Fairness Opinions & Financial Advisors

Recent Cases and Other Considerations
Baker v. Goldman Sachs

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Recent Cases – *Baker v. Goldman Sachs*

Baker v. Goldman Sachs & Co., 656 F.Supp. 2d 226 (D. Mass. 2009).

Holding

- The Federal District Court refused to dismiss a number of claims brought by the founder/controlling shareholder of Dragon Systems and her husband against the financial advisor to Dragon Systems in connection with the sale of the Company, including, among others, breach of contract/third party beneficiary and breach of fiduciary duty claims.

Background

- In June 2000 Dragon Systems, a private company, was acquired by Lernout & Hauspie Speech Products in a merger pursuant to which the shareholders of Dragon Systems received L&H stock as consideration.
- Within months of the merger, public disclosure of an accounting fraud at L&H rendered L&H stock worthless and ultimately led L&H to file for bankruptcy.

Recent Cases – *Baker v. Goldman Sachs*

- Plaintiffs, the founders and controlling shareholders of Dragon asserted seven claims, including:
  - breach of fiduciary duty;
  - violation of Massachusetts Unfair Trade Practices statute;
  - breach of contract;
  - breach of contract/third party beneficiary;
  - breach of implied covenant of good faith and fair dealing;
  - negligence; and
  - negligent misrepresentation.
- For purposes of defendants' motion to dismiss, all reasonable inferences were drawn in favor of the plaintiffs.

Recent Cases – *Baker v. Goldman Sachs*

- In December, 1999 Dragon's CFO executed an engagement letter agreement with Goldman Sachs.
  - The engagement letter was addressed to the (i) CFO of Dragon, (ii) one of the founders who was also a member of the Board of Dragon and (iii) an EVP and the CAO of Seagate, a significant stockholder of Dragon.
  - The engagement letter stated that:
    - "any written or oral advice provided by Goldman Sachs in connection with our engagement is exclusively for the information of the Board of Directors and senior management of the Company." *Id.* at 230.
    - the opinion provider "is exclusively engaged by Dragon Systems, Inc. (the "Company") as financial advisor in connection with the possible sale of all or a portion of the Company. During the term of our engagement, we will provide you with financial advice and assistance in connection with this potential transaction. . ." *Id.*
  - the founder/board member and Seagate only signed the engagement letter for purposes of a single exculpatory provision and were not responsible for the payment of the financial advisor's fees.

Recent Cases – *Baker v. Goldman Sachs*

Federal District Court Decision

- With respect to the contract claims, the Court noted that:
  - As addressees, neither the founder nor Seagate were identified in a representative capacity on behalf of Dragon. For purposes of the motion to dismiss the Court assumed the founder and Seagate were made addressees of and signed the engagement letter in their capacities as shareholders of Dragon.
  - According to the complaint, the financial advisor also had direct and persistent dealings with the founder/board member addressee throughout the course of the engagement.
    - Because the founder/board member only signed the engagement letter for purposes of a single exculpatory provision and was not responsible for the payment of the financial advisor's fees, the Court held that the founder/board member was not a party to the engagement letter and dismissed the breach of contract claim.
    - However, the Court found that the allegations in the complaint were sufficient to evidence an intent by the financial advisor to benefit the founder/board member and refused to dismiss the breach of contract/third party beneficiary claim.

Recent Cases –
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Takeaways:

- Even if person other than the client will sign the engagement letter (e.g., for purposes of exculpation and cooperation provisions), only address the engagement letter to the client company or, if to individuals, solely in a representative capacity on behalf of the Company.
- Avoid ambiguity - modify quoted provision in engagement letter to read ". . . as financial advisor [*insert* - to the Company] in connection with the possible sale of all or a portion of the Company. During the term of our engagement, we will provide [*delete* - you] [*insert* - *the Company*] with financial advice and assistance . . ."[Note: when referencing "the Board of Directors of the Company" also insert "(solely in such capacity)" to avoid allegations that such reference includes members of the Board in other capacities (e.g., as shareholders).

Recent Cases – *Baker v. Goldman Sachs*

Takeaways (cont'd):

- Engagement letters should clearly state (and most already do) that:
  - The engagement letter only creates duties to the client company and disclaim any third party beneficiaries (other than indemnified parties).
  - Although [financial advisor] may, in the course of engagements, arrangements or understandings with other parties have acquired or in the future acquire nonpublic information regarding the client's prospective counterparty, other potential participants in the proposed transaction, or their respective businesses, strategies or proposals, [financial advisor] shall have no obligation to disclose such information, or the fact that [financial advisor] is in possession of such information, to the Company, the Board of Directors of the Company or any of the Company's securityholders or to use such information for their benefit.
  - [Financial advisor] has adopted policies and procedures designed to preserve the independence of its research and credit analysts whose views may differ from those of the team of investment banking professionals performing the engagement.
  - [Financial advisor] will rely upon and assume the accuracy and completeness of all financial and other information furnished by or discussed with the Company, the Target and their respective Representatives, or available from public sources, and [financial advisor] does not assume responsibility for the accuracy or completeness of any such information. It is understood and agreed that [financial advisor] will not and will have no obligation to verify such information or to conduct any independent evaluation or appraisal of the assets or liabilities of the Company, the Target or any other party and [financial advisor] will assume that any financial projections or forecasts (including cost savings and synergies) that may be furnished by or discussed with the Company or the Target or their respective Representatives have been reasonably prepared and reflect the best then currently available estimates and judgments of the Company's or the Target's management.

Recent Cases – *Baker v. Goldman Sachs*

- With respect to the fiduciary duty claims, the Court noted that:
  - "plaintiffs have made sufficient allegations that special circumstances existed to create a fiduciary relationship apart from the terms of the contract." *Id.* at 237.
  - "There is no explicit waiver in the Engagement Letter precluding an extra-contractual fiduciary duty, as there was in Joyce." *Id*.
  - Accordingly, the Court denied the motion to dismiss the fiduciary duty claims.

Takeaway:

- Ensure that the engagement letter includes an express acknowledgment that the financial advisor is acting as an independent contractor with respect to its engagement by the client and is not undertaking any other duties (as fiduciary, agent or otherwise), to the client or any other person in connection with the engagement, regardless of any past or concurrent dealings or relationships.