Revlon in Review

By J. Anthony Terrell

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In March 1986, the Supreme Court of Delaware issued its landmark opinion in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) ("*Revlon*"), enunciating the duty of directors of a Delaware corporation to seek the highest price for the corporation's stockholders when the corporation is for sale or when a break-up has become inevitable. In perhaps the most quoted statement in the decision, the court held that, in these circumstances, "[t]he directors' role changed from defenders of the corporate bastion to *auctioneers* charged with getting the best price for the stockholders at a sale of the company." *Id*. at 182 (emphasis added).

Following the *Revlon* decision, there has been much litigation and academic discussion of what circumstances trigger the *Revlon* duty and what do not, as well as what actions a board of directors may take, in addition to conducting an auction, to satisfy that duty. It is submitted that *Revlon* and its progeny are not crystal clear, and many decisions of the Delaware Chancery Court appear to be inconsistent, to some extent, with precedential decisions of the Delaware Supreme Court, as well as with each other. Academics have attempted to rationalize these decisions and come to a conclusion as to what the law is or should be. This note will not do that. Rather, the objective of this note is to provide a snapshot of the important decisions with a view to giving practical guidance to corporate directors as to:

- the circumstances that may give rise to the *Revlon* duty and

- what actions directors should take in order to discharge that duty.

I. Revlon – The Decision

Pantry Pride, Inc. (headed by Ronald Perelman) had made unsolicited overtures to Revlon, Inc., all of which were rejected, followed by a hostile cash tender offer at successively increasing prices. Lazard Freres (in the person of Felix Rohatyn), Revlon's financial advisor, advised that this was likely a "bust up" tender offer, to be financed by junk bonds and the sale of certain assets. In response, Revlon, based on the legal advice of Wachtell Lipton Rosen & Katz (in the person of Martin Lipton), instituted a variety of defensive measures, including a poison pill. However, Revlon went further and commenced negotiations with Forstmann Little & Company (headed by Theodore Forstmann), as a "white knight", eventually accepting a cash offer not significantly higher than Pantry Pride's offer at the time (and lower than Pantry Pride's final offer), granting Forstmann Little a "lock-up" option on valuable assets at a bargain price and agreeing to a "no-shop" provision. Forstmann Little also agreed to issue its promissory notes in exchange for certain notes of Revlon the holders of which had been threatening litigation against the Revlon directors following a significant drop in their market price. As part of the deal, Forstmann Little required Revlon to sell off three operating divisions to other parties.

In an action brought by MacAndrews & Forbes Holdings, Inc. (the controlling stockholder of Pantry Pride), the Supreme Court of Delaware affirmed the preliminary injunction granted by the Chancery Court. The Court found that the poison pill and other defensive measures initially instituted were appropriate under the enhanced standards of *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (which requires defensive measures in the context of a hostile takeover to be both reasonable and proportionate to the threat posed). However, the "no-shop" and the "lock- up" granted to Forstmann Little effectively ended the bidding for Revlon and made it inevitable that Revlon would be broken up. Under these circumstances, the Revlon board had a duty to seek the highest price rather than granting one bidder preference over another.

> However, when Pantry Pride increased its offer to $50 per share, and then to $53, it became apparent to all that the break-up of the company was inevitable. The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit…The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the Company. *Revlon*, 506 A.2d at 182.

The Court also noted that the principal benefit of the Forstmann deal, as compared to the Pantry Pride offer, "went to the directors, who avoided personal liability to a class of creditors to whom the board owed no duty under the circumstances". *Id*. At 184.

II. Revlon Triggers

As noted above, in *Revlon* both the Forstmann Little offer and the Pantry Pride offer were (1) solely for cash and (2) involved the break-up of the company and the sale of parts thereof. The principles embodied in *Revlon* have been amplified, clarified, refined and, perhaps, confused in a multitude of decisions of the Supreme Court and the Chancery Court of Delaware, some of which are briefly summarized below. As will be shown, whether or not the Delaware courts will find that the *Revlon* duty was triggered in any particular case depends on, among other things, the nature of the transaction, and the ownership structure of the acquirer and the type of merger consideration, as well as the specific allegations made by the plaintiff.

A. MacMillan

In *Mills Acquisition Co. et al v. MacMillan, Inc.*, 559 A.2d 1261 (Del. 1989) ("*MacMillan*"), MacMillan, Inc. was, first, the subject of a proposed management buyout and unsolicited cash tender offers and, ultimately, the subject of two competing tender offers, one by Kolberg Kravis Roberts & Co. in a transaction in which senior management would have a significant interest. The details of the long and tortuous saga are omitted from this note, with only the observation that this decision tells a story of unbridled self-dealing and breaches of the duty of loyalty. While the subject of competing tender offers, the board of directors granted a "lock-up" option to KKR and otherwise favored KKR by providing to it confidential information. The Delaware Court of Chancery denied the unsuccessful bidder's motion for a preliminary injunction against the KKR transaction.

On appeal, the Delaware Supreme Court found, among other things, that the actions of the board of directors in granting the lock-up option and furnishing confidential information to KKR impeded the auction of MacMillan:

> Clearly, this auction was clandestinely and impermissibly skewed in favor of KKR. The record amply demonstrates that KKR received material advantages to the exclusion and detriment of Maxwell to stymie, rather than enhance, the bidding process. *MacMillan*, 559 A.2d at 1281.

The Supreme Court further found that these actions violated the board's fiduciary duties as set forth in *Revlon*:

> In *Revlon*, we addressed for the first time the parameters of a board of directors' fiduciary duties in a sale of corporate control [emphasis added].
>
> * * * * * *
>
> There, we affirmed the Court of Chancery's decision to enjoin the lockup and no-shop provisions accepted by the Revlon directors, holding that the board had breached its fiduciary duties of care and loyalty. [FN34]
>
> > FN34. Following *Revlon*, there appeared to be a degree of "scholarly" debate about the particular fiduciary duty that had been breached in that case, i.e., the duty of care or the duty of loyalty. In *Ivanhoe*, 535 A.2d at 1345, we made it abundantly clear that both duties were involved in *Revlon* and that both had been breached.
>
> Perhaps the most significant aspect of *Revlon* was our holding that when the Revlon board authorized its management to negotiate a sale of the company [emphasis added]:
>
> > [t]he duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit…"
>
> *MacMillan* at 1284 (quoting *Revlon*, 506 A.2d at 182).

While the Court in *Revlon* did not use the terminology "sale of corporate control", the same Court in *MacMillan* appeared to equate, for purposes of *Revlon* analysis, the terms "sale of corporate control" and "sale of the Company". (See also *Barkan v. Amsted Industries, Incorporated*, 567 A.2d 1279 (Del. 1989) at 1286.)

The Court emphasized that, in this case, it was not necessary for it to determine when the company was put up "for sale", since the record was clear that the board of directors had determined that it would be in the best interests of the stockholders to sell the company. However, the decision contains an instructive footnote:

> FN35. This Court has been required to determine on other occasions since our decision in *Revlon*, whether a company is "for sale". *See Ivanhoe*, 535 A.2d at

> 1345; *Bershad v. Curtiss-Wright Corp.*, Del.Supr., 535 A.2d 840, 845 (1987). Clearly not every offer or transaction affecting the corporate structure invokes the *Revlon* duties. A refusal to entertain offers may comport with a valid exercise of business judgment. See *Bershad*; *Ivanhoe*, 535 A.2d at 1341-42; *Pogostin*, 480 A.2d at 627; *Aronson*, 473 A.2d at 812-16. Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer; its legality, feasibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the stockholders; the company's long term strategic plans; and any special factors bearing on stockholder and public interests. *Unocal*, 493 A.2d at 954-56. See also *Smith*, 488 A.2d 872-78. In *Ivanhoe* we recognized that a change in corporate structure under the special facts and circumstances of that case did not invoke *Revlon*, 535 A.2d at 1345. Specifically, Newmont's management faced two potentially coercive offers. In responding to such threats management's efforts were viewed as reasonable decisions intended to guide the corporation through the minefield of dangers directly posed by one bidder, and potentially by another. *Id*. at 1342-45. While it was argued that the transaction benefited management by strengthening its position, at most this was a secondary effect. There was no proof of self-dealing, and the evidence clearly sustained the conclusion that the board of Newmont punctiliously met its fiduciary obligations to the stockholders in the face of two major threats. *MacMillan*, 559 A.2d at 1285.

The Court noted that the *Revlon* duty is triggered "whether the 'sale' takes the form of an active auction, a management buyout or a 'restructuring' such as that which the Court of Chancery enjoined in *MacMillan I*." *Macmillan*, 559 A.2d at 1285.

In *MacMillan*, the Court found that the unfair advantages afforded to KKR may have impaired the effectiveness of the auction to the detriment of the stockholders. However, the Court did not indicate that equal treatment of bidders was required in all events:

> Directors are not required by Delaware law to conduct an auction according to some standard formula, only that they observe the significant requirement of fairness for the purpose of enhancing general shareholder interests. That does not preclude differing treatment of bidders when necessary to advance those interests. Variables may occur which necessitate such treatment. [FN38] However, the board's primary objective, and essential purpose, must remain the enhancement of the bidding process for the benefit of the stockholders.
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>> FN38. For example, this Court has upheld actions of directors when a board is confronted with a coercive "two-tiered" bust-up tender offer. See *Unocal*, 493 A.2d at 956; *Ivanhoe*, 535 A.2d at 1342. Compare *Revlon*, 506 A. 2d at 184.
>
> *MacMillan*, 559 A.2d at 1286.

