the shares to the selling shareholders. *Id.* at 152. The parallels are stunning.

application of gatekeeper liability, which has been applied to auditors and, to a lesser extent, lawyers in analogous situations.[75] The policy question is whether the analogy from lawyers and auditors to bankers holds, keeping in mind Cardozo's statement about the danger of blindly following metaphors.

One important element of gatekeeper liability is its potency. A.A. Sommer said nearly two decades ago that lawyers who are asked to issue a legal opinion as a condition to closing a merger or other agreement are in an ideal position to blow the whistle on illegality or fraud.[76] Consider the even more powerful, and more central, position of the investment banker whose opinion is requested on the fairness of the terms of a negotiated merger or an MBO. Even a White House veto can be overridden, but can we imagine a board of directors proceeding with the merger or MBO that the banker just labelled "unfair"? Would not the transaction grind to a halt without further damage, including wasteful litigation? A banker's veto power is at least as great as the auditor's opinion in a registered offering or the lawyer's opinion in the merger illustration.

By the same token, an incorrect banker's blessing can ruin many fortunes. As Judge Friendly suggested in *United States v. Benjamin*,[77] "In our complex society the accountant's certificate and the lawyer's opinion [or, we may add, the banker's fairness opinion] can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."[78] Witness the *Wells* case in which shareholders ostensibly lost three billion dollars.

Bankers can be very effective in deterring improvident deals. The banker is much closer to the fulcrum of many transactions for which her opinion is needed than is the auditor or lawyer.

Another advantage of gatekeeper liability is that the banker is hired for the very purpose of guarding the gates—unlike lawyers or auditors in many cases. Hence, imposing a duty here entails no cost for an additional task, but merely the cost of performing that task carefully. In other words, the banker need perform no task in addition to that for which the banker and client have already contracted. Thus, liability is

75. Much of the discussion in this part traces Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857 (1984).

76. A.A. Sommer, Jr., *The Emerging Responsibilities of the Securities Lawyer*, [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,631 (1974).

77. 328 F.2d 854 (2d Cir. 1964).

78. *Id.* at 863.

not a cost, but an economic benefit because it minimizes wasteful activity.[79]

Further, the banker's expertise makes it much easier for her than for the directors to comprehend the results of her investigation and to apply her experience and knowledge from other situations. This represents a further saving because directors generally are lower on the learning curve. Hence, it is more efficient to impose the full duty and responsibility on the banker.

Moreover, the investment-banking industry's stock in trade is its reputation and assets, which provide a valuable bond, already incurred, to assure that the banker will act carefully and skillfully. The individual banker, her firm, and the whole banking industry suffer when she commits an error or an irregularity, and liability for the individual banker can take advantage of this by making the opinions more reliable.

Moreover, bankers may need the extra stimulus of potential liability because they lack some of the strictures that help assure lawyers' and auditors' skill and care. Bankers have neither an ethics code nor a professional association to administer sanctions for deviations from norms. There is no minimum education or licensing procedure in place. Additionally, some segments of the banking community possess an entrepreneurial ethos very different from that traditionally found in accounting and law.

The benefits of imposing gatekeeper liability on bankers are clear. If liable in damages for issuing an incorrect opinion, bankers will not be easily corrupted by a desire to present an opinion echoing that of those who pay them, and directors will not tempt bankers with improvident deals for fear of drawing an adverse opinion. Liability will prevent bad transactions that otherwise might go through undiscovered amid the complexities of life.

Of course, gatekeeper liability of bankers will cause additional costs. Bankers' fees will increase to pay for the risk premium and the additional

79. Judge Cardozo again provides support:

> An automobile is manufactured with defective wheels. The question is whether the manufacturer owes a duty of inspection to anyone except the buyer. The occupant of the car, injured because of the defect, presses one view upon the court; the manufacturer, another. There is small chance, whichever party prevails, that conduct would have been different if the rule had been known in advance. The manufacturer did not say to himself, "I will not inspect these wheels, because that is not my duty." Admittedly, it was his duty, at least toward the immediate buyer. A wrong in any event has been done. The question is to what extent it shall entail unpleasant consequences on the wrongdoer.

