Del Monte Foods and Airgas: Two Important M & A Decisions From The Delaware Court of Chancery

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Last week, the Delaware Court of Chancery issued two decisions which provide important guidance in the context of public company M & A.

First, in *In Re Del Monte Foods Co. S'holder Litig.,* C.A. No. 6027-VCL (Del. Ch. Feb. 14, 2011), Vice Chancellor Laster delayed for 20 days the stockholder vote to approve the leveraged buyout of Del Monte Foods and enjoined the private equity buyers from utilizing deal protection provisions in the merger agreement. The Court's decision is grounded primarily on certain conduct by the Del Monte Board's financial advisor. The Court concluded there was a "reasonable probability of success on the merits of a claim for breach of fiduciary duty against the individual defendants [*i.e.,* the Del Monte board members], aided and abetted by KKR," the private equity buyer.

One day later, in *Air Products and Chemicals, Inc. v. Airgas, Inc., et al.,* C.A. No. 5249-CC (Del. Ch. Feb. 15, 2011), in a 153 page post-trial decision, Chancellor Chandler refused to order a board of directors to redeem a poison pill which impeded the Air Products hostile tender offer. The Court concluded that the Airgas board had met its burden under *Unocal* and its progeny of establishing a legally cognizable threat (that the price offered was inadequate and that a majority of shareholders were likely to tender into the inadequate offer) and had undertaken reasonable defensive measures in response.

In re Del Monte Foods Company Shareholder Litigation

In the *Del Monte Foods* case, the Court issued its order on the eve of the shareholder vote to approve a $5.3 billion leveraged buyout of Del Monte by a group of three private equity firms: Kohlberg, Kravis, Roberts & Co. ("KKR"); Centerview Partners; and Vestar. Although Vice Chancellor Laster described the terms of the LBO favorably - highlighting the price premium and describing board decisions on the LBO as predominately reasonable - the Vice Chancellor

nonetheless concluded there was a reasonable probability of success on the merits of a claim for breach of fiduciary duty against the Del Monte board that merited a 20-day stay on the vote and a ban on enforcing customary deal protection devices in the merger agreement.

The Court was particularly critical of the conduct of Del Monte's financial advisor, Barclays Capital. The Court stated that Barclays "secretly and selfishly manipulated the sale process to engineer a sale transaction that would permit Barclays to obtain lucrative buy-side financing fees. On multiple occasions, Barclays protected its own interests by withholding information from the Board that could have led Del Monte to retain a different bank . . . ."

The Court stated that Barclays did not disclose

- the behind-the-scenes efforts of its Del Monte coverage officer to put Del Monte into play;
- its explicit goal, harbored from the outset, of providing buy-side financing to the acquirer; and
- that in September of 2010, without Del Monte's authorization or approval, Barclays steered Vestar into a club bid with KKR, the potential bidder with whom Barclays had the strongest relationship, **in violation of confidentiality agreements that prohibited Vestar and KKR from discussing a joint bid without written permission from Del Monte.**

It is worth noting that in recent years the Delaware Chancery Court has not tolerated situations where board advisors have conflicting loyalties. See, e.g., *In re John Q. Hammons Inc., S'holder Litig.,* C.A. No. 758-CC (Del. Ch. Oct. 2, 2009), where the Court would not summarily dismiss a shareholder challenge to a going private transaction, in part because of undisclosed conflicts of interest on the part of the special committee's financial and legal advisors. See our client alert dated October 15, 2009 on the *Hammons* decision.

Even though the Court concluded that the Del Monte board appeared to have sought in good faith to discharge its fiduciary duties and may have been misled by its advisors, the Court found the Del Monte board may have breached its fiduciary duty by failing to properly supervise its financial advisor and by permitting its financial advisor to have dual allegiances. A board is required to take an "active and direct role" in a sale process.

The LBO

In late 2009, Barclays Capital began to condition the market for Del Monte's acquisition and pitched the Del Monte acquisition to various private equity firms including Apollo Management and KKR. In early January of 2010, KKR communicated to Barclays Capital it was interested in moving forward with the acquisition. Before Barclays and KKR could communicate this to Del Monte, however, Apollo presented Del Monte with a written expression of interest in an acquisition at $14 to $15 per share.

After receiving Apollo's expression of interest, Del Monte contacted Barclays Capital and retained them to advise Del Monte on the potential deal. **Barclays did not disclose to Del Monte it had pitched the LBO acquisition to Apollo, KKR and other private equity firms prior to being retained as advisor on the deal by Del Monte**. Barclays made recommendations regarding strategic LBO firms to invite to submit expressions of interest. Ultimately, Del Monte signed confidentiality agreements with six potential buyers; on the list were KKR and Vestar.

By mid-March of 2010 Del Monte had received expressions of interest from five of the six potential buyers. However, the Del Monte board decided not to move forward with the acquisition and instructed Barclays the company was no longer for sale.