Relevant Nuggets from MacMillan

- *Revlon* is focused, in part, on a "sale of the company" as a *Revlon* trigger. In MacMillan the same court clarified and, perhaps, expanded the concept by focusing on a "sale of corporate control" as a trigger.

- A "sale" that triggers the *Revlon* duty may take a variety of forms, but not every transaction triggers the duty.

- Unequal treatment of bidders may impair the effectiveness of an auction, although, in certain limited circumstances, differing treatment of bidders may be permissible when necessary to advance the interests of stockholders.

B. Time

In *Paramount Communications, Inc. v. Time Inc.,* 571 A.2d 1140 (Del. 1989) ("*Time*"), Time Inc. had entered into a merger agreement with Warner Communications, Inc. under which, in an all stock reverse triangular merger, Warner would become a subsidiary of Time and Warner stockholders would end up owning approximately 62% of the outstanding common stock of Time. The merger had to be approved by Warner stockholders and the issuance of stock by Time had to be approved by Time shareholders pursuant to the rules of the New York Stock Exchange. Paramount Communications, Inc. then made an unsolicited cash offer to purchase all outstanding shares of Time at a price that included a premium to market. Perhaps to avoid the necessity of stockholder approvals, Time and Warner revised the transaction to an outright acquisition by Time of Warner stock with cash and securities. Paramount and certain Time stockholders brought an action seeking to enjoin the Time-Warner transaction alleging, among other things, that the original Time-Warner merger agreement had triggered *Revlon* duties for the Time board and that, as a consequence, the Time board had to seek to maximize stockholder value in the immediate term.

The Delaware Supreme Court, affirming the decision of the Chancery Court denying the requested preliminary injunction, held, among other things, that *Revlon* duties had not been triggered for the Time board by the original merger agreement:

> We first take up plaintiffs' principal *Revlon* argument, summarized above. In rejecting this argument, the Chancellor found the original Time-Warner merger agreement not to constitute a "change of control" and concluded that the transaction did not trigger *Revlon* duties. The Chancellor's conclusion is premised on a finding that "[b]efore the merger agreement was signed, control of the corporation existed in a fluid aggregation of unaffiliated shareholders representing a voting majority – in other words, in the market." The Chancellor's findings of fact are supported by the record and his conclusion is correct as a matter of law. However, we premise our rejection of plaintiffs' *Revlon* claim on different grounds, namely, the absence of any substantial evidence to conclude that Time's board, in negotiating with Warner,

made the dissolution or break-up of the corporate entity inevitable, as was the case in *Revlon*.[1]

> Under Delaware law there are, generally speaking and without excluding other possibilities, two circumstances which may implicate *Revlon* duties. The first, and clearer one, is when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company. See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc.*, Del.Supr., 559 A.2d 1261 (1988). However, *Revlon* duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company. Thus, in *Revlon*, when the board responded to Pantry Pride's offer by contemplating a "bust-up" sale of assets in a leveraged acquisition, we imposed upon the board a duty to maximize immediate shareholder value and an obligation to auction the company fairly. If, however, the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered, though *Unocal* duties attach. See, e.g.*, Ivanhoe Partners v. Newmont Mining Corp.*, Del.Supr., 535 A.2d 1334, 1345 (1987).

Time, 571 A.2d at 1150.

Additional comments of the Chancery Court regarding change in control are worthy of note:

> If the appropriate inquiry is whether a change in control is contemplated, the answer must be sought in the specific circumstances surrounding the transaction. Surely under some circumstances a stock for stock merger could reflect a transfer of corporate control. That would, for example, plainly be the case here if Warner were a private company. But where, as here, the shares of both constituent corporations are widely held, corporate control can be expected to remain unaffected by a stock for stock merger. This in my judgment was the situation with respect to the original merger agreement. When the specifics of that situation are reviewed, it is seen that, aside from legal technicalities and aside from arrangements thought to enhance the prospect for the ultimate succession of Mr. Nicholas, neither corporation could be said to be acquiring the other. Control of both remained in a large, fluid, changeable and changing market.

[1] It is submitted that a more complete quotation of the Chancery Court, in its finding that there would have been no change in control, is helpful:

> There was no control block of Time shares before the agreement and there would be none after it, they point out. Before the merger agreement was signed, control of the corporation existed in a fluid aggregation of unaffiliated shareholders representing a voting majority—in other words, in the market. After the effectuation of the merger it contemplated, control would have remained in the market, so to speak. *In re Time Incorporated Shareholder Litigation*, C.A. No. 10670, 1989 WL 79880 at 22 (Del. Ch. July 14, 1989).

The existence of a block of stock in the hands of a single shareholder or a group with loyalty to each other does have real consequences to the financial value of "minority" stock. The law offers some protection to such shares through the imposition of a fiduciary duty upon controlling shareholders. But here, effectuation of the merger would not have subjected Time shareholders to the risks and consequences of holders of minority shares. This is a reflection of the fact that no control passed to anyone in the transaction contemplated. The shareholders of Time would have "suffered" dilution, of course, but they would suffer the same type of dilution upon the public distribution of new stock.

Paramount Communications, Inc. v. Time Inc., CA No. 10670, 10866, 10935 (Del. Ch. 1989).

Relevant Nuggets from Time

- There is no change in control (and no sale of control) in an all-stock transaction in which the acquirer has no controlling stockholder – that is, where control remains in a fluid aggregation of unaffiliated stockholders representing a voting majority (where control remains "in a large, fluid, changeable and changing market").

- Absent a change in control or a company-initiated bidding process, the inevitability of a break-up of the corporate entity is needed to trigger *Revlon*.

C. QVC

In *Paramount Communications, Inc. v. QVC Network, Inc.,* 637 A.2d 34 (Del. 1994) ("*QVC*"), Paramount Communications Inc. had entered into a merger agreement with Viacom, Inc. under which, in a cash and stock transaction, Paramount would merge into Viacom. Viacom had a controlling stockholder, Sumner M. Redstone, who owned or controlled 85.2% of Viacom's voting common stock and 69.2% of its non-voting common stock. QVC Network, Inc. then made a competing offer to acquire Paramount in a cash and stock transaction, followed by a formal tender offer. After increases in price by both Viacom and QVC, the Paramount board nevertheless favored a transaction with Viacom despite the higher price offered by QVC. QVC and certain Paramount stockholders brought an action seeking to enjoin the Paramount-Viacom transaction alleging, among other things, that the Paramount-Viacom merger agreement had triggered the *Revlon* duty for the Paramount board and that, as a consequence, the Paramount board had to obtain the highest immediately available value for Paramount's stockholders.

The Delaware Supreme Court, affirming the decision of the Chancery Court granting the requested preliminary injunction, held, among other things, that the proposed Paramount-Viacom transaction, due to Sumner Redstone's controlling interest in Viacom, had indeed triggered the *Revlon* duty for the Paramount board:

A. The Significance of a Sale or Change of Control.

When a majority of a corporation's voting shares are acquired by a single person or entity, or by a cohesive group acting together, there is a significant diminution in the voting power of those who thereby become minority stockholders. Under the statutory framework of the General Corporation Law, many of the most fundamental corporate changes can be implemented only if they are approved by a majority vote of the stockholders. Such actions include elections of directors, amendments to the certificate of incorporation, mergers, consolidations, sales of all or substantially all of the assets of the corporation, and dissolution. 8 Del. C. §§ 211, 242, 251-258, 263, 271, 275. Because of the overriding importance of voting rights, this Court and the Court of Chancery have consistently acted to protect stockholders from unwarranted interference with such rights.

In the absence of devices protecting the minority stockholders, stockholder votes are likely to become mere formalities where there is a majority stockholder. For example, minority stockholders can be deprived of a continuing equity interest in their corporation by means of a cash-out merger. *Weinberger*, 457 A.2d at 703. Absent effective protective provisions, minority stockholders must rely for protection solely on the fiduciary duties owed to them by the directors and the majority stockholder, since the minority stockholders have lost the power to influence corporate direction through the ballot. The acquisition of majority status and the consequent privilege of exerting the powers of majority ownership come at a price. That price is usually a control premium which recognizes not only the value of a control block of shares, but also compensates the minority stockholders for their resulting loss of voting power.

In the case before us, the public stockholders (in the aggregate) currently own a majority of Paramount's voting stock. Control of the corporation is not vested in a single person, entity, or group, but vested in the fluid aggregation of unaffiliated stockholders. In the event the Paramount-Viacom transaction is consummated, the public stockholders will receive cash and a minority equity voting position in the surviving corporation. Following such consummation, there will be a controlling stockholder who will have the voting power to: (a) elect directors (b) cause a break-up of the corporation (c) merge it with another company; (d) cash-out the public stockholders; (e) amend the certificate of incorporation; (f) sell all or substantially all of the corporate assets; or (g) otherwise alter materially the nature of the corporation and the public stockholders' interests. Irrespective of the present Paramount Board's vision of a long-term strategic alliance with Viacom, the proposed sale of control would provide the new controlling stockholder with the power to alter that vision.

