

# Client Update

## Another Rural/Metro Lesson for Sell-Side Advisors: Bank Agrees to Pay \$2.5 Million to SEC to Settle Proxy Statement Claims

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The 2011 sale of Rural/Metro Corporation has for years served as a cautionary tale for sell-side investment bankers.<sup>1</sup> Those lessons continued on August 31, when the Securities and Exchange Commission announced a \$2.5 million settlement with RBC Capital Markets, Rural/Metro's sell-side financial advisor, for Exchange Act violations in connection with the fairness opinion rendered to the company's board of directors and the description of the analysis underlying that opinion contained in the company's merger proxy statement. This appears to be the first instance of the SEC sanctioning a financial advisor for proxy statement disclosure issues relating to its fairness analysis, and may indicate an increased focus by the SEC on financial advisors.

In its August 31 order instituting cease-and-desist proceedings against Rural/Metro's financial advisor, the SEC alleged that the precedent transaction analysis contained in the fairness presentation made to the Rural/Metro board was false and misleading. That analysis produced a valuation range by applying transaction multiples derived from comparable transactions to Rural/Metro's pro forma adjusted EBITDA for the 2010 calendar year. The analysis used two different EBITDA figures: one based on the management estimates and the other based on Wall Street analyst "consensus projections." In both cases, the deal price fell within the resulting valuation range.

The SEC found that the EBITDA figure described in the fairness presentation as representing consensus analyst projections was in fact derived from

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<sup>1</sup> For additional background, see our previous Client Updates on Rural/Metro matters: *How Sell-Side Advisors Can Reduce Litigation Risk in Light of Delaware's Rural/Metro Decision* (March 14, 2014), available [here](#); *Delaware Supreme Court Affirms "Narrow" Rural/Metro Ruling; Declines to Characterize Sell-Side Financial Advisors as "Gatekeepers"* (December 1, 2015), available [here](#).

Rural/Metro's actual 2010 adjusted EBITDA. Moreover, the SEC determined that the advisor did not adjust this figure for "non-recurring" expenses that most analysts had added back to the company's 2010 earnings. As a result, the SEC asserted that the description in the advisor's fairness presentation of the "analyst consensus case" was false and misleading.

The SEC also found that the description of the analysis underlying the advisor's fairness opinion in Rural/Metro's proxy statement to be false and misleading. In addition to the specific issues noted above, the SEC's order noted that while the portion of the proxy statement discussing the fairness opinion analysis did not disclose the amount of "analyst consensus" 2010 adjusted EBITDA estimates, the company disclosed 2010 adjusted EBITDA numbers elsewhere in the proxy and, as a result, a reasonable stockholder could have been led to believe that this figure was used by the advisor for its precedent transaction analysis and was consistent with Wall Street "consensus projections." The SEC observed that the advisor had prepared the initial summary of its valuation analysis for inclusion in the proxy statement and that it had reviewed both the preliminary and definitive proxy statements before they were filed.

On the basis of the foregoing, the SEC found that the advisor had violated Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, which prohibit solicitations by means of a proxy statement that contains materially false or misleading statements. In offering to settle with the SEC, the advisor agreed to disgorge the \$500,000 fee it received for rendering the fairness opinion (together with interest of \$77,759) and to pay a civil penalty of \$2,000,000.

Sell-side financial advisors have over the past several years – including as a result of the several Rural/Metro decisions of the Delaware courts – become highly sensitized to the risk of being dragged into shareholder litigation and seeing their advice second-guessed by plaintiff's counsel and judges. RBC's recently announced settlement with the SEC demonstrates that advisors should be equally sensitive to the risk that their opinions – and the descriptions thereof in their clients' proxy statements – will attract regulatory scrutiny. Advisors can best mitigate that risk by ensuring the accuracy not only of the financial analyses contained in the board books that accompany their fairness opinions, but also of the descriptions of those analyses – and any other matters relating to the advisor (including conflicts disclosure) – contained in their clients' proxy statements.

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Please do not hesitate to contact us with any questions.