The Harvard Law School Forum on Corporate Governance and Financial Regulation
SUPPORTED BY: CSC CORPORATION SERVICE COMPANY

Buyout and Deal Protections Enjoined due to Conflicted Advisor

Posted by Theodore Mirvis, Wachtell, Lipton, Rosen & Katz, on Wednesday February 16, 2011

Editor's Note: Theodore Mirvis is a partner in the Litigation Department at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Mirvis, Trevor S. Norwitz, Andrew J. Nussbaum, William Savitt and Ryan A. McLeod, and relates to the decision of the Delaware Court of Chancery in *In re Del Monte Foods Co. S'holders Litig.*, which is available here.

Another memorandum on the case, by George Bason, Arthur F. Golden and Justine Lee, of Davis Polk & Wardwell LLP is available here.

The Delaware Court of Chancery yesterday enjoined both the shareholder vote on a premium LBO transaction and the buyers' "deal protection" devices. *In re Del Monte Foods Co. S'holders Litig.*, C.A. No. 6027-VCL (Del. Ch. Feb. 14, 2011). The Court held that the advice the target's board received from its financial advisor was so conflicted as to give rise to a likelihood of a breach of fiduciary duty and indicated that the bidding buyout firm may face monetary damages as an "aider and abettor" of the potential breach.

On a preliminary record, the Court found that after the Del Monte board called off a process of exploring a potential sale in early 2010, its investment bankers continued to meet with several of the bidders — without the approval or knowledge of Del Monte — ultimately yielding a new joint bid from two buyout firms late in 2010. While still representing the board and before the parties had reached agreement on price, Del Monte's bankers sought and received permission to provide buy-side financing, which required the company to retain another investment advisor to render an unconflicted fairness opinion. Del Monte reached a high-premium deal with a "go-shop" provision and deal protection devices including a termination fee and matching rights. The original bankers were then tasked with running Del Monte's go-shop process (which yielded no further offers), although the Court noted they stood to earn a substantial fee from financing the pending acquisition.

Vice Chancellor Laster was troubled by the investment bank's effort to combine two bidders without consulting the board and in apparent contravention of a "no teaming" provision in confidentiality agreements entered into in connection with the original process. While the Court noted that "the blame for what took place appears at this preliminary stage to lie with [the bankers], the buck stops with the Board," because "Delaware law requires that a board take an active and direct role in the sale process." The Court also faulted the board for agreeing to allow the competing bidders to work together and the bankers to provide buy-side financing (even while overseeing the go-shop period) without "making any effort to obtain a benefit for Del Monte and its stockholders." Invoking the Court of Chancery's 2005 *Toys "R" Us* decision, the Court warned that "investment banks representing sellers [should] not create the appearance that they desire buy-side work" but instead focus on assisting the target board in fulfilling its fiduciary duties.

In response to these process deficiencies, the Court enjoined the vote on the transaction and the enforcement of the deal protection devices for twenty days, holding that without such relief, "the Del Monte stockholders will be deprived forever of the opportunity to receive a pre-vote topping bid in a process free of taint from [these] improper activities." The Court also expressly held open the possibility of a damages remedy against the lead bidder for "colluding" with the bankers.

While the case is at a preliminary stage, the decision serves as an important reminder to all participants in M&A transactions that the terms of confidentiality agreements should be properly respected, that bankers should receive and follow clear instructions from selling boards, and that bankers should ensure that any conflicts of interest are disclosed in advance, with specificity, to the selling board of directors.