* * * * * *

B. The Obligations of Directors in a Sale or Change of Control Transaction.

The consequences of a sale of control impose special obligations on the directors of a corporation. In particular, they have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders. The courts will apply enhanced scrutiny to ensure that the directors have acted reasonably. The obligations of the directors and the enhanced scrutiny of the courts are well-established by the decisions of this Court. The directors' fiduciary duties in a sale of control context are those which generally attach. In short, "the directors must act in accordance with their fundamental duties of care and loyalty." *Barkan v. Amsted Indus., Inc.*, Del.Supr., 567 A.2d 1279, 1286 (1989). As we held in *Macmillan*:

> It is basic to our law that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. In discharging this function, the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders. **This unremitting obligation extends equally to board conduct in a sale of corporate control**. 559 A.2d at 1280 (emphasis supplied) (citations omitted).

In the sale of control context, the directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the stockholders—and they must exercise their fiduciary duties to further that end. The decisions of this Court have consistently emphasized this goal. *Revlon*, 506 A.2d at 182 ("The duty of the board … [is] the maximization of the company's value at a sale for the stockholders' benefit."); *Macmillan*, 559 A.2d at 1288 ("[I]n a sale of corporate control the responsibility of the directors is to get the highest value reasonably attainable for the shareholders."); *Barkan*, 567 A.2d at 1286 ("[T]he board must act in a neutral manner to encourage the highest possible price for shareholders."). See also *Wilmington Trust Co. v. Coulter*, Del.Supr. , 200 A.2d 441, 448 (1964) (in the context of the duty of a trustee, "[w]hen all is equal … it is plain that the Trustee is bound to obtain the best price obtainable").

QVC, 637 A.2d at 42.

Upon argument by the Paramount defendants that, under *Revlon*, a break-up of the company is also required to trigger *Revlon* duties, the Supreme Court clarified its holding in *Time* and emphatically stated:

> Accordingly, when a corporation undertakes a transaction which will cause (a) a change in corporate control; **or** (b) a break-up of the corporate entity, the directors' obligation is to seek the best value reasonably available to the stockholders. This obligation arises because the effect of the Viacom-Paramount transaction, if consummated, is to shift control of Paramount from the public stockholders to a controlling stockholder, Viacom. Neither *Time-Warner* nor any other decision of this Court holds that a "break-up" of the company is essential to give rise to this obligation where there is a sale of control. *Id.* at 48.

Relevant Nuggets from QVC

- When a majority of a company's voting stock is acquired by a single person or entity, or by a cohesive group acting together, as opposed to remaining in the hands of a "large, fluid, changeable and changing market", there is a significant diminution in the voting power of minority stockholders. In the absence of protective devices, this results in a change in control.

- Clarification: the *Revlon* duty is triggered by either (a) a change in corporate control or (b) a break-up of the corporate entity. A break-up is not required if there will be a change in control.

D. Arnold

In *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994) ("*Arnold*"), Society for Savings Bancorp, Incorporated merged with Bank of Boston Corporation. Plaintiff Arnold, a Bancorp stockholder, brought an action for damages alleging, among other things, that the transaction triggered the *Revlon* duty because, by investigating options for increasing shareholder value, the Bancorp board had put the company "in play" or "up for sale", and, in any event, becausea change in control had occurred.

The Delaware Supreme Court, affirmed the decision of the Chancery Court denying the *Revlon* claim. The Chancery Court had found that exploring options or putting a company "in play" did not amount to initiating an active bidding process and that, even if Bancorp had been put on the auction block, the board had subsequently taken it off and abandoned its consideration of a break- up. In addition, the Chancery Court had found that there was no change in control since "[c]ontrol of both [companies] remain[s] in a large, fluid, changeable and changing market" (citing theChancery Court's decision in *Time*).

The Delaware Supreme Court elucidated and consolidated its prior holdings as to *Revlon* triggers thus:

> The directors of a corporation "have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders," *Paramount Communications, Inc. v. QVC Network, Inc.*, Del.Supr., 637 A.2d 34, 43 (1994), in at least the following three scenarios:
> (1) "when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company," *Paramount Communications, Inc. v. Time Inc.*, Del.Supr., 571 A.2d 1140, 1150 (1990) [*Time-Warner*]; (2) "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company," *id*.; or (3) when approval of a transaction results in a "sale or change of control," *QVC*, 637 A.2d at 42- 43, 47. In the latter situation, there is no "sale or change in control" when "[c]ontrol of both [companies] remain[s] in a large, fluid, changeable and changing market." *Id*, at 47 (citation and emphasis omitted). *Arnold*, 650A.2d at 1289, 1290.

Relevant Nuggets from Arnold

- Exploring strategic alternatives or other actions that may put a company "in play" donot, without more, trigger the *Revlon* duty; and

- Clarification: the *Revlon* duty is triggered in at least three scenarios:

- a corporation initiates an active bidding process to sell itself or to effect a business reorganization involving a clear break-up of the company; or

- in response to a bidder's offer, a corporation abandons long-term strategy and seeks an alternative transaction involving a break-up of the company; or

- a transaction will result in a sale or change in control (there being no change in control when control remains in a "large, fluid, changeable and changing market").

E. Santa Fe

In *In re Santa Fe Pacific Corporation Shareholder Litigation,* 669 A.2d 59 (Del. 1995) ("*Santa Fe*"), Santa Fe Pacific Corporation had entered into a merger agreement with Burlington Northern Inc. calling for a stock-for-stock merger of the two companies. In response to unsolicited offers by Union Pacific Corporation to merge with or acquire Santa Fe, followed by a hostile cash tender offer by Union Pacific, the Santa Fe – Burlington merger agreement was restructured to provide for:

- a joint cash tender offer for shares of Santa Fe for up to 33% of Santa Fe's outstanding common stock, whereby Burlington would purchase up to 13% and Santa Fe would purchase up to 20%;

- a repurchase program, following the joint tender offer but prior to the merger, whereby Santa Fe would be allowed to repurchase up to 10 million shares of Santa Fe common stock;

- the exemption of the purchase by Allegheny Corporation of up to 14.9% of Santa Fe's outstanding common stock from the provisions of Santa Fe's stockholder rights plan; and

- the merger of Santa Fe and Burlington.

The stock purchases contemplated above would have, if fully consummated,

- resulted in cash purchases of 33% of Santa Fe's outstanding common stock; and

- according to the decision, placed 33% of Santa Fe's shares in the hands of parties committed to the Santa Fe – Burlington merger. [It is submitted that, under §160(c) of the Delaware Corporation Law, Santa Fe was likely not permitted to vote shares of treasury stock.]

Stockholders of Santa Fe brought an action challenging the merger on the grounds, among others, that the discussions and merger agreement with Burlington, combined with the interaction with Union Pacific, had triggered the *Revlon* duty for the Santa Fe board to seek the best value reasonably available. The Chancery Court dismissed the *Revlon* claim.

The Delaware Supreme Court, while noting the plaintiffs' allegations that the Santa Fe board had initiated an active bidding process, affirmed the dismissal of the *Revlon* claims by the Court of Chancery on the grounds that an active bidding process, in and of itself, is not sufficient to trigger the *Revlon* duty – prospective sale of control or break-up is also required to trigger the *Revlon* duty – a prospective sale of control or break-up is also required to trigger the duty:

> Plaintiffs appear to rest their claim of a duty to seek the best value reasonably available on allegations that the Board initiated an active bidding process. Plaintiffs do not consider, however, that this method of invoking the duty requires that the Board also seek to sell control of the company or take other actions which would result in a break-up of the company. While the Board properly encouraged Union Pacific to improve its offer and may have used the results as leverage against Burlington, the Plaintiffs do not allege that the Board at any point decided to pursue a transaction which would result in a sale of control of Santa Fe to Burlington. Rather, the complaint portrays the Board as firmly committed to a stock-for-stock merger with Burlington.
>
> Conspicuously absent from the complaint is a description of the stock ownership structure of Burlington. Absent this factual averment, plaintiffs have failed to allege that control of Burlington and Santa Fe after the merger would not remain "in a large, fluid, changeable and changing market". *Arnold v. Soc'y for Sav. Bancorp., Inc.*, Del.Supr., 650 A.2d 1270, 1290 (1994) (quoting *Paramount Communications, Inc. v. QVC Network, Inc.*, Del.Supr., 637 A.2d 34, 47 (1993)).
>
> *Santa Fe*, 669 A.2d at 70.

The court thus noted, but did not elaborate on, the fact that the stock-for-stock exchange in the merger could have applied to as little as 67% of the Santa Fe shares outstanding prior to the transactions contemplated by the Santa Fe-Burlington merger agreement. The implication is that a transaction in which 67% of the consideration is paid in stock does not constitute a sale of control. However, the court did note that the plaintiffs failed to allege that the transaction would result in a change of control, so that issue was not specifically addressed.

Relevant Nugget from Santa Fe

Where the merger consideration is both stock and cash, if 67% or more of the consideration is stock there will likely not be a change in control (assuming that the acquiring company does not have a controlling stockholder).

F. Lukens

In *In re Lukens, Inc. Shareholders Litigation,* 757 A.2d 720 (Del. Ch. 1999) ("*Lukens*"), Lukens, Inc., after extended negotiations and a competing offer by Allegheny Ludlum Corporation, entered into a merger agreement with Bethlehem Steel Corporation under which Bethlehem would pay a combination of cash and stock having a total value of $30 per share for 100% of Lukens' common stock. Each Lukens' stockholder would have the right to receive cash or stock, subject to payment of a maximum of 62% of the total consideration given in the transaction being paid incash. Certain Lukens stockholders, without ever having sought to enjoin the transaction, sought an order rescinding the merger or, if not possible, awarding rescissory damages for breach of fiduciary duties, including *Revlon* duties.

