“Sunshine is the Best Disinfectant”: A Financial Advisory Update

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Since December 2010, the Delaware Court of Chancery has emphasized in at least four cases the need for additional disclosures relating to financial advisors in merger and acquisition (M&A) transactions. The court has focused on increasing the breadth, depth and specificity of disclosures regarding any potential conflicts the financial advisor may have in serving the various parties to the transaction, the role of and work performed by the financial advisor, and the fees received by the financial advisor. In each of these cases the court required additional disclosure and enjoined the transaction for a period of time to allow the information to be considered by stockholders. Because delay poses risk to closing any transaction, detailed and specific disclosure in these areas is recommended.

In the first of these four cases, *In re Art Technology Group, Inc. Shareholders Litigation*, the court enjoined the acquisition of Art Technology Group Inc. by Oracle Corporation, requiring the financial advisor to Art to disclose a description of the type of services it had performed for Oracle and the aggregate compensation paid by Oracle to the financial advisor for the prior four years. This disclosure exceeds the disclosure requirements of Item 1015(b)(4) of Regulation M-A under the Securities Exchange Act of 1934, which only requires disclosure of material relationships in the past two years between the financial advisor and the parties and any compensation received as a result of that relationship. It also exceeds the two-year look-back period specified by FINRA Rule 5150 for disclosing compensation received by the advisor. The court enjoined the merger for 10 days while the disclosures were made in a public filing with the U.S. Securities and Exchange Commission (SEC).

In the second case, *Steinhardt v. Howard-Anderson*, the court enjoined the acquisition of Occam Networks Inc. by Calix Inc. until additional proxy statement disclosures were made regarding the role of Calix’s financial advisor in shopping the company and assisting in the negotiation of the mix of cash and stock consideration, and the accretion/dilution analysis conducted by the financial advisor, among other issues. The court also expressed concern regarding discrepancies between the earlier financial presentations prepared for the board by the financial advisor and the final financial presentation (which supported the advisor’s fairness opinion). The court enjoined the transaction for 10 days and required the financial advisor to produce one of the two managing directors who “quarterbacked” the transaction for deposition as the Rule 30(b)(6) witness (one who testifies on behalf of the entity, in this case the financial advisor firm). The court noted it was insufficient to “send a fifth year junior banker who has

only done six fairness opinions, and who came into the process late in the game with only three months left [on the transaction], as your 30(b)(6) witness."

In the third case, *In re Del Monte Foods Company Shareholders Litigation*, the court halted a stockholder vote on the proposed buyout of Del Monte Foods Company because the court found that the merger agreement between Del Monte and a group of private equity firms resulted from the collusion between Del Monte's financial advisor and those firms. The court criticized the financial advisor for its conflicting roles in bringing together competing bidders, thus limiting the competition, and seeking to provide buy-side financing while simultaneously acting as the financial advisor assisting the board of Del Monte in its potential sale. Del Monte's board of directors allowed the financial advisor to run the 45-day go-shop process, despite the advisor's expectation of earning a fee for participating in the financing of the deal. The financial advisor stood to earn $21–$24 million from the financing and approximately $23 million for its advisory role, yet Del Monte, at the advisor's request and without any consideration from the advisor, engaged a second financial advisor and incurred an added $3 million expense. The court enjoined the stockholder vote for 20 days and found that Del Monte's board of directors breached its fiduciary duty of care to stockholders even though the court found that the board was misled by the financial advisor. "Although the blame for what took place appears at this preliminary stage with the [financial advisor], the buck stops with the Board." Quoting from the 1989 case of *Citron v. Fairchild Camera and Instrument, Corp.,* the court emphasized that "the role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management [and here I add other contingently compensated professionals like investment banks] may not necessarily be impartial." The court also enjoined the buyer's enforcement of the no-solicitation, match-rights and termination fee provisions in the merger agreement.

Lastly, in *In re Atheros Communications, Inc. Shareholder Litigation*, the court enjoined the target, Atheros Communications Inc., from holding a stockholders meeting to approve a merger with Qualcomm Inc. pending curative proxy statement disclosure of the amount of contingent fees to be paid to the financial advisor, among other issues. The original proxy statement did not disclose the exact amount of the financial advisor's fee nor the exact percentage of the fee that was contingent upon closing of the merger. The proxy statement did state, as many do, that the financial advisor would "be paid a customary fee, a portion of which is payable in connection with the rendering of its opinion and a substantial portion of which will be paid upon completion of the [m]erger." Though declining to announce a bright-line rule, the court reasoned that "it is clear that an approximately 50:1 contingency ratio requires disclosure to generate an informed judgment by the shareholders as they determine whether to rely upon the fairness opinion in making their decision to vote for or against the [t]ransaction." The amount of fees paid to the financial advisor was also required to be disclosed.

Click here to view a PDF of the four cases discussed in the article.

In these four cases the Delaware Court of Chancery emphasized the need for additional disclosure in order to make more transparent any potential conflicts financial advisors may have that would influence their ability to deliver an impartial opinion, the role of and work performed by financial advisors, and the amount and type of fees paid to these financial advisors. It is recommended these types of disclosures be made with as much detail and specificity as possible.

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