CORPORATE ALERT

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RECENT DELAWARE COURT OF CHANCERY DECISIONS ADDRESS *REVLON* DUTIES IN SINGLE-BIDDER SALE-OF-CONTROL TRANSACTIONS

The Delaware Court of Chancery recently addressed on two separate occasions—in *In re Plains Exploration & Production Co. Stockholder Litigation*[1] and *Koehler v. NetSpend Holdings, Inc.*[2] —whether a board of directors satisfied its Revlon duties in connection with a sale-of-control transaction involving negotiations with a single bidder. In both cases, the court found that the board's initial decision to pursue a single-bidder process was reasonable. However, while the court in Plains found that the directors satisfied their fiduciary duties under the *Revlon* standard, the court in *NetSpend*, found that the directors would likely fail to meet their burden, under Revlon, of proving that they were fully informed and acted reasonably throughout the sale process. Specifically, in *NetSpend*, the court found that deficiencies in the fairness opinion and the combination of deal protection devices—which included a no-shop provision, a short preclosing period and a "don't ask, don't waive" provision that crystallized existing standstill agreements with parties that had previously expressed an interest in the company—did not pass muster under *Revlon*. These cases provide important lessons for companies considering whether to pursue, and how to conduct, a single-bidder sale-of-control transaction.

Revlon Duty

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[3] the Supreme Court of Delaware held that, in a sale-of-control transaction, a company's directors must channel their fiduciary duties toward one objective: to obtain the best price reasonably available for the stockholders. The *Revlon* duty "is not an independent duty, but rather a restatement of directors' duties of loyalty and care."[4] *Revlon* claims are reviewed under an enhanced scrutiny test, which includes:

- "'. . . a judicial determination regarding the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision; and
- . . . a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing.'"[5]

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[1] 2013 WL 1909124 (Del. Ch. May 9, 2013).

[2] 2013 WL 2181518 (Del. Ch. May 21, 2013).

[3] 506 A.2d 173 (Del. 1986).

[4] *NetSpend*, 2013 WL 2181518, at 10 (citing *In re Answers Corp. S'holder Litig.*, 2012 WL 1253072, at 6 (Del. Ch. Apr. 11, 2012)).

[5] *Plains*, 2013 WL 1909124, at 4 (citing *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994)).

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In applying the *Revlon* standard, courts will not second-guess the sale price approved by a board of directors, nor do they require or endorse a specific path toward obtaining the best available price. However, courts will evaluate the reasonableness of the process employed by a board of directors for obtaining the best price and whether the directors were fully informed and acting in good faith.

The Cases

Plains

On May 9, 2013, Vice Chancellor Noble ruled in *In re Plains Exploration & Production Co. Stockholder Litigation* that the decision-making process of the board of directors of Plains Exploration & Production Co. ("***Plains***") in a sale-of-control transaction involving a single bidder was reasonable and that the Plains board did not violate its *Revlon* duty.

The Plains board did not seek other acquirers or discuss other possible business combinations. Rather, the board was satisfied to either make a deal with Freeport-McMoRan Copper & Gold Inc. ("***Freeport***") or continue as a stand-alone company. Further, the Plains board did not establish a special committee to consider the transaction, and its CEO led negotiations with Freeport. (Additionally, during negotiations, Freeport expressed its desire to retain Plains' management following the merger.) Nevertheless, the court found that the board's decision to allow the CEO to lead negotiations was not inherently unreasonable and that, in doing so, the board did not abdicate its duties with respect to the transaction. The court reasoned that, as a stockholder, the Plains CEO was aligned with the other stockholders, and, as the person with the deepest knowledge and experience regarding Plains' assets, he was best positioned to lead the negotiations. Further, the court found that the CEO did not dominate or control the board, and seven of the eight board members were independent and experienced in the oil and gas industry.

Ultimately, Plains and Freeport signed a merger agreement that provided for a substantial period between signing and closing, and contained mild deal-protection devices (including a "no-shop" clause with a fiduciary out for superior proposals and a 3 percent breakup fee). The court noted that, despite the market knowing about the sale for five months, no competing offers had emerged. The court stated that "a post-agreement market check can be an effective way to ensure that a company obtains the best price reasonably available"[6] and concluded that the Plains board "went through a reasonable decision-making process and acted reasonably to maximize the sales price of Plains."[7]

NetSpend

On May 21, 2013, Vice Chancellor Glasscock ruled in *Koehler v. NetSpend Holdings, Inc.* that the board of directors of NetSpend Holdings Inc. ("***NetSpend***") likely breached its Revlon duty in connection with a sale-of-control transaction involving a single bidder.