Following a detailed discussion of the various fiduciary duties that can be implicated in M&A transactions (i.e., the duties of loyalty, good faith and due care), and after finding that rescission was not available because "it is impossible to unscramble the eggs", the Chancery Court found for the defendants on all claims. However, the crux of the decision pertinent to this note – i.e. the discussion of whether or not *Revlon* duties applied at all – is contained in footnote 25:

> The parties have spent a great deal of time arguing about whether *Revlon* duties apply. I find that, assuming that *Revlon* is implicated, the Complaint must still be dismissed. I nevertheless note that although there is no case directly on point, I cannot understand how the Director Defendants were *not* obliged, in the circumstances, to seek out the best price reasonably available. The defendants argue that because over 30% of the merger consideration were [*sic*] shares of Bethlehem common stock, a widely held company without any controlling shareholder, *Revlon* and *QVC* do not apply. I disagree. Whether 62% or 100% of the consideration was to be in cash, the directors were obliged to take reasonable steps to ensure that the shareholders received the best price available because, in any event, for a substantial majority of the then-current shareholders, "there is no long run". *TW Servs., Inc. v. SWT Acquisition Corp*., Del. Ch., C.A. Nos. 10427, 10298, mem. op. at 20, 1989 WL 20290, Allen, C. (Mar. 2, 1989). I do not agree with the defendants that *Santa Fe*, in which shareholders tendered 33% of their shares for cash and exchanged the remainder for common stock, controls a situation in which over 60% of the consideration is cash. The Supreme Court has not set out a black line rule explaining what percentage of the consideration can be cash without triggering *Revlon*. I take for granted, however, that a cash offer for 95% of a company's shares, for example, even if the other 5% will be exchanged for shares of a widely held corporation, will constitute a change of corporate control. Until instructed otherwise, I believe that purchasing more than 60% achieves the same result. *Lukens*, 757 A.2d at 732 n.25.

It is noteworthy that, as Vice Chancellor Lamb observed, the Delaware Supreme Court had not then set down any rule as to the maximum portion of merger consideration that could be paid in cash without triggering *Revlon* duties. In *Santa Fe*, the Supreme Court did not indicate that any specific percentage of consideration paid in cash would necessarily trigger the *Revlon* duty, although the implication is that, where stock represents 67% of the merger consideration, there is no sale of control and, accordingly, *Revlon* does not apply.

Relevant Nugget from Lukens

Where the merger consideration is both stock and cash, if less than 40% of the consideration is stock there will in all likelihood be a change in control.

G. Lyondell Chemical

In *Lyondell Chemical Company et al v. Walter E. Ryan et* al, 970 A.2d 235 (Del. 2009) ("*Lyondell II*"), after preliminary discussions with Basell AF, the acquisition by an affiliate of Basell of a number of shares necessitating the filing of a Schedule 13D and serious negotiations with Basell resulting in successive increases in the bid, Lyondell Chemical Company entered into a merger agreement with Basell whereby

Lyondell would be acquired in an all cash transaction. Certain stockholders of Lyondell challenged the merger on the grounds, among other things, that the filing of the Schedule 13D put Lyondell "in play" and triggered the *Revlon* duty which the directors allegedly failed to perform.

The Delaware Supreme Court reversed the decision of the Chancery Court that, among other things, the filing of the Schedule 13D had triggered the *Revlon* duty and that by taking a "wait and see" approach the Lyondell directors had breached that duty. While the Supreme Court clearly acknowledged that the *Revlon* duty was triggered later when the directors began negotiating the sale of Lyondell to Basell in an all cash transaction, the Court held that the *Revlon* duty did not arise simply because Lyondell had been put "in play" and that the directors' "wait and see" approach at that point in time "was an entirely appropriate exercise of the directors' business judgment. The time for action under *Revlon* did not begin until July 10, 2007, when the directors began negotiating the sale of Lyondell." *Lyondell II*, 970 A.2d at 242.

Since the exculpatory provision in Lyondell's certificate of incorporation precluded liability for breach of the duty of due care, the only question before the court was whether or not the directors had breached their duty of loyalty by acting in bad faith through an "intentional dereliction" or "conscious disregard" of their fiduciary duties. The court found that they did not.

Of particular interest, the Supreme Court made many clarifying comments on the directors' duties of due care and loyalty (including the possible breach of the duty of loyalty by failing to act in good faith) and on the effect of *Revlon* on those duties:

> As the trial court correctly noted, *Revlon* did not create any new fiduciary duties. It simply held that the "board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise." *Id*. at 239.
>
> * * * * * *
>
> There is only one *Revlon* duty – to "[get] the best price for the stockholders at a sale of the Company." (citing *Revlon*) *Id*. at 242

Relevant Nugget from Lyondell II

Actions that may put a company "in play", in and of themselves, do not trigger the *Revlon* duty.

H. Smurfit-Stone

In *In re Smurfit-Stone Container Corp. Shareholder Litigation,* C.A. No-6164-VCP, WL 2028076 (Del. Ch. 2011) ("*Smurfit-Stone*") (unpublished), Smurfit-Stone Container Corp., after seeking and receiving an analysis of strategic alternatives from its financial advisors, received an expression of interest from another company. Smurfit-Stone's immediate response was that it was "not for sale". After exploratory discussions, the offer was increased but ultimately declined as inadequate. Subsequently, Smurfit-Stone received an offer of $30.80 per share from Rock-Tenn Company, 50% in cash and 50% in stock. After negotiations and an increase in the offer to $35.00, with the same 50/50 mix, Smurfit-Stone entered into a merger agreement with Rock-Tenn that would result in Smurfit-Stone being acquired by Rock-Tenn and Smurfit-Stone stockholders owning approximately 45% of Rock-Tenn's outstanding shares. The proposed merger was challenged by Smurfit-Stone stockholders seeking a preliminary injunction on the grounds, among others, that the transaction triggered the *Revlon* duty and that the directors had breached that duty byfailing to take steps to maximize value.

The Delaware Chancery Court found that the plaintiffs were likely to succeed on their argument that the 50% cash and 50% stock consideration triggered the *Revlon* duty. First, the court noted that *Revlon* clearly applies in an all cash transaction, citing *In re NYMEX Shareholder Litigation*, 2009 WL 3206051 (Del. Ch. 2009), *In re Topps Co. Shareholders Litigation*, 926 A.2d 58 (Del. Ch. 2007) and *TW Services, Inc. v. SWT Acquisition Corp.*, 1989 WL 20290 (Del. Ch. 1989):

> On the other hand, *Revlon* will govern a board's decision to sell a corporation where stockholders will receive cash for their shares. *Revlon* applies in the latter instance because, among other things, there is no tomorrow for the corporation's present stockholders, meaning that they will forever be shut out from future profits generated by the resulting entity as well as the possibility of obtaining a control premium in a subsequent transaction. [Citing *Air Products and Chemicals, Inc. v. Airgas, Inc. et al*, 16 A.3d 48, 101-02 (Del. Ch. 2011)] Heightened scrutiny is appropriate because of an "omnipresent specter" that a board, which may have secured a continuing interest of some kind in the surviving entity, may favor its interests over those of the corporation's stockholders. [Citing *Lukens* 1757 A.2d at 732]

The court then discussed *Santa Fe*, noting that the plaintiffs therein had failed to allege that the transaction would result in a sale of control. The court then discussed *Lukens*, in which the cash portion of the merger consideration could have been up to 62%.

The court was not persuaded by the defendants' arguments that, unlike in *Lukens*, no Smurfit-Stone stockholders could be totally cashed out. Rather, the court was persuaded by the fact that approximately one-half of each stockholder's investment would be liquidated. Notwithstanding the above views of the court, Vice Chancellor Parsons did acknowledge that "my conclusion that *Revlon* applies here is not free from doubt."

Relevant Nugget from Smurfit-Stone

Where the merger consideration is both stock and cash, if only 50% of the consideration is stock there will likely be a change in control. (But this conclusion "is not free from doubt".)

I. ***Rural/Metro***

In *RBC Capital Markets, LLC v. Jervis*, No. 140, 2015, C.A. No. 6350-VCL (Del. 2015) ("*Rural/Metro*"), the Delaware Supreme Court affirmed a decision of the Chancery Court finding, among other things, that RBC Capital Markets, LLC ("RBC"), as financial advisor to Rural/Metro Corporation, aided and abetted a breach of the *Revlon* duty by directors of Rural/Metro in connection with the sale of that company. As to the breach by directors, there was no dispute as to whether or not the *Revlon* duty had been triggered, only as to when the duty was triggered.

While Rural/Metro's board had decided to explore "strategic alternatives" and appointed a Special Committee for that purpose, the Chancery Court found that, in fact, there had been no such exploration at all and that the Special Committee, without authorization, proceeded directly to a sale process and hired RBC Capital Markets, LLC to assist in such sale.

The defendants argued that *Revlon* could not have applied in December 2010, when the sale process was initiated, since, at that point in time, the sale of the Company was not "inevitable." Rather, the defendants contended that *Revlon* did not apply until the end of the sale process in late March 2011, since Rural/Metro could not have been sold without the approval of the full board.