BENJAMIN CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 146 (1921).

investment in diligent investigation. Some "good" transactions may never take place because the bankers are unwilling to risk a favorable opinion. Even here, the opportunity for bankers to present their opinions carefully, disclosing assumptions, illustrating the sensitivity of final conclusions as assumptions are altered, and explaining risks, should serve not only to minimize liability, but also to inform investors better. Indeed, bankers' liability for opinions is largely a requirement of full and candid disclosure. In a mature system, one would expect few cases of actual liability.

All these benefits and costs are subject to fine tuning by courts administering the protocol of the banker's duties as experience accrues. Indeed, the courts presumably will vary the bankers' due-diligence duties with the transaction and the context much as SEC Rule 176[80] varies with respect to underwriters' due-diligence duties in public offerings.

A set of due-diligence duties for bankers will not disrupt existing practices. Bankers investigate facts now. Presumably, managers seeking only a cursory investigation could continue to do so, but appropriate disclosure would accompany the bankers' disclaimers. Absent disclosure and disclaimers, more complete due-diligence investigations will be required, presumably regulated by weighing the costs of various procedures against the benefits—much like the auditors' investigation of internal controls for the purpose of issuing audit opinions.

Furthermore, under present practice we have seen too many instances of bankers' dereliction even in reported decisions.[81] What could be more costly than to permit inadequately prepared fairness opinions to facilitate transactions that result in ruined companies, costly litigation, and a cynical investing community?

IV. DETERMINANTS OF THE UTILITY OF FAIRNESS OPINIONS

Finding a basis in fiduciary duty for imposing a duty of care on bankers and justifying it on policy grounds still leaves the question of the

80. 17 C.F.R. § 230.176 (1991).

81. *See, e.g.*, Howing Co. v. Nationwide Corp., 826 F.2d 1470, 1478-79 (6th Cir. 1987) (bankers' opinion pursuant to SEC Rule 13e-3 is "too conclusory" to justify board's fairness determination); Herskowitz v. Nutri/System, Inc., 857 F.2d 179, 183-85 (3d Cir. 1988) (jury to determine reasonableness of valuation based on assumption of continuing 46% income tax rate at time when rate cut was being heavily discussed), *cert. denied*, 489 U.S. 1054, 1060 (1989); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1283 (Del. 1988) (banker's tipping one side in an auction with strategically material information and failing to inform board of this auction process taint was a "fraud on the board").

contours of that duty. A good deal of work already has been published to enable a skeletal outline of the characteristics of fairness opinions. Part IV briefly describes those characteristics, so that we may sketch in Part V the raw outlines of a protocol for bankers preparing and issuing fairness opinions.

A. The Variety of Fairness Concepts

Several writers have convincingly explicated the large variation in conceptions of "fairness" depending on the nature of the transaction and its context.[82] To illustrate, Bebchuk & Kahan state:

> Take freeze-out mergers as an example. In these mergers, fair price might focus on the company's value as an independent entity, as the market price of the minority shares, or as the price the minority shares would receive if auctioned off as a block. In addition, one might add to any of these measures a fraction of any freeze-out gains that might arise, or an appropriation for the tax expenses and reinvestment transaction costs that minority shareholders must incur.[83]

The profusion of differing concepts of value may cause both director and banker error. For example, assume a case in which a banker determines that a range of fair prices for a target's shares is twenty-two to twenty-eight dollars. When a hostile bid is made at twenty-four dollars, the banker reasonably may opine that the bid is "inadequate from a financial point of view" on the belief that the company has a reasonable possibility of doing better by some alternative. In the same case, if management instead wishes only to make the best deal possible without risk of losing out even on this first offer, the bid could be determined to be "fair from a financial point of view absent another solid bid."[84]

It is important that the banker recognizes and properly articulates the issue here. One who confuses the two issues might in the second case opine that the offer is "unfair." At that point, the board is hamstrung because it would invite litigation by accepting an unfair offer, even should the banker reverse itself after clarifying the issue.

