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Del Monte Settlement Highlights Risk of Conflicts in Buyout Financing

Posted by Theodore Mirvis, Wachtell, Lipton, Rosen & Katz, on Friday October 21, 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, Paul K. Rowe, William Savitt, and Ryan A. McLeod. This post is part of the Delaware law series, which is co-sponsored by the Forum and Corporation Services Company; links to other posts in the series are available here.

Recently, there was the announcement of a proposed $89.4 million settlement of shareholder claims arising out of the buyout of Del Monte Foods Company. The shareholders had alleged that the sales process was tainted by collusion between the buyers and Del Monte's banker, which had sought to provide financing to the buyout group. The settlement follows the closing of the transaction and will be funded by both the new owners of the company and the banker.

The $89.4 million payment is one of the larger settlements to occur in Delaware shareholder litigation. The driver of the settlement was the Court of Chancery's February ruling granting a motion for a preliminary injunction. (See our memo of February 15, 2011 on the decision.) The case highlights the following considerations relevant to sale-of-a-company processes:

- When financial advisors play a dual role—both acting as the seller's advisor and also seeking to provide financing to the buyer—issues of conflict arise. The Delaware courts have recognized that, in some contexts, stapled financing offered by sell-side advisors can be permissible as a benefit to shareholders of the seller by inducing prospective bidders to compete for the target. But, recognizing the potential for divided loyalties, the courts require good reasons for allowing such an arrangement and close oversight by the board. In *Del Monte*, both were found lacking, as the record demonstrated (1) no need for or benefit from the target banker's participation in the financing and (2) the target board found out about its banker's interest in providing buy-side financing *after* the prospective buyers did.

- Especially as to private equity buyers, boards should pay close attention to how a sales process is managed to avoid findings of favoritism. The board should lead any sales process and actively supervise company advisors. In *Del Monte*, the preliminary record led the court to believe that the investment banker, without the board’s knowledge, had crafted a collusive sales process and pursued its own self- interest in seeking to provide financing to the favored buyer without obtaining the board’s prior approval. The board was faulted for failing to take sufficiently strong measures to restore a fair process or oversee its advisor.