The defendants further argued that, under *Lyondell II*, the *Revlon* duty is not triggered simply because a company is "in play". The court, however, found *Lyondell II* not applicable, noting that *Lyondell II* involved a third party putting the company "in play" and that the court, in that case, had found that the *Revlon* duty had not been triggered by the company so being put "in play" and was not triggered until the directors began negotiating the sale of the company.

In contrast, the Rural/Metro Special Committee itself had initiated the sale process immediately, satisfying the first of the three *Revlon* triggers enunciated in *Arnold*. While it was the members of the Special Committee, not other directors, who first breached their *Revlon* duty, when the full board ratified, retroactively, all action taken by the Special Committee, actions of the Committee became, retroactively, actions of the full board, thus resolving the timing issue noted above.

Rural/Metro is further discussed in part IV of this note.

III. Performance of the Revlon Duty, Generally

Assuming that given circumstances trigger the *Revlon* duty, the question then becomes what actions must directors take to perform that duty.

A. Barkan

In *Barkan v. Amsted Industries, Incorporated*, 567 A.2d 1279 (Del. 1989) ("*Barkan*"), the Delaware Supreme Court affirmed the approval by the Court of Chancery of a settlement of various class action lawsuits that had arisen out of a management-sponsored leveraged buyout of Amsted Industries, Incorporated. Plaintiff-shareholder Barkan appealed the order approving the settlement on the grounds, among others, that the Chancery Court neglected to recognize that Amsted's directors had breached their fiduciary duties of due care by failing to implement procedures designed to maximize Amsted's sale price once its sale became inevitable. While recognizing the *Revlon* duty generally, as a subset of the fundamental duties of care and loyalty, the court uttered one of the most well-known lines in *Revlon* literature:

> …there is no single blueprint that a board must follow to fulfill its duties. *Barkan,* 567 A.2d at 1286.

The court further explained that

> This Court has found that certain fact patterns demand certain responses fromthe directors. Notably, in *Revlon* we held that when several suitors are actively bidding

> for control of a corporation, the directors may not use defensive tactics that destroy the auction process. *Revlon,* 506 A.2d at 182-85. When it becomes clear that the auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders. *Id.* However, *Revlon* does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest. *Revlon* is merely one of an unbroken line of cases that seek to prevent the conflicts of interest that arise in the field of mergers and acquisitions by demanding that directors act with scrupulous concern for fairness to shareholders. When multiple bidders are competing for control, this concern for fairness forbids directors from using defensive mechanisms to thwart an auction or favor one bidder over another. *Id.* When the board is considering a single offer and has no reasonable grounds upon which to judge its adequacy, this concern for fairness demands a canvass of the market to determine if higher bids may be elicited. *In re Fort Howard Corp. Shareholders Litig.*, Del. Ch., C.A. No. 991, 1988 WL 83147 (Aug. 8, 1988). When, however, the directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market. As the Chancellor recognized, the circumstances in which this passive approach is acceptable are limited. "A decent respect for reality forces one to admit that…advice [of an investment banker] is frequently a pale substitute for the dependable information that a canvas of the relevant market can provide." *In re: Amsted Indus. Litig.*, letter op. at 19-20. The need for adequate information is central to the enlightened evaluation of a transaction that a board must make. Nevertheless, there is no right method that a board must employ to acquire such information. *Barkan,* 567 A.2d at 1286-87.

In *Barkan*, the Supreme Court noted, among other things, that Charles Hurwitz, a known sophisticated investor, had been accumulating a significant number of shares of Amsted Industries and that, as a consequence, Amsted was a likely target for a takeover or management buyout — i.e., Amsted was "in play". However, no bidders other than management emerged for a period of ten months. Furthermore, the transaction proposed by management resulted in tax advantages to management that were reflected in the offered price with the result that, especially in light of Amsted's declining earnings, the directors had good reason to believe that no other deal would result in a better price.

As to the necessity of a pre- or post-signing market check, the Supreme Court stated, among other things, that:

> Thus, while numerous factors—timing, publicity, tax advantages, and Amsted's declining performance—point to the directors' good faith belief that the shareholders were getting the best price, we decline to fashion an iron-clad rule for determining when a market test is not required. The evidence that will support a finding of good faith in the absence of some sort of market test is by nature circumstantial; therefore, its evaluation by a court must be open-textured. However, the crucial element supporting a finding of good faith is knowledge. It must be clear that the board had sufficient knowledge of relevant markets to form the basis for its belief that it acted in the best interests of the shareholders. The situations in which a completely passive approach to acquiring such knowledge is appropriate are limited.

The Chancellor found this to be such a situation, however, and we believe his finding to be within the scope of his discretion. *Barkan*, 567 A.2d at 1286

Relevant Nugget from Barkan

- "[T]here is no single blueprint that a board must follow to fulfill its duties" under *Revlon* (once triggered).

- In the absence of an active market test, it must be clear that the directors had "sufficient knowledge of relevant markets" (or another "body of reliable evidence"), however obtained, to evaluate a transaction.

B. Lyondell II

In *Lyondell Chemical Corporation v. Ryan*, 970 A.2d 235 (Del. 2009) ("*Lyondell II*"), the Delaware Supreme Court stated, among other things:

> There is only one *Revlon* duty – to "[get] the best price for the stockholders at a sale of the company." [*Revlon*, 506 A.2d at 182.] No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control. As we noted in *Barkan v. Amsted Industries, Inc.*, "there is no single blueprint that a board must follow to fulfill its duties." [*Barkan*, 567 A.2d at 1286.] That said, our courts have highlighted both the positive and negative aspects of various boards' conduct under *Revlon*. [*Barkan*, 567 A.2d at 1287; *Paramount*, 637 A.2d at 49; *In re Netsmart Technologies, Inc. Shareholders Litig.*, 924 A.2d 171, 199 (Del. Ch. 2007).] The trial court drew several principles from those cases: directors must "engage actively in the sale process," [*Ryan v. Lyondell Chem. Co.*, C.A. No. 3176- VCN, 2008 WL 2923427, (Del. Ch. July 29, 2008) ("*Lyondell I*") at 12] and they must confirm that they have obtained the best available price either by conducting an auction, by conducting a market check, or by demonstrating "an impeccable knowledge of the market." [*Lyondell I* at 97] *Lyondell II*, 970 A.2d at 242-43.

As mentioned in part II(G) of this note, the central holding of *Lyondell II* involves the distinction between a breach of the duty of due care and a breach of the duty of loyalty via a breach of the duty of good faith. In *Lyondell II* the issuer's charter contained a provision exculpating directors from liability unless the director acted in bad faith. Accordingly, the plaintiff alleged, among other things, a breach of the duty of loyalty in bringing suit against the directors, challenging, among other things, the sufficiency of the merger price, the process by which the merger was negotiated and the deal protection provisions. In reversing the Delaware Court of Chancery, the Supreme Court held that

> …if the directors failed to do all that they should have under the circumstances, they breached their duty of care. Only if they knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty. The trial court approached the record from the wrong perspective. Instead of questioning whether disinterested, independent directors did everything that they (arguably) should have done to obtain the best sale price, the inquiry should have been whether those directors utterly failed

to attempt to obtain the best sale price. *Id.* at 243-44(citation omitted).

Relevant Nugget from Lyondell II

Directors must actively engage in the sale process and be able to confirm that they have obtained the best available price by:

- conducting an auction,
- conducting a market check or
- demonstrating "an impeccable knowledge of the market".

C. Plains Exploration

In *In re Plains Exploration & Production Company Stockholders Litigation*, C.A. No. 8090 – VCN, 2013 WL 1909124 (Del. Ch. May 9, 2013) ("*Plains*"), the Delaware Chancery Court heldthat

> *Revlon* claims are reviewed under the enhanced scrutiny test, which includes two key features: "(a) a judicial determination regarding the adequacy of the decision making process employed the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing". [*QVC* at 45] While Director Defendants bear the burden of showing that they were "adequately informed and acted reasonably," they are not required to show that they made a perfect decision, only a reasonable one." [*Id.*] *Plains* at 6.

IV. Revlon Without an Auction

Once the *Revlon* duty is imposed, "[t]here is no single path that a board must follow in order to reach the required destination of maximizing shareholder value." *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 487 (Del. Ch. 2010) ("*Cogent*"). Ultimately, the court will analyze all the facts and circumstances leading up to the signing of a merger or sale agreement and the provisions of the agreement, particularly those governing the ability of the directors to entertain superior proposals after the merger or sale agreement is signed. Such factors, circumstances and provisions include, without limitation:

- whether or not there was in fact a market check of any kind (active or passive), either before or after the merger or acquisition agreement was executed;
- the sophistication and experience of the directors in the particular industry and/or the segment of the financial markets and their knowledge of the company;
- how well-known the company was in the particular industry and in the financial community;

- whether or not there had been serious negotiations and bargaining over the price and other terms of the agreement;

- whether the price represented a premium over market;

- the opportunity for other interested parties to submit superior proposals after the agreement was signed and the ability of the board to talk to parties that might be expected to make superior proposals, including without limitation,

    - the terms of the "no-shop" and "fiduciary out" clauses;

    - the length of time between execution of the agreement and anticipated closing;

- whether or not other terms of the agreement, individually or in the aggregate, were preclusive or would discourage an interested party from making a superior proposal, such terms including without limitation:

    - termination fee (amounts in the neighborhood of 3% of deal value having beenfound to be reasonable);

    - "matching rights"; and

    - "lock-up" provisions; and

- the quality of the fairness opinion and the firm issuing the same.