This fairness-inadequacy example merely illustrates that the concept of

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82. Bebchuk & Kahan, *supra* note 6, at 30-34; Leonard Chazen, *Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third Party Sale Value" the Appropriate Standard?*, 36 BUS. LAW. 1439, 1443-50 (1981); Elliott J. Weiss, *The Law of Take Out Mergers:* Weinberger v. UOP, Inc. *Ushers in Phase Six*, 4 CARDOZO L. REV. 245, 256 (1983); Donald M. Feuerstein, *Valuation and Fairness Opinions*, 32 BUS. LAW. 1337 (1977).

83. Bebchuk & Kahan, *supra* note 6, at 33 (citations omitted).

84. Chazen, *supra* note 82, at 1453-56.

fairness depends on the transaction or its context. Other more subtle varieties of fairness are explained by the above authorities[85] and need not be pursued further here. The point is that the banker's duty should include both addressing the issue and disclosing why the banker chose the particular fairness concept at issue.

B. Varieties of Measurement of Values

Bebchuk and Kahan further describe the well-known fact that there are a large variety of measures of value.[86] These include the three familiar elements that had constituted the old Delaware block—asset values, discounted values of estimated future profits, and market value of shares—and a fourth, the Delaware block rule itself—an average of the three elements weighted to taste.[87] Another is the discounted future cash flow measurement method expressly sanctioned in *Weinberger v. UOP*. There are still others described in the cited articles.[88] Since all of these are susceptible to subjective judgment, no two analysts in a blindfold test would ever arrive at identical figures. For example, in using discounted cash flows, estimating the amount and timing of all future cash flow—with such variables as changes in tax and inflation rates, technology, and the risks of the particular company and industry—approaches mere guesswork.[89]

C. Bankers' Independence

Additionally, as Bebchuk and Kahan detail,[90] bankers frequently have interests that conflict with the shareholders' and the corporation's. Bankers are unlikely to bite the (managers') hand that feeds them. Further, their success may depend on a reputation for innovativeness, for spectacular success, or for "always winning"—perhaps at any cost.

D. Summary

As to each of these—the variety of fairness concepts, the variations in measurement techniques, and the conflicts of interest—Bebchuk and Kahan make clear that they are merely detailing ancient wisdom. Their

85. *See supra* notes 83-84 and accompanying text.
86. Bebchuk & Kahan, *supra* note 6, at 34-37.
87. *See* Piemonte v. New Boston Garden Corp., 387 N.E.2d 1145, 1153 (Mass. 1979).
88. *See supra* note 82.
89. TED J. FIFLIS, ACCOUNTING ISSUES FOR LAWYERS 695-701 (4th ed. 1991).
90. Bebchuk & Kahan, *supra* note 6, at 37-45.

contribution makes the evidence absolutely clear and convincing, and their conclusions are taken as established for purposes of this paper.

V. The Protocol for the Investment Bankers' Duty in Preparing and Issuing Fairness Opinions

To summarize, we concluded in Part II that no doctrinal difficulty prevents holding bankers liable to shareholders for breach of a duty of care, regardless of shareholder reliance, since the banker's opinion is commissioned for the ultimate benefit of shareholders. We also outlined in Part III the gatekeeper policy analysis for making bankers liable. In Part IV, we briefly recalled the findings of the literature on the characteristics of fairness opinions, including the varieties of fairness concepts and measurements, and the relevance of conflicts of interest of the banker.

As a final question, what shall be the outlines of the protocol for bankers' duties? The fleshing out of the answer will take place through ordinary common-law, case-by-case development. But the outlines may be here tentatively sketched merely for illustrative purposes.

A. The Contents of the Standard of Care

Presumably, the standard of care required of bankers will be the same as for other professionals—that of their profession unless the individual claims a higher standard. These would include duties of care: (1) in maintaining the appropriate level of skill; (2) in selecting and disclosing the appropriate fairness concept for the transaction; (3) in selecting, disclosing, and explaining the measurement techniques used—e.g., discounted cash flow, liquidation value; (4) in fully disclosing any and all of the bankers' conflicts of interest; and (5) in fully disclosing all qualifications, assumptions, and sensitivity studies deemed necessary to give an adequate comprehension of the opinion.