In September of 2010 Barclays once again approached KKR and Vestar and proposed a joint bid to acquire Del Monte. Both KKR and Vestar agreed to submit a bid despite both having non-circumvention obligations under the confidentiality agreements they signed with Del Monte. Without disclosing Vestar's involvement, KKR made a formal bid to the Del Monte board in October of 2010 and the Del Monte board formally re-engaged Barclays as its financial advisor to negotiate the deal.

The Del Monte board did not become aware of Vestar's involvement until the beginning of November of 2010. However, the Del Monte board acquiesced to the involvement of Vestar and did not attempt to enforce the confidentiality agreements. At around the same time, Barclays formally requested the Del Monte board to permit Barclays to provide buy-side financing. The Del Monte board agreed and therefore retained Perella Weinberg Partners LP as a second financial advisor, thereby incurring additional advisory fees of $3 million.

At the end of November of 2010 the board unanimously approved KKRs offer of $19 per share. Per the terms of the deal, Del Monte authorized Barclays to run a 45-day go-shop solicitation. None of the parties Barclays contacted showed any interest in a topping bid.

On January 12, 2011, Del Monte issued its definitive proxy statement. The plaintiffs asserted the proxy disclosures were false and misleading. During discovery in connection with the preliminary injunction application Del Monte learned Barclays had elicited the initial LBO bid from Apollo and that as early as January of 2010 - many months before asking the Del Monte board for permission to do so - Barclays intended to have a buy-side role in the transaction.

The Court concluded Barclays' actions prior to the commencement of and during the LBO negotiations tainted the transaction to the detriment of Del Monte's stockholders. Barclays' dual role on the LBO as Del Monte's financial advisor and as buy-side financier, coupled with Barclays' involvement in putting Del Monte into play by pitching the LBO prior to being retained by Del Monte and Barclays' involvement in bringing together KKR and Vestar to submit a joint bid in violation of confidentiality agreements, materially reduced the prospect of true price competition for an acquisition of Del Monte.

The Court added that Barclays' role in providing buy-side financing seemed unnecessary from the record and led Del Monte to unjustifiably incur additional expenses. While the Court recognized the Del Monte board was not always aware of the extent of Barclays' misconduct, the Court determined the Del Monte board breached their fiduciary duties "by failing to provide the serious oversight that would have checked Barclays' misconduct". The Court also criticized the Board's decision to allow Barclays to run the go-shop when Barclays had an interest in seeing the KKR deal succeed.

KKR Probably Helped - Aiding and Abetting Liability

The Court also concluded there was a reasonable probability of success on the merits of a claim for aiding and abetting against KKR. Vice Chancellor Laster reasoned that KKR knowingly prepared a joint bid in violation of a no teaming provision in the Del Monte confidentiality agreement. Consequently, in addition to enjoining the board of directors from proceeding with the LBO vote for 20 days, the Court enjoined the parties from enforcing deal protection measures in the merger agreement until the stockholder vote, explaining that KKR "should not benefit from the misconduct they participated in."

Vice Chancellor Laster also determined that allowing the stockholder vote to proceed without affording Del Monte the occasion to conduct an untainted go-shop process would cause Del Monte irreparable harm by withholding forever the **opportunity** to gain a higher sale price. The Court therefore enjoined the vote for 20-days. The Court reasoned that enjoining the vote for a longer period would unnecessarily expose the transaction to market risk and could deprive the Del Monte shareholders of the premium being offered in the transaction.

Are the Del Monte Directors at Risk of Personal Liability?

The Court signaled the Del Monte directors were not necessarily exposed to significant personal liability from these matters.

"To hold that the Del Monte directors breached their fiduciary duties for purposes of granting injunctive relief does not suggest, much less pre-ordain, that the directors face a meaningful threat of monetary liability. On this preliminary record, it appears that the Board sought in good faith to fulfill its fiduciary duties, but failed because it was misled by Barclays. Unless further discovery reveals different facts, the one-two punch of exculpation under Section 102(b)(7) and full protection under Section 141(e) makes the chances of a judgment for money damages vanishingly small. The same cannot be said for the self-interested aiders and abettors. But while the directors may face little threat of liability, they cannot escape the ramifications of Barclays' misconduct. For purposes of equitable relief, the Board is responsible."

Air Products & Chemicals, Inc. v. Airgas Inc.

For one year, Airgas Inc. ("Airgas") has been resisting an unsolicited takeover by Air Products & Chemicals Inc. ("Air Products"). This battle has been waged publicly through extensive litigation, press releases, and SEC filings. Airgas has relied heavily on a "poison pill" and its conclusion that even the increased premium offered by Air Products is inadequate.