A. Pennaco

In re Pennaco Energy, Inc. Shareholder Litigation, 787 A.2d 691 (Del. Ch. 2001) ("*Pennaco*") was one of the first significant cases after *Barkan* to address the issue of whether the *Revlon* duty could be performed in the absence of a pre-signing market check. The Delaware Court of Chancery denied plaintiff shareholders' motion for a preliminary injunction, concluding, among other things, that the plaintiffs were not likely to succeed on their *Revlon* claims. In reaching this conclusion, the Court noted, among other things, that:

- while there had been no pre-signing market check, the company was a "source of industry interest" and was already known to "industry players"; the Company was followed by "reputable analysts" and had a history of communicating with "interested parties";

- even after discussions with Marathon Oil had begun, Pennaco received an expression of interest from Alberta Energy Company and gave Alberta its "pitch" book (although Alberta did not proceed with further discussions);

- the directors had relevant expertise and experience in the energy business;

- the officers bargained hard and got Marathon Oil to increase its offer from $17 to $19; this "exceeded the Company's all-time trading high by nearly 10% andpresented a healthy premium to all relevant benchmarks";

- the “no shop” clause was relatively non-restrictive and permitted Pennaco to talk to any party that could reasonably be expected to make a superior offer that could be consummated without undue delay;

- the only protection from competition from rival bidders were the

  - the 3% termination fee; and

  - Marathon’s “matching rights.”

- there was a “healthy period of time” (December 22 – January 8) between the signing of the agreement and when Marathon could commence a tender offer to allow rival bidders to digest the proposed transaction and make a competing bid. [It should be noted that this period is considerably shorter than similar periods noted with favor in other cases discussed in this note. It is submitted that, depending upon the circumstances, a longer period might be advisable and might, in any event, be required if stockholder and/or regulatory approval are required.]

The Court also noted, in what should be regarded as dicta, that, after the agreement was signed, Lehman in fact did make phone calls to a list of industry players (without Pennaco’s knowledge and “arguably” in violation of the “no-shop” clause).

Relevant Nugget from Pennaco

Knowledge of the company among securities analysts and otherwise in the marketplace, combined with directors’ expertise and experience in the industry and non-restrictive “no-shop” clause, among other things, may obviate the need for a pre-signing market check.

B. Netsmart

In *In re Netsmart Technologies, Inc. Shareholders Litigation*, 974 A.2d 171 (Del. Ch. 2007), the Delaware Chancery Court found a likely breach of the *Revlon* duty in the absence of any substantial pre-signing market check, even though the merger agreement in question contained only reasonable provisions, including:

- “fiduciary out” clause;

- reasonable break-up fee of 3%; and

- “executory period” of over three months.

The Court noted that while these provisions may suffice in transactions involving large-cap companies, they may not suffice for a micro-cap, niche company like Netsmart because a strategic buyer might not even notice that such a company is being sold and, even if it did notice, might not be willing to invest the resources necessary to make a topping bid to acquire such a small company. The Court suggested that, in these circumstances, a more sophisticated sales effort targeted at potential strategic buyers would have been more appropriate. In response to the defendants’ argument that the liberal provisions in the merger agreement had sufficed in prior cases before that Court, the Court observed that:

[T]he problem with this argument is that it depends on the rote application of an approach typical of large-cap deals in a micro-cap environment. The "no single blueprint" mantra is not a one way principle. The mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics. *Netsmart* at 197.

C. Cogent

In *Cogent*, the Delaware Chancery Court, after elegantly reformulating the well-known thrust of *Barkan*, noted above, denied a motion for a preliminary injunction finding, among other things, that plaintiff stockholders were not likely to succeed in demonstrating that the directors had breached their *Revlon* duty in selling the Company.

After analyzing the sale process and the provisions of the merger agreement, particularly those that could affect the likelihood of competing bids, the Court succinctly discussed the cumulative effect of material provisions of the agreement:

Is the cumulative effect of all the deal protections unreasonably preclusive?

Having concluded that none of the above-mentioned provisions are preclusive, I also must consider their cumulative effect. Having carefully reviewed the record, I am not persuaded that, collectively, the Merger Agreement's provisions unreasonably inhibit another bidder from making a Superior Proposal. For example, based on the considerations discussed *supra*, if someone were to make a firm offer of $11.00 today, there is no reason to believe the Cogent Board would not consider it. First, such an offer presumably would trigger the fiduciary out clause of the no-shop provision, allowing the Board to consider the offer and to share information with the offeror. Second, while it is true that 3M would be able to match such an offer, this would not preclude an offer from being made. Third, it is unlikely that the Termination Fee would inhibit a buyer willing to pay as much as $11.00 per share. Fourth, if a higher bid emerged, the Company's stockholders presumably would not tender their shares and the Board would not waive the provision restricting 3M's ability to waive the Minimum Tender Condition. Therefore, it is unlikely that the Top-Up Option would even be implicated. Fifth, a competing bidder probably would view the retention agreements and bonuses as immaterial in the context of the overall negotiations and transaction. Lastly, if the Board decided to pursue such a Superior Proposal, the lock-up provisions of the V&T Agreement would terminate, allowing Hsieh to back a more favorable deal. Therefore, when viewed in the aggregate, these provisions are unlikely to deter a bidder from making a Superior Proposal. Accordingly, I find that Plaintiffs are unlikely to succeed in proving that the deal protections contained in the Merger Agreement are unreasonable. *Cogent*, 7A.3rd at 508.

Relevant Nugget from Cogent

Where the merger agreement contains multiple deal-protection provisions, the question is whether or not these provisions, as a whole, are likely to deter a bidder from making a superior proposal (such deterrence being suggestive of a likely violation of the *Revlon* duty).

D. Plains Exploration

In *Plains,* while no market check had been conducted, the Delaware Chancery Court denied plaintiff's motion for a preliminary injunction, having concluded, among other things, that it was not reasonably likely that directors would be unable to show that they had performed their *Revlon* duties. The Chancery Court held, among other things, that:

> The Plaintiffs challenge the Board's decision not to shop Plains at all. That course of action can make it more difficult (or less likely) to obtain the best available price. But there is no bright-line rule that directors must conduct a pre-agreement market check or shop the company. "When . . . the directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market." [Citing *Barkan* at 1287] Moreover, as long as the Board retained "significant flexibility to deal with any later-emerging bidder and ensured that the market would have a healthy period of time to digest the proposed transaction," and no other bidder emerged, the Board could be assured that it had obtained the best transaction reasonably attainable. [Citing *Pennaco* at 707] *Plains*, 2013 WL 1909124 at 8.

The Chancery Court further noted that:

- most of the directors had significant experience in the oil and gas industry and as directors of Plains;
- while the merger agreement had a no-shop clause, it also had a "fiduciary out";
- the 3% termination fee was not unreasonable;
- the "matching rights" provision would not deter a fervent bidder intent on paying a materially higher price;
- the price offered represented a 39% premium over the market price and had been negotiated; and
- the board had allowed a sufficient time [at least 5 months] for competing acquirors to emerge.

Relevant Nugget from Plains

Possession by the board of industry experience and reliable evidence as to the fairness of a transaction, combined with significant flexibility to deal with any later-emerging bidder (including a reasonable period of time for the market to digest the proposed transaction), may obviate the need for a pre- or post-signing market check.

E. *NetSpend*

On the other hand, in *Koehler v. NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013) ("*NetSpend*") (unpublished opinion), the Delaware Chancery Court concluded that the directors of NetSpend were not likely to succeed at trial in meeting their burden of proof that they had performed their *Revlon* duty, although the Court denied plaintiff's motion for a preliminary injunction on other grounds. In reaching its conclusion as to the *Revlon* duty, the Court noted, among other things, that:

- the directors were sophisticated with extensive business and financial expertise;
- there were valid business reasons to forego a pre-signing market check;
- while there was a "no-shop" clause, there was a "fiduciary out";
- the agreement contained "matching rights"; and
- the termination fee was 3.9% – but the "matching rights" and this termination fee would not deter a serious bidder;

all of which, individually or in the aggregate, have been held to be within a range of reasonablenessin other decisions. On the other hand, the Court also noted with alarm that:

- the fairness opinion, although from a sophisticated banker (Banc of America Securities LLC), was weak – its discounted cash flow analysis actually showed that the price was too low; and
- the merger agreement prevented NetSpend from waiving prior standstill agreements with other parties, thus preventing those parties from submitting competing bids.

The Chancery Court elaborated:

> Faced with the particular facts I have described above—the lack of a market check at any stage in this process; the Board's reliance on a weak fairness opinion; the deal protections, including the DADW ["don't-ask-don't-waive" standstill] clauses, which were incorporated into the Merger Agreement; and the lack of an anticipated leisurely post-agreement process which would give other suitors the opportunity to appear—I believe that the Defendants will fail to meet their burden at trial of proving that they acted reasonably to maximize share price. Though several of these facts, alone, are not outside the range of reasonable actions the Board could take, in their aggregate, these facts indicate a process that is unreasonable. In particular, in failing to waive the DADW [standstill] provisions prior to entering the Merger Agreement, and in agreeing to forgo the right to waive them in the Merger Agreement, without considering or understanding the effect this would have on its duty to act in an informed manner, the Board acted unreasonably. The sale process, reviewed as a whole, was unreasonable.

