Hiring the Investment Banker - Common Sense Tips for Avoiding Problems in M&A Deals

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Investment bankers provide tremendous value to M&A transactions. And yet, their engagement and delivery of fairness opinions can be a minefield for a public company, its general counsel and outside counsel to navigate. Delaware courts have grown increasingly suspicious of transactions where financial advisors have potential conflicts of interest:

- In *In re Del Monte Foods Company Shareholders Litigation*, the target's financial advisor provided staple financing to the buyer. Notwithstanding the fact that the buyer paid a 40-percent premium to target's stock price, the Delaware Chancery Court determined that the financial advisor "secretly and selfishly manipulated the sale process" by failing to disclose its intention to provide staple financing until too late and by pairing a bidder from earlier in the process with a bidder of its own preference. According to the Court, these maneuvers to obtain "lucrative buy-side financing fees . . . tainted the advice [the financial advisor] gave and the actions it took"; the subsequent shareholder lawsuit was settled by the financial advisor and the target for $90 million.
- In *In re El Paso Corporation Shareholder Litigation*, the financial advisor disclosed its conflict — a 19-percent ownership stake in the buyer and control of two of its board seats — to its client's (the target's) board. Nonetheless, the Delaware Chancery Court found that mere disclosure was inadequate and that the financial advisor had "tainted the cleansing effect of [the second advisor hired by the target]" when it refused to agree to an amendment of its engagement letter that named it the exclusive advisor on a spinoff. The Court noted that this resulted in an incentive structure for the second advisor that paid it $35 million if its client merged with the buyer and "zilch, nada, zero" if its client went with a spinoff or other option. The shareholder lawsuit was settled for $110 million.

Our common sense tips for dealing with investment bankers are as follows:

- The financial advisor should be reputable, with appropriate experience in the relevant industry and in the type of transaction being considered. Now is not the time to hire an inexperienced advisor because someone owes someone a favor.
- Counsel to the board should strive to ensure that the financial advisor has disclosed all material conflicts to the board. This includes material relationships in the past two years with expected bidders, as well as ownership in any such bidders. Depending on the materiality of the relationship/ownership, it's possible that the board can determine to proceed with the advisor. The top financial advisors are likely to be working with multiple clients in the same industry; many such relationships do not present disabling conflicts.
- The financial advisor needs adequate time to perform the analyses that underlie its opinion. Hiring an advisor very late in the game is a bad idea for a number of reasons.
- Counsel to the board needs to keep an eye on the banker books and ask questions; counsel's role is to play plaintiff's lawyer and ensure that the financial advisor's analyses have been impartial and without any solving for the client's desired answer.
- If a material conflict is identified, counsel will need to advise whether to get a fairness opinion from an independent banker and, if so, whether the conflicted banker should still be expected to give an opinion.
- When two bankers are advising the same board (due to a conflict), counsel must ensure that the conflicted bank does not push the independent bank to the sidelines.

These are only some tips designed to establish a good record and protect the board. When in doubt, act conservatively, confer with counsel, and establish a record that will best serve everyone's interests.

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