On February 15, 2011, in *Air Products and Chemicals, Inc. v. Airgas, Inc., et al.,* C.A. No. 5249-CC (Del. Ch. Feb. 15, 2011) and *In Re Airgas Inc. S'holder Litig.,* C.A. No. 5256-CC (Del. Ch. Feb. 15, 2011), Chancellor Chandler confirmed, if a board of directors acts in good faith, is advised by qualified outside experts, and has undertaken a diligent investigation and is well informed, the board has the authority to ward off an inadequate hostile tender offer, even where a majority of shareholders might be inclined to tender their shares into the offer. The hostile

bidder thus must either offer a price which is acceptable to the board or seek to elect a board which will support its offer.

Accordingly, the Court held the Airgas directors did not breach their fiduciary duties and denied the request of Air Products and shareholder plaintiffs to order Airgas to redeem its poison pill and allow shareholders to tender into Air Products' offer. The decision "brings to the fore one of the most basic questions animating all of corporate law . . . in the context of a hostile tender offer, who gets to decide when and if the corporation is for sale?"

The Tender Offer

Private merger negotiations between Air Products and Airgas stagnated until January of 2010 when Air Products informed Airgas of its intention to take a $60 per share offer directly to the stockholders. After conferring with outside, independent financial advisors, the Airgas board communicated to Air Products that $60 "was too low and that it 'significantly undervalued Airgas and its future prospects.'" Nevertheless, in February of 2010 Air Products launched its tender offer at $60 per share and conditioned the offer on the Airgas board redeeming its poison pill or the poison pill otherwise having been deemed inapplicable.

After consulting with its financial advisers again, Airgas communicated to the Airgas shareholders the board's recommendation not to tender into Air Products' offer because of the inadequacy of the price.

Airgas has a three year staggered board; hence, only one-third of the board is up for re-election each year. In March of 2010, Air Products nominated a slate of three independent directors for election and proposed amendments to the Airgas bylaws that would, among other things, accelerate the date of the 2011 annual meeting - all initiatives to be voted on at the Airgas 2010 annual meeting. In response, the Airgas board amended its bylaws and pushed back the 2010 annual meeting to September 15, 2010. After the new meeting date was set, Air Products raised its offer price to $63.50 and then raised the offer to $65.50. Both offers were unanimously rejected by the Airgas board as inadequate after consulting each time with their financial advisors.

Both Airgas and Air Products aggressively campaigned shareholders during these months, and at the annual meeting in September of 2010, **all three of the Air Product nominees were elected to the board** and all three of the Air Product bylaw proposals were adopted. Airgas

immediately filed suit against Air Products to invalidate the bylaw that accelerated the 2011 annual meeting date. The Delaware Supreme Court ultimately invalidated that bylaw.

On December 2, 2010 Air Products made its "best and final" offer at $70 per share. After conferring with three outside independent financial advisors, **the offer was unanimously rejected by the Airgas board, including the three directors elected on Air Products slate**. Subsequently, Air Products and plaintiff shareholders brought suit.

The Airgas Board Met Its Burden Under *Unocal*

Chancellor Chandler dismissed Plaintiffs' concerns "that companies with staggered boards and poison pills are 'takeover proof'" and that boards can essentially "just say never" to a hostile tender. Chancellor Chandler was clear that a board cannot "just say no" to a tender offer. The board's decision is subject to the two pronged judicial scrutiny required under the *Unocal* standard, articulated in *Unocal Corp. v. Mesa Petroleum Co.,* 493 A 2d 946 (Del 1985).

Under the first prong of *Unocal*, the Court found the Airgas board was comprised of a majority of independent directors and had, in good faith, engaged and relied on three outside and independent financial advisers in concluding the price offered by Air Products was inadequate. Chancellor Chandler explained that the inadequate price of Air Products' offer and the likelihood a majority of Airgas' stockholders would tender into the offer constituted a legally cognizable threat under *Unocal*.

Under the second prong of *Unocal*, the Chancellor determined that the defensive measures the board took, including adopting a poison pill with a 15% threshold, were reasonable and proportionate to the threat posed by the inadequate price. The Chancellor observed that the poison pill had served its purpose by providing the Airgas board with an entire year to communicate its views to the shareholders regarding the inadequacy of Air Products' offer and that, if a poison pill has an expiration date, its protective measure becomes ineffective. Moreover, the Court reasoned that mechanisms to overcome the poison pill existed and these mechanisms were clearly available to Air Products - Air Products had succeeded in electing a slate of three directors to the Airgas board and could nominate three more directors at the next election.

Ultimately, the Court answers the question it presented at the outset of the decision quite clearly: "the power to defeat an inadequate hostile tender offer ultimately lies with the board of

directors." In doing so, the *Airgas* decision reiterates the Court's longstanding support of well-informed defensive measures taken in good faith by independent boards under the threat of inadequate tender offers.

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