In contrast, an example of a successful single-bidder sale can be found in *Pennaco*. In that case, the Pennaco board intentionally conducted a single-bidder process similar to the process undertaken here. Then-Vice Chancellor Strine upheld the Pennaco board's sales process as reasonable. In that case, the Pennaco board had bargained hard for loose deal protections to ensure 'that an effective post-agreement market check would occur.' [*Pennaco*, 787 A.2d at 707.] The board had negotiated to obtain a non-restrictive no-shop clause and to reduce the termination fee from 5% to 3%. [*Id.* at 702.]…Finally, despite the presence of the loose no-shop clause, Pennaco and its board contacted other potential bidders before the deal closed to see if any other entity was interested in acquiring Pennaco. [Note that according to the *NetSpend* decision, this post-signing market check was conducted by Lehman, without Pennaco's knowledge and "arguably" in violation of the "no-shop" clause.] Citing *Barkan*, the Court upheld this sales process as reasonable. But, in dicta, the Court noted that in choosing to proceed without a market check, "the validity of the Pennaco board's decision to proceed in the manner it did *would be subject to great skepticism had the board acceded to demands to lock up the transaction from later market competition*." [*Id.* at 707 (emphasis added by Court).] The Court continued: "if the merger agreement with Marathon contained onerous deal protection measures that presented a formidable barrier to the emergence of a superior offer, the Pennaco board's failure to canvass the market earlier might tilt its actions toward the unreasonable." [*Id.*] The Court distinguished that 'unreasonable' hypothetical from the facts in *Pennaco* where "the Pennaco board was careful to balance its single buyer negotiation strategy by ensuring that an effective post-agreement market checkwould occur." [*Id.*]

Here, I believe the NetSpend Board has manifested the *Pennaco* Court's prophesy of an unreasonable single-bidder process. As I noted above, I believe NetSpend's decision to conduct a single-bidder process was reasonable at the time the decision was made. After taking that decision, however, once the Board had a clear indication that a sale to NetSpend would occur without a formal market check, the Board had a duty to follow a careful sales process to inform itself otherwise that it had achieved the best price. Instead, the combination of the Board's single-bidder strategy, the failure to obtain a go-shop period or otherwise solicit other acquirers post-agreement (including through providing sufficient time, post-merger, for a suitor to appear), the reliance on a weak fairness opinion and, in particular, the failure to waive the DADW [standstill] clauses, resulted in the Board's approving the merger consideration without adequately informing itself of whether $16.00 per share was the highest price it could reasonably attain for the stockholders.

It is this combination of factors which distinguishes the case before me today from *Pennaco*, *Smurfit-Stone*, *Plains*, and other cases in which this Court has found reasonable a sales process in which a corporate board declined to test its estimate of the company's value against the market. As noted above, the challenged merger in *Pennaco* featured loose deal protections, and the board in fact shopped the company before the merger closed. [See above.] In both *Smurfit-Stone* and *Plains*, the directors were informed by de facto market checks. Furthermore, in none of those cases did the directors preclude likely buyers from entering the bidding process through an illogical use of don't-ask-don't-waive restrictions. The directors had aduty to maximize price through an informed process.[FN 248]

FN248. *See Netsmart*, 924 A.2d at 195 n. 76 ("[W]hen [the directors] do not possess reliable evidence of the market value of the entity as a whole, the lack of an active sales effort is strongly suggestive of a *Revlon* breach.") (emphasis removed). Under *Revlon*, in general, "there is less tolerance for slack by directors." *Netsmart, 924 A.2d at 192*. The issue of whether the directors are adequately informed is particularly important in cases in which there has been no market canvass, since "[t]he goal of the canvassing requirement is to ensure that a board has adequately informed itself as to whether it is getting the best deal reasonably possible for the shareholders." *In re Vitalink Commc'ns Corp. S'holders Litig.*, 1991 WL 238816, at 1327 (Del. Ch. Nov. 9, 1991). Without that canvass, the directors need reliable and complete information to make an informed decision. *See Barkan*, 567 A.2d at 1278.

The Directors would have the burden of proving that they were fully informed at trial. Given these facts, it is reasonably likely that the Directors would fail to meet that burden.

NetSpend, 2013 WL 2181518, at *20-21.

Relevant Nugget from NetSpend

Reliance on a weak fairness opinion, combined with an inadequate period post-signing for competing bidders to emerge plus a provision in the merger agreement foregoing the right to waive previous standstill agreements with companies that would have been likely competing bidders, all in the absence of a pre- or post-signing market check, suggest a breach of the *Revlon* duty.

F. C&J Energy

In *C&J Energy Services, Inc. et al v. City of Miami General Employees' Retirement Trust*, 107 A.3[rd] at 1049 (Del. 2014), after extended negotiations C&J Energy Services, Inc. ("Old C&J") entered into an agreement with Nabors Industries Ltd. under which

- Nabors would drop the assets of its completion and production services division into a new subsidiary, Red Lion;
- C&J would merge with Red Lion, with Red Lion surviving and C&J shares being converted on a 1-for-1 basis into Red Lion shares, and Red Lion would be renamed C&J Energy Services Ltd. ("New C&J"); and
- as a result of the merger, former C&J shareholders would end up owning 47% of New C&J and Nabors would own 53%. Nabors would also receive a cash payment.

City of Miami General Employees' Retirement Trust, on behalf of itself and other plaintiffs, sought and obtained an injunction on the grounds, among others, that the Old C&J board breached its duty under

Revlon. The Delaware Chancery Court found that there was a "plausible" violation of the board's *Revlon* duty because the board did not affirmatively shop the company either before or after signing the agreement. The Court made this finding despite its also finding that the board "harbored no conflict of interest and was fully informed about its own company's value" and had received two fairness opinions.

On appeal, the Delaware Supreme Court reversed as to the *Revlon* claims, with hints of incredulity. First, the Supreme Court, while recognizing that the transaction would likely lead to a change of control due to Nabors ownership of 53% of New C&J, noted that the agreement called for certain devices "to temper Nabors' majority voting control of the surviving company," including,

- a by-law guaranteeing that all stockholders of New C&J would share pro rata in an future sale of New C&J;

- Old C&J stockholders having the power to designate four board members, including the chairman;

- for five years a 2/3 vote of New C&J stockholders being required (with certain exceptions) to amend the by-laws, sell the Company, issue stock or repurchase more than 15% of the outstanding shares in one year; and

- for five years Nabors being prohibited from increasing its ownership above 53% and would be restricted from various activities in furtherance of a business combination.

The Delaware Supreme Court did not, and did not have to, make a determination as to whether or not these mitigation measures were sufficient to take the transaction out of *Revlon* territory:

> Although we are reluctant in the context of this expedited appeal to conclude that these provisions were, in themselves, sufficient to take the transaction out of the reach of *Revlon*, they do constitute important efforts by the C&J directors to protect their stockholders and to ensure that the transaction was favorable to them.[FN 98]
>
> FN98. We assume for the sake of analysis that *Revlon* was invoked. We recognize that *QVC* suggests that contractual provisions limiting the power of a majority stockholder and securing the minority's ability to share in any future control premium might take a transaction out of *Revlon*'s reach *See QVC*, 637 A.2d 34, 42 n. 12. But given the timing exigencies and the fact that this is an issue of first impression before this Court, we decline to reach the question of whether *Revlon* applies. *C&J Energy*, 107 A.3rd at 1069.

While assuming that the *Revlon* duty was triggered, the Supreme Court nevertheless couldnot conclude that it was likely that the Old C&J directors breached their *Revlon* duty:

> We assume for the sake of analysis that *Revlon* was invoked by the pending transaction because Nabors will acquire a majority of New C&J's voting shares. But we nonetheless conclude that the Court of Chancery's injunction cannot stand. A preliminary injunction must be supported by a finding by the Court of Chancery

that the plaintiffs have demonstrated a reasonable probability of success on the merits. The Court of Chancery made no such finding here, and the analysis that it conducted rested on the erroneous proposition that a company selling itself in a change of control transaction is required to shop itself to fulfill its duty to seek the highest immediate value. But *Revlon* and its progeny do not set out a specific route that a board must follow when fulfilling its fiduciary duties, and an independent board is entitled to use its business judgment to decide to enter into a strategic transaction that promises great benefit, even when it creates certain risks. [Citing *Lyondell*, *QVC* and *Fort Howard*] When a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its stockholders a fully informed, uncoerced opportunity to vote to accept the deal, we cannot conclude that the board likely violated its *Revlon* duties. It is too often forgotten that *Revlon*, and later cases like *QVC*, primarily involved board resistance to a competing bid after the board had agreed to a change of control, which threatened to impede the emergence of another higher-priced deal. No hint of such a defensive, entrenching motive emerges from this record. *C&J Energy*, 107 A.3rd at 1053.

* * * * *

Not only did the Court of Chancery fail to apply the appropriate standard of review, its ruling rested on an erroneous understanding of what *Revlon* requires. *Revlon* involved a decision by a board of directors to chill the emergence of a higher offer from a bidder because the board's CEO disliked the new bidder, after the target board had agreed to sell the company for cash. *Revlon* made clear that when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable.[FN83]

FN83. *Revlon*, 506 A.2d at 182 ("the duty of the board [in a change of control transaction] … [is] the maximization of the company's value at a sale for the stockholders' benefit.").

