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Chancery Court Sensitive to Potential Conflicts of Financial Advisers in M&A

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Over the past few years, the level of disclosure regarding the work performed by a financial adviser rendering a fairness opinion in connection with an M&A transaction has increased substantially, due in part to decisions of the Delaware Court of Chancery. At the same time, the number of complaints challenging the adequacy of the disclosure with respect to potential conflicts of interest on the part of the target's financial adviser is seemingly on the rise.

In a recent opinion in *In re Ness Technologies Inc. Shareholders Litigation*, the Court of Chancery has shown it is sensitive to these potential conflicts and may enjoin a transaction where the proxy statement omits material information regarding such potential conflicts.

In July 2010, Citi Venture Capital International (CVCI) submitted an unsolicited indication of interest in acquiring Ness Technologies Inc. (Ness) for between $5.50 and $5.75 per share. Because one of Ness's directors was affiliated with CVCI, the board formed a special committee to respond to CVCI's offer and to consider Ness's other strategic alternatives. The board retained Bank of America Merrill Lynch (BofA) to serve as its financial adviser, and the committee engaged Jefferies & Co. (Jefferies).

After failing to negotiate a price increase with CVCI, the committee instructed Jefferies to contact other potential buyers, both financial and strategic. As a result of its outbound inquiries, the committee secured offers from several potential buyers — all of which were higher than CVCI's initial indication of interest. Ness ultimately entered into an exclusivity agreement with a strategic bidder offering $7.40 per share. While the exclusivity period was in effect, CVCI submitted an unsolicited indication of interest, raising its offer to $7.75 per share. At the conclusion of the exclusivity period, the strategic bidder lowered its bid to $7, at which point the committee resumed negotiations with CVCI. Those negotiations eventually resulted in the execution of a merger agreement on June 10, at the $7.75 offer price, representing a 68 percent premium over Ness's trading price on the day before its discussions with potential buyers became public.

Plaintiffs challenged the transaction on price and process grounds, as well as disclosure grounds, and moved to expedite the proceedings. To succeed on the motion to expedite, plaintiffs were required to articulate a "sufficiently colorable claim" and show a "sufficient possibility of a threatened irreparable injury" to justify imposing on "defendants and the public the extra (and sometimes substantial) costs of an expedited preliminary injunction proceeding."

The Court of Chancery dismissed most of the price and process claims, noting, in particular, the robust 11-month sale process and the relatively "mundane" deal protections (e.g., a no-shop provision with a standard fiduciary out and a termination fee of 2.72 percent of the deal price). The court also noted that the process resulted in a final sale price that was $0.65 per share higher than any other bid — and $2 per share higher than CVCI's initial offer.

But the court stated that, at least in one instance, the plaintiffs "possibly stated a colorable claim." The plaintiffs alleged that potential conflicts of interest on the part of BofA and Jefferies impaired the advisers' ability to render an impartial fairness opinion. The allegations stemmed from the disclosure in the preliminary proxy statement to the effect that both Jefferies and BofA had provided financial advisory and investment banking services to CVCI or its affiliates in the past and may do so in the future. The preliminary proxy statement did not disclose "how much business the financial advisers have done, are doing, or might expect to do in the future with CVCI or its affiliates" or whether "the amount of business would be material to the advisers."

The court found that if the amount of business involved would be material to the advisers, the plaintiffs might have a colorable claim. Accordingly, in a procedural setting where the court acts with "a certain solicitude for plaintiffs," the court granted the plaintiffs' motion for expedited discovery for the limited purpose of investigating whether either financial adviser's past, present or expected future dealings with CVCI created a conflict of interest.

The court then stated that the plaintiffs' claims regarding the financial advisers' potential conflicts could also give rise to viable disclosure claims. But the court indicated that there may not be a viable disclosure claim if the fees received by the financial advisers for their past services to CVCI were not material.

Despite the court's concerns over the potential conflicts of interest, this case should be viewed in light of the unique procedural posture.

In our view, it should not be viewed as a blanket prohibition against the use of financial advisers with potential buy-side or other conflicts. As the court noted in *Maric Capital Master Fund Ltd. v. Plato Learning Inc.,* every large financial adviser, because of its extensive client base and activities in the market, is bound to have conflicts of interest of some type or degree. As the *Maric* court indicated, those facial conflicts of interest, standing alone, will not necessarily taint a sales process.

Where such conflicts exist, however, they should be fully and fairly disclosed, such that stockholders can make a fully informed decision whether to approve a transaction.

Nevertheless, in light of *In re Ness* and other recent opinions of the Court of Chancery, corporations and their advisers should be mindful of potential challenges stemming from a financial adviser's buy-side activities or other potential conflicts and should ensure that those potential conflicts are adequately disclosed.

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