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Delaware Court Enjoins Stockholder Vote and Deal Protection Provisions Over Process-Based Claims

On February 14, 2011, Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued a significant decision in *In re Del Monte Foods Co. S'holders Litig.*, in which he enjoined a stockholders meeting to vote on a merger for 20 days due in large part to the alleged conduct of the target's financial advisor and the bidder's participation in the advisor's resulting conflict. He also enjoined the operation of the merger agreement's no-shop, matching right, and termination fee provisions. He further found that the stockholder-plaintiffs had a reasonable probability of success on the merits in proving that the target company's directors breached their fiduciary duties by permitting the company's financial advisor to provide buy-side financing and by allowing certain private-equity bidders to partner in their bid, though he also emphasized that the directors were unlikely to face monetary liability for their actions. The injunction is a highly unusual remedy in these circumstances because it was based on the target company's sale process rather than on disclosure claims. In addition, Delaware courts historically have been very reluctant to enjoin a transaction and expose it to market risk in the absence of a topping bid.

Background

The case involved the $5.3 billion acquisition of Del Monte Foods by a private-equity consortium. On a preliminary record, the court found that the target's financial advisor had started assembling the consortium without the prior approval or knowledge of Del Monte's board of directors. It also found that the financial advisor had assembled the consortium in apparent violation of the private-equity bidders' confidentiality agreements, which included so-called "no teaming" provisions requiring Del Monte's consent before they could discuss a joint bid. The court further found that, from the outset, the financial advisor hoped to provide buy-side financing to the consortium, which could lead to fees equal to or in excess of the sell-side fees payable to the financial advisor by Del Monte. Importantly, the court found that Del Monte's board did not know of these facts prior to the litigation. Once they were discovered, Del Monte amended its proxy statement accordingly.

The court also found that the stockholder-plaintiffs had a reasonable probability of success in challenging the Del Monte board's later decisions to (i) permit the financial advisor to provide financing to the bidding consortium, (ii) permit the private equity firms to form the consortium (which arguably reduced competition to acquire the company), and (iii) allow the financial advisor to oversee the company's "go-shop process" in light of the financial advisor's buy-side financing role. The court emphasized that the board should have sought to extract a corresponding benefit for stockholders before taking any of these actions.

Finally, based on the preliminary record, the court found that there was a reasonable probability of success on the merits of plaintiff's aiding and abetting claims brought against the private equity bidders. These claims were based on the apparent breaches of the "no teaming" provisions in the confidentiality agreements with the company and by knowingly participating in the conflict of interest created by the financial advisor's buy-side financing role, including the potential for the advisor to limit competition during the go-shop period.

Implications

Del Monte reflects a very unusual judicial remedy because the Del Monte board had already made supplemental proxy statement disclosures regarding the activities of its financial advisor

and because there was no topping bid. The court concluded that the 20-day delay in the stockholder vote and related injunction of the enforcement of the deal protection provisions were necessary, however, in order to replicate an environment in which a third party could bid for the company free from the tainted process. At the same time, the court noted that the chances of Del Monte's directors being held personally liable were "vanishingly small" since nothing in the record suggested they acted in bad faith.

Del Monte will likely cause boards to more closely investigate their financial advisors, including by seeking full disclosure of their activities and to more fully supervise their activities during any sale process. As the court noted, "the blame for what took place appears at this preliminary stage to lie with" Del Monte's financial advisor but the "buck stops with the Board" since it is required to take "an active and direct role in the sale process."

The decision also will encourage stockholder-plaintiffs to continue focusing on such conflicts in discovery. In December 2010, for example, Vice Chancellor Laster temporarily enjoined a stockholders' meeting until a target company disclosed more details about the relationship between its financial advisor and the bidder.[1] Likewise, Delaware courts previously have been skeptical of target financial advisors that provide buy-side or "stapled" financing because of the incentives it provides for the advisor to favor a particular bidder or type of bidder.[2] In *Toys R' Us, Inc. S'holder Litig.*, 877 A.2d 975 (Del. Ch. 2005), for example, Vice Chancellor Leo E. Strine, Jr., observed that "[i]n general... it is advisable that investment banks representing sellers not create the appearance that they desire buy-side work, especially when it might be that they are more likely to be selected by some buyers for that lucrative role than by others." Nevertheless, the courts have recognized that there is no per se bar to such joint roles.

The *Del Monte* court was quite critical of the board's decision to permit its financial advisor to provide buy-side financing, particularly before the parties had finalized the merger agreement negotiations. In addition the court expressed particular concern about whether there was any compelling reason to allow the target's financial advisor to provide financing. "Without some justification reasonably related to advancing stockholder interests," the court stated, "it was unreasonable for the Board to permit [its financial advisor] to take on a direct conflict when still negotiating price." The court also disagreed with the board's decision to permit its financial advisor to oversee the go-shop process in light of the "direct financial conflict" created by the buy-side financing role.

Del Monte also garners attention with respect to the aiding and abetting claims brought against the bidders. Such claims rarely survive motions to dismiss, as bidders generally are free to bargain at arms-length with the target company, and typically are limited to claims involving collusion with insiders. The potential liability for these claims, however, could be significant. *Del Monte* shows the prospect for liability where a bidder allegedly participates in an outside advisor's conflict of interest that is not disclosed to the target's board of directors.

Finally, *Del Monte* provides guidance for managing sales processes where private equity bidders are likely to form bidding consortiums (also referred to as "clubbing" or "teaming"). One of the bidders had been the high bidder in a prior sale process run by Del Monte. As such, the court felt that permitting that bidder to join the other bidder had the potential effect of reducing price competition for the company. The court's analysis shows that boards must give careful thought to the effects of consortium bids and determine whether such bids are likely to enhance stockholder value or minimize competition for the company. The decision also reflects the importance of including "no teaming" provisions in confidentiality agreements.

If you have any questions about this decision or other corporate law matters, please contact Gary Thompson at (804) 788-8787 or gthompson@hunton.com, Roth Kehoe at (404) 888-4056 or rkehoe@hunton.com, Steven Haas at (804) 788-7217 or shaas@hunton.com or your Hunton & Williams LLP contact.

[1] *See In re Art Techn. Group, Inc. S'holders Litig.*, C.A. No. 5955-VCL, trans. (Del. Ch. Dec. 20, 2010).

[2] *See, e.g., Ortsman v. Green*, 2007 WL 702475 (Del. Ch. Feb. 28, 2007) (finding plaintiffs were entitled to expedited discovery where, among other things, the target's financial advisor had a conflict of interest due to its buy-side financing role); *In re Lear Corp. S'holder Litig.*, 926 A.2d 94 (Del. Ch. 2007) (noting favorably that the target was offering stapled financing to facilitate topping bids where a second banker conducted the go-shop process).

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