But *Revlon* does not require a board to set aside its own view of what is best for the corporation's stockholders and run an auction whenever the board approves a change of control transaction. As this Court has made clear, "there is no single blueprint that a board must follow to fulfill its duties," [citing *Barkan*] and a court applying *Revlon*'s enhanced scrutiny must decide "whether the directors made a reasonable decision, not a perfect decision." [citing *Unitrin, Inc. et al v. American General Corp.*, 651 A.2d 1361 (Del. 1995) (quoting *QVC*) and *Pennaco*]. *C&J Energy*, 107 A.3d at 1067

In support of the proposition that the Old C&J board likely performed its *Revlon* duty (and in addition to the Chancery Court's having found that the Old C&J board was fully informed as to the company's value), the Supreme Court found that "There were no material barriers that would have prevented a rival bidder from making a superior offer", noting that the merger agreement provided for:

- a "fiduciary out" that enabled the board to terminate the transaction with Nabors if a more favorable deal emerged;

- a competing bidder facing "only the barrier of a $65 million termination fee" (only 2.27% of the deal value); and

- a period of nearly four months between the announcement of the deal and the expected closing date, "a period of time more than sufficient for a serious bidder to express interest and to formulate a binding offer for the C&J board to accept."

Finally, the Supreme Court noted that the transaction was subject to the approval of the stockholders of Old C&J, indicating that this was "contextually relevant" and could be taken into account by the board:

> It is also contextually relevant that C&J's stockholders will have the chance to vote on whether to accept the benefits and risks that come with the transaction, or to reject the deal and have C&J continue to run on a stand-alone basis. [Citing *In re El Paso Corporation Shareholders Litigation*, 41 A.3d 432 (Del. Ch. 2012), *Cogent* and *In re Netsmart Technologies, Inc. Shareholders Litigation*, 924 A.2d 171 (Del. Ch. 2007)] Although the C&J board had to satisfy itself that the transaction was the best course of action for stockholders, the board could also take into account that its stockholders would have a fair chance to evaluate the board's decision for themselves. As the Court of Chancery noted, "[t]he shareholders are adequately informed." *C&J Energy*, 107 A.3d at 1070.

As to the cleansing effect of subsequent stockholder approval, reference is made to *Corwin et al v. KKR Financial Holdings LLC et al.*, 125 A.3d 304 (Del. 2015) which held, among other things, that, if a transaction is not subject to the entire fairness standard, in reviewing post-closing a transaction that was approved by stockholders on a fully-informed and uncoerced basis the court should apply the business judgment rule and not the enhanced scrutiny otherwise required by *Revlon* (even if *Revlon* would have applied pre-closing). See also *Santa Fe*, however.

Relevant Nuggets from C&J Energy

- A "fiduciary out" clause, combined with reasonable termination fee (less than 3%) plus a period of nearly four months before the expected closing date suggest that there was no violation of the *Revlon* duty even without any pre- or post-signing market check.

- The court may consider other mitigating factors such as charter and bylaw provisions tempering the degree of voting control of the acquiring company, as well as the fact that the transaction is subject to the approval by fully-informed stockholders.

G. Rural/Metro

The significance of the Delaware Supreme Court's decision in *Rural Metro* goes far beyond what triggers the *Revlon* duty, as discussed earlier. First, the court found that the *Revlon* duty was breached by the Special Committee's proceeding to sell the Company without any previous market check:

> We agree with the Court of Chancery's principal conclusion that the Board's overall course of conduct fails *Revlon* scrutiny. *Revlon* permits a board to pursue the transaction it reasonably views as most valuable to the stockholders, provided "the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so." We stated in *C&J Energy* that "[s]uch a market check does not have to involve an active solicitation, so long as interested bidders have a fair opportunity to present a higher- value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal."

Furthermore, it was found that RBC had a significant conflict of interest and steered the sale process in a direction that would enable it to participate in the financing of a transaction involving a competitor of Rural/Metro rather than in a direction that would maximize the sales price. RBC had not fully disclosed the ramifications of its conflict of interest to the board – it had not explained the advantages to RBC, or the disadvantages to Rural/Metro, of the sale process it recommended. The court then found, among other things, that contributing to the breach by the Rural/Metro directors of the *Revlon* duty was their failure to inquire as to whether or not RBC's advice as to the sale process was influenced by any conflict of interest on RBC's part. While that process had been designed by RBC and, under Section 141(e) of the Delaware Corporation law, directors may rely on experts,

> …in change of control transactions, sole reliance on hired experts and management can "taint the design and execution of the transaction." Thus, we look particularly for evidence of a board's active and direct role in the sale process. [citing *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66 (Del. 1989)]
>
> While a board may be free to consent to certain conflicts, and has the protections of 8 De. C. § 141(e), directors need to be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest. But, at the same time, a board is not required to perform searching and ongoing due diligence on its retained advisors in order to ensure that the advisors are not acting in contravention of the company's interests, thereby undermining the very process for which they have been retained. A board's consent to a conflict does not give the advisor a "free pass" to act in its own self- interest and to the detriment of its client. Because the conflicted advisor may, alone, possess information relating to a conflict, the board should require disclosure of, on an ongoing basis, material information that might impact the board's process.

Thus, the Rural/Metro directors' failure adequately to investigate whether or not RBC's recommended sale process was influenced by any conflict of interest was an integral part of their breach of the *Revlon* duty.

Fortunately for the Rural/Metro directors, Rural/Metro's certificate of incorporation contained an exculpatory provision by virtue of which directors were not liable for monetary damages for breach of fiduciary duty (other than, among other things, the duty of loyalty). Unfortunately for RBC, however, the Court held that, if an advisor to the directors, such as RBC, intentionally and knowingly aided and abetted the directors' breach of fiduciary duty, such provision in the certificate of incorporation would not protect the advisor. Hence, RBC was held liable for such aiding and abetting.

Relevant Nuggets from Rural/Metro

- Directors' *Revlon* duty includes the obligation to make reasonable inquiry as to whether or not the advice of experts may be influenced by a conflict of interest.

- Conflicted advisors may be liable for aiding and abetting directors' breach of the *Revlon* duty where they knowingly steer the directors to a path that results in such breach, even though the directors themselves may be exculpated.

General Takeaway from Barkan and its Progeny

All relevant factors should be examined in determining whether or not the *Revlon* duty is satisfied, it being understood that, "there is no single path that a board must follow in order to reach the required destination of maximizing shareholder value". *Cogent,* 7 A.3d at 487. As the Delaware Supreme Court stated in *Barkan*,

> …we decline to fashion an iron-clad rule for determining when a market test is not required. The evidence that will support a finding of good faith in the absence of some sort of market test is by nature circumstantial; therefore, its evaluation by a court must be open-textured. However, the crucial element supporting a finding of good faith is knowledge. It must be clear that the board had sufficient knowledge of relevant markets to form the basis for its belief that it acted in the best interests of the shareholders. The situations in which a completely passive approach to acquiring such knowledge is appropriate are limited. The Chancellor found this to be such a situation, however, and we believe his finding to be within the scope of his discretion. *Barkan*, 567 A.2d at 1288.

V. Consideration of Other Constituencies

The *Revlon* duty, as enunciated in *Revlon* and its progeny, inures to the benefit of the stockholders of the corporation. As mentioned above, the agreement between Revlon and Forstmann contemplated benefits for the holders of certain promissory notes of Revlon (the ultimate purpose of which may have been to protect the incumbent board). The Revlon directors argued that protecting the noteholders was permitted under *Unocal* which held, among other things, that, in determining whether a defensive measure is reasonable in relation to the threat posed, a board of directors may consider, among other things, "the impact on 'constituencies' other than shareholders (i.e. creditors, customers, employees; and perhaps even the community generally)…." *Unocal*, 493 A.2d at 955. The *Revlon* court, however, held that

> A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. *Unocal*, 493 A.2d at 955. "However, such concern for non- stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder. *Revlon*, 506 A.2d at 182.

It should be noted that *Revlon*, being a decision of the Supreme Court of Delaware, applies to Delaware corporations and may apply to corporations formed in other jurisdictions that look to Delaware corporate law generally or have expressly adopted *Revlon*. However, many states, including Pennsylvania, New York and Florida, have adopted “corporate constituency statutes” which provide, in general and with certain exceptions, that a board of directors may (but is not required to) consider, in addition to the interests of stockholders, the interests of other constituencies such as customers, suppliers, creditors, employees and/or the local community, as well as long-term as opposed to just short-term interests. These statutes are not identical and there is not much case law interpreting them. In addition, it may not be clear that any such statute is intended to apply even in a situation that would otherwise trigger the *Revlon* duty. However, these statutes, in some jurisdictions, could have the effect, expressly or by implication, of limiting or rejecting the *Revlon* doctrine by allowing a board of directors, in theory, to approve a transaction that does not produce the maximum value for the stockholders but instead favors another constituency. Discussion of which states have followed or rejected *Revlon*, by statute or otherwise, is beyond the scope of this note.

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* This note was prepared by J. Anthony Terrell as of January 31, 2016. At the time, Mr. Terrell was a partner in the New York office of an international law firm. He is now of counsel at Bracewell LLP, resident in the New York office. The views expressed herein are those of Mr. Terrell and do not necessarily reflect the views of those firms.

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