King & Spalding

Client Alert

Finance Practice Group

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In re Del Monte Foods Company Shareholders Litigation[i]

Sell-Side Advisor Conduct Prompts Delaware Court to Enjoin Merger Vote and Deal Protections in Del Monte Buyout

In a move that further limits the actions of investment banks to pair buyers and sellers in acquisition transactions, the Delaware Court of Chancery (the Court) granted a 20-day preliminary injunction with respect to the shareholder vote required to approve the merger between (i) Del Monte Foods Company (Del Monte) and (ii) a group of private equity firms. Moreover, the Court held that the parties to the merger agreement (the Merger Agreement) were enjoined from enforcing the deal protections set forth in the Merger Agreement.

The Court's decision to enjoin the shareholder vote was based on its finding that the Merger Agreement was entered into as a result of the collusion of Del Monte's sell-side investment bank (the Advisor) and certain private equity funds and that the price per share offered to Del Monte was obtained through a flawed sale process. In addition, the Court found that the board of directors (the Board) of Del Monte breached its fiduciary duty to the shareholders despite evidence that the Board was misled and deceived by the Advisor during the sale process.

BACKGROUND

Investments banks provide numerous services to their clients including buy-side advice, sell-side advice and suggesting strategic transactions to their clients. In this case, the Advisor had a long-standing relationship with each of Del Monte and the primary private equity fund (the Sponsor) seeking to acquire Del Monte.

In late 2009, Del Monte received a tender offer from a private equity firm and reached out to the Advisor to provide sell-side advice. The Advisor did not disclose to Del Monte that it has been pitching the acquisition of Del Monte to potential buyers or that it intended to participate in the buy-side financing. In addition, the Advisor indicated to Del Monte that the most advantageous manner to consummate the sale would be a targeted, non-public process to enable Del Monte to explore other opportunities that primarily focused on private equity firms. In connection with the initial sale process, each of the interested parties, including the Sponsor, signed confidentiality agreements

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(the Confidentiality Agreements) that did not allow the interested parties to discuss the deal amongst themselves (the No Teaming Provision) for a period of two years. After reviewing the proposals generated from the targeted buyer search process[ii], the Board decided that its stand-alone growth prospects were sufficiently strong. As a result, the Board informed the Advisor to shut down the sale process.

Six months later, the Advisor "sensed that the timing was right"[iii] to renew discussions of the Del Monte acquisition and reached out to the Sponsor as well as the highest bidder in the initial sale process (the Highest Bidder) to discuss a partnership. The Advisor was not authorized by Del Monte to partake in such discussions and none of the parties had any waiver of the No-Teaming provision in the Confidentiality Agreements. Further, by pairing the Sponsor with the Highest Bidder and, in effect, eliminating the prospect for any "real competition,"[iv] the Court held that the Advisor, the Sponsor and the Highest Bidder violated the No Teaming Provision.

With the Highest Bidder in the shadows, the Sponsor made a written indication of interest to purchase Del Monte's shares for $17.50 per share in cash. Given that (a) no other potential buyers had communicated with Del Monte since the Board initially decided to shut down the sale process, (b) the Sponsor's offering price equaled the highest price offered in the initial sale process and (c) that the Board felt a renewed process could have a detrimental effect on employees, customers and the stock price, the Board decided to adopt a single-bidder strategy with the Sponsor. After the Board's meeting, Del Monte once again called on the Advisor to provide financial advice. The Advisor did not disclose that it had been working with the Sponsor or that the Highest Bidder would be included in the acquisition process.

With "momentum building towards a deal,"[v] the Advisor finally informed Del Monte that the Sponsor had requested that the Highest Bidder be included in the acquisition team. In addition, the Advisor asked Del Monte if the Advisor could provide buy-side financing for the acquisition. The Advisor did not disclose that the Highest Bidder had been involved from the beginning or that the Sponsor had already agreed to allow the Advisor to provide one-third of the debt financing for the acquisition. Further, the Advisor required that Del Monte obtain a second fairness opinion to cover any potential conflict of interest created by having the Advisor provide buy-side financing for the acquisition.

On November 24, 2010, the Board unanimously approved the merger at a $19 per share price. The Merger Agreement contained customary go-shop and break-up fee provisions. Despite the apparent conflict created when the Advisor decided to participate in the buy-side financing, the Board allowed the Advisor to run the go-shop process. At this point, the Advisor was positioned to earn more in fees based on the buy-side financing than it would for its role as the sell-side advisor. The Advisor, therefore, was not motivated to find a new strategic buyer. Although, the Advisor did contact fifty-three parties during the go-shop process, because the Advisor had already teamed up the two most interested parties prior to the go-shop period, no potential buyers expressed interest in the transaction.

LEGAL RULING

The Court found that based on the facts in the preliminary record, the actions of the Advisor did not provide the shareholders of Del Monte with an open and fair sale process. Further, the Court found that the Board did not meet its fiduciary obligations to Del Monte's shareholders because it did not attempt to actively seek additional buyers or hire a new or additional sell-side advisor once they learned that the Highest Bidder would be included in the acquisition group and that the Advisor wanted to participate in the buy-side financing. Therefore, the Court granted a 20-day injunction to

allow other potential bidders an opportunity to exceed the $19 per share merger price offered by the Sponsor and its co-investors. In addition, during such 20-day period the Court removed the matching-rights, non-solicitation and termination fees embedded in the Merger Agreement.

LOOKING FORWARD

This is not the first Delaware case to focus on investment banks working both sides of a transaction. In the *Toys "R" Us* case[vi] in 2005, the Court stated that stapled financing provided by sell-side advisors "tends to raise eyebrows by creating the appearance of impropriety." Stapled financing, if done properly, can provide a benefit to a seller in that it arguably helps the deal get to market more quickly and efficiently. That being said, as a result of *Toys "R" Us*, most sell-side advisors are aware that their activities will face closer scrutiny by the courts and that the disclosures made to the seller as well as the sale strategy need to be fully vetted with the seller before going to market.

The Court in *Del Monte* acknowledged that the activities of the Advisor went "far beyond" the activities set forth in *Toys "R" Us*. In fact, the plaintiff is bringing a claim of aiding and abetting a breach of fiduciary duty against the Advisor. Although the facts of this case will most likely not be repeated, this case still presents a cautionary tale to investment banks that wish to provide sell-side advice as well as provide buy-side financing. By definition the role of an investment bank is to evaluate, explore and implement strategic alternatives for companies and one of their greatest assets is the ability to pair buyers and sellers based on their expertise and contacts in the marketplace. Post *Del Monte*, an investment bank will need to accurately weigh what role it can play on the sale side of a transaction if the investment bank wants to entertain buy-side financing economics. Further, the investment bank will need to determine what type of disclosure is required and when to make those disclosures to the interested parties. While *Del Monte* does not specifically state what an investment bank must do to stay fully above board in a transaction of this type, the opinion certainly makes it clear that investment banks need to walk the fine line between using their contacts to structure a strategic transaction while also maintaining client confidences.

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[i] *In re Del Monte Foods Company Shareholders Litigation*, Consol. C.A. No. 6027-VCL, at 13 (Del. Ch. February 14, 2011).
[ii] The highest bid was $17.50 per share.
[iii] *Id.* at 13.
[iv] *Id.* at 14.
[v] *Id.* at 18.
[vi] *In re Toys "R" Us, Inc. Shareholder Litigation*., 877 A.2d 975, 1000 (Del. Ch. 2005).