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Delaware Court of Chancery Halts Del Monte Merger Based on Financial Advisor Conflicts

On February 14, Vice Chancellor Laster temporarily enjoined the stockholder vote on the proposed buyout of Del Monte Foods Company. The court was harshly critical of Del Monte's financial advisor for its numerous conflicting roles as matchmaker of otherwise competing bidders, financial advisor to Del Monte and provider of buy-side financing. Due largely to the failure of the Del Monte board to understand and deal effectively with these numerous conflicts (some of which the court stated were actively concealed from the board), the court found that the board had not discharged its *Revlon* duties in connection with the merger. The court enjoined both the stockholder vote and certain of the deal protections in the merger agreement for 20 days to allow possible alternative bidders to emerge.

In late 2009, the financial advisor (which had a previous relationship with Del Monte), on its own, began shopping a possible buyout of Del Monte to private equity firms. Even at this early stage, the advisor's internal documents suggest that it wanted to participate in any financing that a buyer would need to fund the purchase of Del Monte. Del Monte was an attractive target for buyouts because of the cash it generated, and several firms began evaluating a possible transaction. After one of those firms sent a letter to the Del Monte board expressing interest in a buyout, the company turned to the advisor for financial advice. The advisor did not disclose its earlier discussions with potential acquirors or its interest in providing buy-side financing.

The financial advisor suggested, and the company agreed to pursue, a targeted, nonpublic sale process that consisted of the advisor contacting five private equity firms, each of whom were potential candidates of the buy-side debt-financing that the advisor could provide. Several others, including a strategic bidder, also joined the process after word leaked. Each bidder entered into a confidentiality agreement with Del Monte that prohibited the bidders from teaming up with any other bidder without the express consent of Del Monte (the "No Teaming Provision"). The board decided to halt the sale process in March 2010 because the company's standalone prospects were sufficiently strong such that the board determined that it was not in the best interests of stockholders to pursue a sale at that time. The board instructed the financial advisor to "shut [the] process down and let buyers know that the company is not for sale."

In late 2010, the financial advisor reached out to the two bidders that had made the highest bids in March. Notwithstanding the No Teaming Provision, the advisor urged them to make another overture to Del Monte. One then took the lead and made an offer. The advisor and the two bidders apparently agreed to conceal the involvement of the second bidder.

In response, the board re-engaged the financial advisor and decided against another auction, instead adopting a single-bidder strategy with a post-signing market check. Only later, after

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the bid began to firm up, did the advisor and the bidder ask the board's approval for the team bid. The board agreed without extracting any concessions for the loss of a potential competitive bidder.

Soon thereafter, the financial advisor told the Del Monte board of its interest in providing one-third of the debt financing in the proposed transaction (an allocation earlier agreed on with the bidder). The board agreed to allow the financial advisor to participate in the debt financing, and engaged a second financial advisor to provide a fairness opinion at considerable expense.

The deal was signed and the board decided it was appropriate to have the same financial advisor run the 45-day go-shop process, despite the financial conflict of interest created by the advisor's expectation of earning a fee for providing financing in the deal. According to the opinion, the original financial advisor stood to earn $21-24 million for the financing and approximately $23 million for its advisory role.

On these preliminary facts, the court held that there was a reasonable probability that the Del Monte board, even if it had acted in subjective good faith, failed to act reasonably in conducting the sale process because its decisions had been tainted by its advisors' conflict of interest. "Although the blame for what took place appears at this preliminary stage to lie with [the financial advisor], the buck stops with the Board." The court then faulted the board for not taking an "active and direct role in the sale process," and quoted the opinion of the Delaware Supreme Court in *Paramount Commc'ns Inc. v. QVC Network Inc.* in saying 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 then enjoined the stockholder vote on the transaction, and also enjoined buyers' enforcement of the no-shop, board recommendation and termination fee provisions in the merger agreement. This injunction is to remain in place for 20 days to allow the possibility that an alternative bidder will emerge. In enjoining the merger agreement, the court stated that it would normally respect the parties' contracted rights, but that "[w]hen a party aids and abets a breach of fiduciary duty, . . . the contract rights that the aider and abetter secures as a result of the interaction must give way to the superior equitable rights and interests of the beneficiaries." The court further noted that its injunction would not give the buyers the right to terminate the transaction because it did not "permanently" enjoin the transaction and thus did not trigger any of the buyers' termination rights under the merger agreement.

Notwithstanding the board's possible breach of fiduciary duties, the court noted that, due to a charter provision authorized by Delaware law, the directors were unlikely to be subject to monetary damages because it appears that the directors tried in good faith to fulfill their fiduciary duties, but failed because they were misled by their financial advisors.

This decision will serve as an important reminder to financial and other advisors to boards of directors that all conflicts of interest must be revealed to the board, and further that they owe important duties to the directors and to the corporation they are retained to serve that should always be of paramount importance.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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