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*Expert Analysis*

# Delaware Court Delays Del Monte Merger over Investment Banker Misconduct Concerns

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The Delaware Chancery Court, on a preliminary record, found that the Del Monte Foods board of directors breached its *Revlon* duties by failing to provide sufficient oversight of the sale process as a result of the investment banker's alleged misconduct. The court delayed for 20 days the stockholder vote on the $5.3 billion merger and enjoined the buyer from enforcing the deal-protection provisions during that time in order to permit a potentially higher bid to emerge without the taint of the alleged misconduct.

## A BLACK EYE

*In re Del Monte Foods Co. Shareholders Litigation* tells a story worthy of Shakespeare and leaves the investment banking industry with a black eye. Corporate directors familiar with *Del Monte* may wonder whether they can trust their own financial advisers.[1]

In light of *Del Monte*, the board of directors of a potential acquisition target will need to interview investment bankers carefully. The board needs to probe carefully regarding conflicts of interest in order to protect the integrity of the sale process. The directors may bluntly ask whether the candidate has had discussions with or made presentations to potential buyers regarding acquisition of the company. The board should discuss at the outset whether the bank intends to seek the buy-side financing work for the transaction, and potential conflicts of interest that may result.

## HOW TAINTED?

The central question in *Del Monte* was whether the alleged conflicts of interest and misconduct of Barclays Capital, Del Monte's financial adviser, so tainted the sale process that remedial action was required. In fairness to Barclays, when reviewing the facts of the case, we must remember that Vice Chancellor J. Travis Laster made his findings on an incomplete record and that Barclays did not have an opportunity to fully defend itself.

Barclays has a strong presence in the consumer food and pet product sectors where Del Monte operates. Barclays was one of Del Monte's principal investment banks. Barclays handled several engagements for Del Monte during 2009 and 2010.

Barclays had an even stronger relationship with Kohlberg Kravis Roberts & Co. and with other private equity firms. During the past two years, KKR paid Barclays more than $66 million in fees.

*The Del Monte ruling tells a story worthy of Shakespeare and leaves the investment banking industry with a black eye.*

### DIRECTORS OUT OF THE LOOP

In late 2009 when Barclays was working for Del Monte on other matters and with-out Del Monte's authorization or knowledge, Barclays met with KKR, Apollo Management and other private equity firms to pitch investment opportunities, including the acquisition of Del Monte.

In early January of 2010, during a follow-up meeting, KKR said it was ready to pursue the acquisition of Del Monte. Barclays proceeded to outline for KKR how its client would respond to receiving the unsolicited offer — a private solicitation of interest from approximately five private equity sponsors with no strategic bidders. Needless to say, to the extent Barclays anticipated serving as Del Monte's financial adviser, sharing the client's strategy with the other side raised ethical issues.

Before KKR could make its move, Apollo advised Del Monte of its interest in acquiring the company at $14 to $15 per share. Del Monte's board engaged Barclays as its investment banker in connection with Apollo's expression of interest. As part of the selection process, Barclays claimed to be well qualified because the firm "knew many of the entities that might be an interested buyer."[2] However, Barclays omitted to mention that it had been pitching the acquisition of Del Monte to them and that Barclays' efforts may have resulted in the unsolicited takeover offer.

### AN UNDISCLOSED ROLE

Barclays also did not mention to the Del Monte board during the engagement discussions that the firm intended to seek a role in providing buy-side financing. However, Barclays' contemporaneous internal documents reflected that, at the appropriate time, Barclays intended to seek the very lucrative, buy-side financing work.

Not surprisingly, once engaged, Barclays recommended that Del Monte pursue a targeted, nonpublic process that tracked precisely what Barclays had outlined to KKR. Vice Chancellor Laster pointed out that there were sound and reasonable justifications for such an approach.

However, a narrow, targeted process involving a few large private equity firms also furthered Barclays' undisclosed goal of securing the lucrative buy-side financing work. Private equity buyers are generally more likely than strategic buyers to require financing, and Barclays was one of a limited group of institutions with sufficient resources to handle a transaction as large as the Del Monte LBO.[3]

### NO TEAMING

As part of the process, each private equity firm signed a confidentiality agreement that contained a "no teaming" provision, which prevented the firm from discussing Del Monte or its bids with anyone else, including another private equity firm.