Note that when the banker selects and discloses the appropriate fairness concept—(2) above—she must frame and explain the issue being addressed. Is the matter one of determining if the value being offered is the best price obtainable, or one of determining if accepting the offer is reasonable in the circumstances? Here the banker must be skillful in ascertaining the client's purposes, and she will often require advice of counsel as to the appropriate concept of value.

B. Due Diligence

Arthur Rosenbloom and Arthur Aufses, a banker and his lawyer, have tentatively assayed three areas for diligence:[91] (1) document review, (2) on site inspections, and (3) interviews of key persons.

An adequate due-diligence investigation would be necessary to have a reasonable basis for the conclusions reached in investment bankers' fairness opinions, a minimum requirement for such opinions.[92]

Due diligence here would be akin to that required of auditors doing an audit, investment bankers underwriting securities offerings, special litigation committees exercising business judgment concerning whether to continue a stockholders' derivative suit, directors investigating merger terms before recommending the merger to shareholders, or an attorney investigating before issuing legal opinions.

Although many express concern that bankers not be put into a straitjacket, their fear is unfounded. The object of establishing due-diligence standards is to ease the task of professionals while assuring quality—the same reasons auditors, lawyers, and others strive to establish standards for their due-diligence duties.

C. Customs and Practices and the T.J. Hooper *Concept*

Because the fairness-opinion industry is still in its infancy, and because the opinion is for the benefit of and affects large numbers of public shareholders, the transaction costs in establishing appropriate practices are so high that courts should feel free to require higher standards than currently may be in effect. Thus, as in *The T.J. Hooper*,[93] in which Learned Hand required ship-to-shore radios for coastwise shipping despite their not being customary, courts should feel free to require certain measures of care for bankers' opinions even if not customary. Thus disclosure standards, compulsory sensitivity studies, and the like might be appropriate.

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91. Arthur Rosenbloom & Arthur Aufses, *On Understanding Investment Banker Liability*, 4 INSIGHTS 3 (1990).

92. For a discussion of "Reasonable Basis," see Ted J. Fiflis, *Current Problems of Accountants' Responsibilities to Third Parties*, 28 VAND. L. REV. 31 (1975).

93. 60 F.2d 737 (2d Cir. 1932).

D. Disclaimers

As with auditors' and attorneys' opinions, certain disclaimers will be necessary on occasion. They should be subject to full disclosure.

E. Indemnification

Principles of indemnification law should be carefully applied here. If the effect of indemnification in a particular case will be to saddle the loss on shareholders, courts should feel free not to enforce such clauses.

F. Exculpation

Bankers will seek exculpation even for ordinary negligence. Where shareholders have the right of recovery, exculpation clauses negotiated with managers ordinarily should not apply. In the legal profession, exculpatory arrangements are unenforceable except against the most sophisticated clients.[94] Courts frequently invalidate exculpatory agreements for professionals.[95] Similar doctrines should apply to exculpatory clauses here.

G. Other Limiting Arrangements

Schneider has stimulated bankers to seek forum-selection, law-selection, and jury-waiver clauses in their engagement agreements. Given the lack of privity with shareholders, these forms of opting out should not be too freely allowed.

CONCLUSION

It appears that liability of bankers to shareholders for negligently prepared fairness opinions is defensible on traditional doctrinal grounds and desirable on policy grounds, at costs far outweighed by the benefits.

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94. None of these should apply for shareholders actions unless contracted away by shareholders.

95. *See, e.g.*, CHARLES W. WOLFRAM, MODERN LEGAL ETHICS §§ 5-7 (1986). In Erlich v. First National Bank, 505 A.2d 220 (N.J. Super. Ct. Law Div. 1985) the court avoided an exculpatory clause in an investment management contract. "As a general rule, the courts will not enforce an exculpatory clause if the party benefiting from exculpation is subject to a positive duty imposed by law or is imbued with a public trust, or if exoneration of the party would adversely affect its public interest." *Id.* at 232.