Like in *Plains*, the NetSpend board did not establish a special committee. Instead, the NetSpend board, which consisted of two affiliates of each of NetSpend's two largest stockholders, three independent

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[6] *Id.* at 6.
[7] *Id.* at 7.

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directors and NetSpend's CEO, allowed the company's CEO to lead the negotiations. The court found no inherent conflict of interest due to the CEO's lead role in the negotiations. The court believed that the interests of NetSpend's CEO, who was a significant stockholder, and the four directors appointed by the two largest stockholders were aligned with those of the other stockholders. In addition, the board instructed the CEO not to discuss any management retention agreements until after material deal terms had been agreed upon, and the board remained heavily involved in the negotiation process. Therefore, the court found no indication that the NetSpend board abdicated its fiduciary duties by delegating negotiations to management.[8]

Next, the court found that the NetSpend board's initial decision to pursue a single-bidder process was reasonable in light of the fact that it had recently gone through several failed attempts to sell the company. The court also found that the NetSpend board's decision to take the position that it was not for sale when talking to potential buyers, which allowed NetSpend to focus on maintaining operations while inducing Total System Services, Inc. ("***TSYS***"), the only bidder, to increase its offer, was an action that a board acting reasonably could take to maximize stockholder value.

However, the court in *NetSpend* found that, after electing to pursue the single-bidder strategy, the board's actions, taken as a whole (as further described below), were not reasonably designed to yield a process that would satisfy its *Revlon* duty to maximize the price payable to its stockholders.[9]

Lessons from Plains and NetSpend

Although the court in *Plains* and *NetSpend* did not adopt any new legal standards, the court's opinions shed light on the manner in which Delaware courts currently apply the *Revlon* standard and reinforce prior lessons.

- Facts Matter. Both *Plains* and *NetSpend* highlight that a Delaware court's decision regarding whether a board of directors has satisfied its *Revlon* duty in connection with a sale-of-control transaction is highly dependent on the particular mix of facts surrounding the transaction.

- The Adoption of a "Not-for-Sale" Strategy Is a Reasonable Approach to Maximize Stockholder Value. The court in *NetSpend* found that the board's decision to adopt a "not-for-sale" strategy that sought to maximize stockholder value by inducing the sole bidder to bid against itself, while dissuading nonserious offers from disrupting NetSpend's business, is within the range of actions a reasonable board can take to obtain the best price for its stockholders.

[8] The court also concluded that the NetSpend board acted in good faith, notwithstanding the fact that NetSpend's two largest stockholders, each of which had previously expressed an interest in selling their stakes in the company, collectively controlled a majority of the NetSpend board. Rather than creating a conflict of interest, the court found that the interests of the two largest stockholders and their representatives on the NetSpend board were aligned with the interests of the Company's stockholders generally. *NetSpend*, 2013 WL 2181518, at 11.

[9] Ultimately, however, the court denied the plaintiff's request for a preliminary injunction on equitable grounds because "the possibility that the stockholders will lose their chance to receive substantial premium over market for their shares" if the transaction was enjoined outweighed the flaw in the Board's deliberation process, since no other bidders appeared after an extended preclosing period or after the "don't ask, don't waive" provisions were lifted. *Id.* at 1, 23.

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- A Board's Decision to Have its CEO Lead Negotiations may be Reasonable. In each of *Plains* and *NetSpend*, the court found that the board's decision to have the CEO lead the negotiations was reasonable. In each of these cases, the court highlighted (a) the alignment of interest that existed between the company's stockholders and the CEO due to the CEO's stock ownership and (b) the board's continued involvement in and oversight of the negotiations.

- Single-Bidder Process Is not Per Se Unreasonable, but Board's Process Will Be Closely Scrutinized. The court in both cases acknowledged that there are circumstances in which a board might find a single-bidder process strategically desirable and in the best interest of a company and its stockholders, including the circumstances facing the Plains and NetSpend boards. However, as highlighted by the court in *NetSpend*, when a board decides to pursue a single-bidder process and forego a market check, the board must ensure that the other actions it takes with respect to the sale-of-control transaction, taken as a whole, result in a process that is reasonably designed to maximize the price to be received by the stockholders.

- In *NetSpend*, but not Plains, the Board's Reliance on the Fairness Opinion Was Unreasonable. In *Plains*, the board received a fairness opinion that the $50 per share purchase price payable to the Plains stockholders was within the range of fair prices. The court did not analyze the fairness opinion in depth, but neither did it find the board's reliance on the fairness opinion to be unreasonable.