The no-teaming provision provided, in part:

> [y]ou further agree that you will not, directly or indirectly … enter into any agreement, arrangement or understanding, or any discussions which would reasonably be expected to lead to such agreement, arrangement or understanding with any other person, including other potential bidders and equity or debt financing sources … regarding a possible transaction involving the company without the prior written consent of the company.[4]

Vice Chancellor Laster found that the no-teaming provision ensured Del Monte would have the contractual right to control the competitive dynamics of the process in determining whether any bidders would be allowed to work together on a joint bid.

Five private equity firms submitted preliminary expressions of interest. KKR submitted the second highest bid at $17 per share. Vestar presented the highest preliminary bid, in the $17-$17.50-per-share range. Vestar had advantages because of its knowledge of the industry and strength as an operator. However, it needed to team up with another private equity firm because of the size of the deal.

## ON THE BUY SIDE

Vice Chancellor Laster pointed out that in order to maximize competitive bidding, Del Monte would want to team Vestar up with a private equity group other than KKR so that the two highest bidders would remain in the game. But given Barclay's objective of providing buy-side financing for the deal, and its particularly close relationship with KKR, such competition would be undesirable because it reduced KKR's chances of winning the company.

***Did the alleged conflicts of interest and misconduct of Barclays Capital, Del Monte's financial adviser, so taint the sale process that remedial action was required?***

On March 18, 2010, the Del Monte Foods board considered the five indications of interest and decided that it was in the stockholders' best interest not to proceed further with the process. The board specifically instructed Barclays "to shut [the] process down and let buyers know the company is not for sale."[5]

In September 2010, without Del Monte's knowledge, Barclays tried to put the Del Monte LBO back together. Barclays met with Vestar and suggested that the time might be right to make another run at Del Monte, and that KKR would be the ideal partner. Barclays also discussed the idea with KKR and then followed up with Vestar to confirm KKR's continued interest.

## PAIRING HIGH BIDDERS

Particularly troubling to Vice Chancellor Laster was the fact that both Vestar and KKR were bound by their confidentiality agreements with Del Monte, which prohibited them from having any discussions, much less entering into an agreement, without Del Monte's prior written consent. Vestar and KKR did not have Del Monte's written consent. Moreover, Barclays was not authorized at that time to do anything on behalf of Del Monte.

Vice Chancellor Laster found that "[b]y pairing Vestar with KKR, Barclays put together the two highest bidders from March 2010, thereby reducing the prospect of real competition in any renewed process. … Teaming up Vestar and KKR served Barclays' interests in furthering the deal with an important client (KKR) that previously had used Barclays for buy-side financing."[6]

KKR presented Del Monte with a written proposal Oct. 11, 2010, to acquire the company for $17.50 per share. KKR's letter did not mention Vestar. In fact, Vice Chancellor Laster found that "Barclays worked with KKR to conceal Vestar's participation."[7]

The Del Monte board authorized reengaging Barclays as its financial adviser. The chairman of the strategic committee met with Barclays to negotiate a new engagement letter. The committee chairman "personally directed that Barclays was not to speak or act on Del Monte's behalf until the terms of the engagement letter had been finalized."[8] Barclays did not advise the chairman that Barclays "had been communicating with Vestar and KKR, put the two firms together, and helped spur the KKR bid. Barclays then began advising Del Monte on the bid [Barclays] engineered."[9]

### THE BOARD DIDN'T KNOW

With the momentum building toward a deal, in mid-November 2010 KKR, through Barclays, requested that the company allow KKR to include Vestar in the deal as an additional member of the sponsor group. The Del Monte board was not told that Vestar in fact had been partnered with KKR since September, when Barclays put them together. The board never considered the ramifications of permitting KKR to team up with the firm that previously submitted the high bid and that could readily have teamed with another large, buy-out shop to acquire the company or the possibility of enforcing the confidentiality agreement and inviting Vestar to participate with a different sponsor to generate competition.

In retrospect, Vice Chancellor Laster found it was not reasonable for the board to agree and "give up its best prospect for price competition without making any effort to obtain a benefit for Del Monte and its stockholders."[10]

***To the extent that Barclays anticipated serving as Del Monte's financial adviser, sharing the client's strategy with the other side raised ethical issues.***

### DOUBLE-DIPPING DESIRE

"Barclays had long been signaling KKR about its desire to participate [in the buy-side financing]."[11] On Nov. 8, 2010, while KKR and Del Monte were in the final stages of negotiation regarding price, Barclays asked KKR to give Barclays one-third of the buy-side financing debt, which could generate additional fees of $21 million to $24 million for Barclays. KKR agreed. The next day, Barclays asked Del Monte management for permission to provide the buy-side financing to KKR.

