Delaware Chancery Court Addresses *Revlon* Applicability in Cash/Stock Transactions

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On May 20, 2011 Delaware Vice Chancellor Parsons issued an opinion in the case *In re Smurfit-Stone Container Corp. Shareholder Litigation* addressing an important open question in Delaware takeover law: what portion of the merger consideration in a takeover must consist of acquirer common stock in order for the transaction to be reviewed under the more deferential business judgment rule rather than heightened *Revlon* standards. In this case, the Chancery Court concluded that an acquisition involving 50% cash and 50% acquirer common stock was subject to *Revlon* standards, although it noted that this conclusion was "not free from doubt."

The *Smurfit-Stone* case involved a company which agreed to merge with a strategic competitor in a negotiated transaction. Plaintiffs in the ensuing litigation alleged that the Smurfit-Stone board was subject to *Revlon* duties because the transaction constituted a "change of control" for Delaware purposes, thereby subjecting the board both to a heightened standard of judicial review as to the reasonableness of its actions and also to a duty to secure the best value reasonably available for its stockholders. The defendants argued that because half the merger consideration consisted of common stock of the acquirer and ownership of the post merger entity would remain widely dispersed in the public market, the transaction was not a "change of control" for *Revlon* purposes and therefore the board's actions were entitled to judicial deference under the business judgment rule.

The Chancery Court noted that a board can become subject to *Revlon* duties in at least three possible scenarios, including when approval of a transaction results in a sale or change of control. The Chancery Court also noted that under longstanding Delaware Supreme Court precedent, a stock-for-stock merger between two public companies with no controlling stockholders does not constitute a "change of control" for purposes of triggering *Revlon* duties because control will remain with a large, disaggregated body of stockholders and the target shareholders will not be foreclosed from an opportunity to receive a control premium in the future for the combined entity. On the other hand, a sale entirely for cash would mean that there will be no "tomorrow" for the target shareholders, who will be permanently shut out from any future profits and control premium realized by the acquirer and its stockholders.

The Delaware courts have wrestled over the years with the question of what amount of cash consideration between 0% and 100% would trigger *Revlon* duties. The Delaware Supreme Court has held that 33% cash consideration does not constitute a *Revlon* change of control[1]; the Chancery Court has held that 62% cash consideration does constitute a *Revlon* change of

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1 *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59 (Del. 1995).

control[2]. The Court in the *Smurfit-Stone* case noted that the transaction in question was marginally closer on a percentage basis to the 62% cash case than the 33% cash case, and concluded that it was appropriate to subject it to *Revlon* on the basis that for a large portion of the target stockholders' investment (i.e., half) there would be no "tomorrow" – no right to share in any future profits or takeover premium of the acquirer company – and therefore the target board should have a duty to seek the maximum value currently available for the target's stockholders.

Smurfit-Stone leaves practitioners with somewhat more guidance than before as to what portion of a transaction can consist of cash without triggering *Revlon* duties for the target board. However, the 50% benchmark is itself somewhat arbitrary, as the Court acknowledged in its decision, and does not provide clear guidance on how to evaluate the remaining ground between 50% and the 33% cash level which the Delaware Supreme Court concluded did not trigger *Revlon* duties. In addition, a different Chancery Court judge (Vice Chancellor Laster) recently made comments from the bench[3] suggesting that *Revlon* analyses should not focus on bright line stock-versus-cash tests but rather on whether the transaction is a final or end-stage transaction for the target company representing its last opportunity to negotiate a premium for its stockholders (including maximizing their ownership interest in the acquiring company).[4] It appears that both Vice Chancellors' views were influenced by an assessment that over the years the *Revlon* standard has developed into an enhanced reasonableness test and is not necessarily "outcome determinative", and therefore the consequences of being subject to *Revlon* standards instead of the business judgment rule are less draconian than in the past.[5] Nevertheless, differences do remain between the two standards that will be important to boards of directors and in litigation, and we expect that this will continue to be a developing area of Delaware takeover law.

You can download a copy of the full *Smurfit-Stone* opinion by clicking here.

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2 *In re Lukens Inc. Shareholders Litigation*, 757 A.2d 720 (Del. Ch. 1999).

3 *Steinhardt v. Occam Networks, Inc.*, Civ. Action No. 5878-VCL (January 24, 2011).

4 The Delaware Supreme Court has previously held specifically that stock-for-stock acquisitions are not "changes of control" for *Revlon* purposes regardless of the relative sizes of the merging parties, as long as the acquiror does not have a controlling stockholder. *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994).

5 After having concluded that *Revlon* was the appropriate review standard, the Court in the *Smurfit-Stone* case proceeded to deny plaintiffs' request for a preliminary injunction notwithstanding that the target board had not conducted a pre-signing market check and that the merger agreement contained full deal protection provisions including a no-shop covenant, matching rights and a 3.4% breakup fee.

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