  On the other hand, in *NetSpend*, the court found that the fairness opinion was weak because (a) the comparable companies used in the analysis were dissimilar to NetSpend and therefore significantly less useful; (b) the comparable transactions cited therein were dated and dissimilar; and (c) the discounted cash flow analysis yielded stock values that, at the low end, were 20 percent higher than the purchase price of $16 per share payable to the NetSpend stockholders. The court noted that, while directors are permitted to rely on expert opinions of financial advisors to the board,[10] the above facts rendered the fairness opinion an insufficient market check substitute —a fact that the NetSpend board was aware of pre-execution of the merger agreement.

- In *NetSpend*, but not *Plains*, the Deal Protection Devices Foreclosed a True Post-Agreement Market Check and Resulted in a Process that Was Not Reasonably Designed to Ensure Best Price.[11] In *NetSpend*, the court also found that, in addition to relying on a weak fairness opinion, the NetSpend board agreed to deal protection devices that, in the aggregate, resulted in the NetSpend board not being sufficiently informed to create a process that would ensure the best stock price for NetSpend's stockholders.

  – *No-Shop Clause*. After attempting and failing to get a "go-shop" provision in the merger agreement and in exchange for greater deal consideration and a lower termination fee, the

[10] See *Id.* at 16, citing 8 Del. C. §141(e).

[11] In addition to the no-shop clause and "don't ask, don't waive" provisions, the court also discussed the 3.9 percent termination fee, matching rights and voting agreements, none of which it found to likely deter a serious potential buyer. *Id.* at 17-18.

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NetSpend board agreed to a “no-shop” provision with a fiduciary out in the event that the board received a superior offer. While “no-shop” clauses are not per se unreasonable, the court found that, in *NetSpend*, the combination of the “no-shop” clause and the short period between signing and closing of the transaction (approximately two months if the plaintiff had not filed for injunctive relief) unreasonably locked up the deal so as to preclude the possibility of a reasonably adequate post-signing market check.

In *Plains*, the merger agreement also contained a no-shop clause with a fiduciary out. However, the *Plains* transaction was consummated more than five months following execution of the merger agreement. The court concluded that five months was a reasonable amount of time to allow the market to fully digest the merger, and, since the Plains board did not receive any competing bids during that time, the board could be reasonably assured that it had obtained the highest price reasonably available.

– *“Don't Ask, Don’t Waive” Provisions*. In connection with an initial effort by NetSpend’s two largest stockholders to sell their NetSpend shares, NetSpend entered into confidentiality agreements with two private equity firms, each of which contained standstill provisions that prevented the private equity firms from seeking to acquire NetSpend for one and two years, respectively, as well as “don’t ask, don’t waive” provisions that prevented the private equity firms from requesting that NetSpend amend, waive or consent to any action inconsistent with the standstill provisions.

  At the time that NetSpend entered into the standstill agreements, NetSpend was not for sale. Therefore, the fact that these standstill agreements existed did not render the NetSpend board’s process unreasonable. However, once the board determined that it was likely that TSYS would acquire NetSpend, its *Revlon* duties attached. Yet, the NetSpend board agreed to a term in the merger agreement that precluded NetSpend from waiving any standstill agreement to which it was a party without TSYS’s consent. The court found that, by “agreeing to continue the validity of the “don’t ask, don’t waive” provisions of the standstill agreements, the board blinded itself to any potential interest”[12] the two private equity firms might have had in purchasing the whole company. Even more troubling, according to the court, was the fact that it did not appear that the NetSpend board even considered whether the standstill agreements should remain in place once negotiations with TSYS began. In the absence of such discussion, the court could not conclude that the board’s decision to retain the “don’t ask, don’t waive” provisions and to import them into the merger agreement was “informed, logical [or] reasoned.”[13]

[12] *Id.* at 19.
[13] *Id.*

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Conclusion

The following are two key takeaways from the *Plains* and *NetSpend* cases:

- While a single-bidder sale process is not per se unreasonable, if a board elects to pursue a single-bidder process and forgo a presigning market check, the board must be cognizant that, in order to satisfy its *Revlon* duties, the other actions it takes with respect to such sale process, taken as a whole, must result in a process that is reasonably designed to maximize the price to be received by the stockholders.

- In a single-bidder sale process, the ability (or lack thereof) of the target to conduct a “de facto,” postsigning market check may be significant to a Delaware court—a fact that a target’s board should be aware of in negotiating both the deal protection measures and length of the preclosing period for the acquisition agreement.

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