"No one thought that KKR needed Barclays, and other banks were already clamoring for their shares. Barclays simply wanted to double dip," Vice Chancellor Laster said.[12]

"As a result," he said, "at the same time Barclays ostensibly was negotiating to get KKR to pay more, Barclays had an incentive as a well-compensated lender to ensure that a deal was reached and that KKR did not over-pay."[13]

Vice Chancellor Laster found the board again failed to act reasonably by agreeing to Barclays' request. "Without some justification reasonably related to advancing stockholder interests, it was unreasonable for the board to permit Barclays to take on a direct conflict when still negotiating price."[14]

The Del Monte board finally approved the transaction at $19 per share.

The merger agreement provided for a 45-day, post-signing go-shop period during which Del Monte had the right to solicit and encourage competing, higher offers. Barclays conducted the "go shop" process for the company. Vice Chancellor Laster found that "Barclays had a direct financial conflict. … For its role in the buy-side financing for KKR, Barclays stood to earn another $21 [million] to $24 million. … If another bidder emerged that did not need financing or who chose not to use Barclays, then Barclays would lose its buy-side financing fees."[15]

## SCARING UP COMPETITION

In fact, Goldman Sachs had a prior relationship with Del Monte, and it independently approached Del Monte about managing the go-shop process. Upon learning of Goldman's interest, Barclays told KKR that Goldman was trying to "scare up competition."[16] According to Vice Chancellor Laster, KKR "solved the problem by letting Goldman participate in 5 percent of the syndication rights for the acquisition financing, which 'squared things away there.' After that, Goldman dropped its efforts to conduct the go-shop."[17]

Barclays' alleged misconduct did not come to light until discovery in a stockholder lawsuit challenging the transaction. The court faced a difficult dilemma because the proposed $19 per share represented an attractive opportunity for Del Monte stockholders, but the sale process was arguably tainted by Barclays' nondisclosure and conflicts of interest.

Vice Chancellor Laster reviewed the situation in terms of a breach-of-fiduciary-duty claim against the Del Monte board under the "enhanced scrutiny" standard in *Revlon*.[18] "Because of the central role played by investment banks in the evaluation, exploration, selection and implementation of strategic alternatives, [the] court has required full disclosure of investment banker compensation and potential conflicts … [and] has examined banker conflicts closely to determine whether they tainted the directors' process."[19]

## BUCK STOPS AT THE BOARD

Vice Chancellor Laster found that "[a]lthough the blame for what took place appears at this preliminary stage to lie with Barclays, the buck stops with the board. Delaware law requires that a board take an active and direct role in the sale process."[20]

In an effort to ameliorate the taint from Barclays' alleged improper activities, and the apparent steering of the deal to KKR, the court enjoined Del Monte from conducting the stockholder vote on the merger for a period of 20 days and enjoined the parties from enforcing the deal-protection devices for any deal that may be forthcoming during that process.

In the end, Vice Chancellor Laster doubted that a higher bid for Del Monte would be forthcoming. The Del Monte stockholders will never know what would have happened if KKR and Vestar had bid in competition for the company, rather than teamed together by Barclays.

But we can be certain that *Del Monte* will serve as a cautionary tale for M&A professionals. Going forward, boards of directors and their counsel will go to additional lengths to protect the integrity of the sale process against the investment banker's potential conflicts of interest.

## NOTES

1 *In re Del Monte Foods Co. S'holders Litig.*, 2011 WL 532014 (Del. Ch. Feb. 14, 2011).

2 *Id.* at *4.

3 *Id.*

4 *Id.* at *5.

 

[5] *Id.* at *7.

[6] *Id.*

[7] *Id.* at *8.

[8] *Id.* at *9.

[9] *Id.*

[10] *Id.* at *18.

[11] *Id.* at *10.

[12] *Id.*

[13] *Id.* at *17.

[14] *Id.* at *18.

[15] *Id.* at *12.

[16] *Id.*

[17] *Id.*

[18] *Revlon Inc. v. MacAndrews & Forbes Holdings Co.,* 506 A.2d 173, 179 (Del. 1986).

[19] 2011 WL 532014 at *16.

[20] *Id.* at *17, quoting *Citron v. Fairchild Camera & Instrument Corp.,* 569 A.2d 53, 66 (Del. 1989).

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