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Delaware Chancery Court Addresses Application of *Revlon* Standard to 50/50 Cash and Stock Merger

Introduction

In a recent opinion issued in the case *In re Smurfit-Stone Container Corp. Shareholder Litigation*, No. 6164-VCP (Del. Ch. May 20, 2011), Vice Chancellor Parsons of the Delaware Chancery Court narrowed the gap in Delaware jurisprudence on whether the heightened standard of judicial review under *Revlon* applies to a merger transaction where the consideration payable to target company stockholders consists of a mixture of cash and acquiror stock. The Chancery Court held that *Revlon* duties applied in a transaction where the merger consideration is 50% cash and 50% acquiror stock, though noted that its position is “not free from doubt”. The decision still leaves open the question as to whether some lesser proportion of cash consideration could trigger *Revlon* duties.

Background

On January 23, 2011, the board of directors of Smurfit-Stone Container Corp. approved a \$3.5 billion merger agreement with Rock-Tenn Company. The agreed upon merger consideration payable to Smurfit-Stone stockholders was split evenly between cash and Rock-Tenn common stock with Smurfit-Stone stockholders expected to control 45% of Rock-Tenn’s outstanding common stock post-merger. The merger agreement also included a set of standard deal protection provisions such as a mutual no-shop covenant with fiduciary outs and matching rights for Rock-Tenn to respond to any superior offer, as well as a breakup fee that was approximately 3.4% of the equity value of the transaction.

On February 2, 2011, stockholders of Smurfit-Stone filed an action against the board of directors of Smurfit-Stone arguing that the proposed transaction should be reviewed under *Revlon*’s heightened standard of reasonableness rather than the more deferential business judgment rule because the transaction constituted a “change of control” of Smurfit-Stone. When *Revlon* applies to a transaction, the fiduciary duties of the target’s board require obtaining the best value reasonably available for its stockholders. Plaintiffs alleged that the board of directors failed to maximize value for the stockholders of Smurfit-Stone by agreeing to place deal protection measures with preclusive effects on other potential bidders. The defendants contended that the *Revlon* standard is inapplicable because half of the merger consideration was in common stock of the acquirer, giving Smurfit-Stone stockholders 45% ownership in the surviving entity, and that there was no “change of control” as the post-merger entity would remain in a “large, fluid, changeable and changing public market.”

Analysis

The Chancery Court agreed with the plaintiffs that the heightened *Revlon* standard of scrutiny is applicable in a transaction with 50/50 cash-and-stock consideration. In reaching its decision, the

Chancery Court considered three types of transactions where *Revlon* duties may be applicable: pure stock consideration, pure cash consideration, and mixed consideration transactions.

The Chancery Court noted that a 100% stock transaction where “ownership shifts from one large unaffiliated group of public stockholders to another,” is not a “change of control” and therefore does not trigger *Revlon* duties for the target company’s board of directors. This is because the stockholders of the target company still have the opportunity to receive a control premium in any future transactions involving the post-merger entity. In contrast, the Chancery Court pointed out that a 100% cash transaction would trigger *Revlon* duties as the transaction would be the final opportunity for stockholders of the target company to maximize the value of their investment before being foreclosed from deriving any future benefit from the post-merger entity or receiving any control premiums for future transactions.

In the case of mixed consideration transactions, however, the Chancery Court acknowledged that Delaware courts have not provided clear guidance as to what portion of cash consideration would trigger *Revlon* duties. The Delaware Supreme Court, in *In re Santa Fe Pac. Corp. Shareholders Litigation*, 669 A.2d 59 (Del. 1995), ruled that *Revlon* did not apply to a transaction involving 33% cash consideration. However, in *In re Lukens Inc. Shareholders Litigation*, 757 A.2d 720 (Del. Ch. 1999), the Chancery Court held that 62% cash consideration does trigger *Revlon* duties because there was “no tomorrow” for a “substantial majority” of the stockholders. Based on such precedents, the Chancery Court reached the conclusion that the *Revlon* standard should apply to the proposed Smurfit-Stone merger transaction noting that (i) the 50% cash consideration is marginally closer to the percentage cash consideration in *Lukens*, and (ii) the 50% portion of the investment in Smurfit-Stone that would be paid in cash, and, therefore, deprived of the right to share in any future benefits or control premiums as a result of the cash-out is substantial enough—i.e., there is “no tomorrow” for 50% of each stockholder’s investment in Smurfit-Stone.

In applying such conclusions to the facts, the Chancery Court nevertheless found that the board of directors of Smurfit-Stone satisfied its duties under *Revlon*. Noting that there is “no single path” for satisfying *Revlon* duties, the Chancery Court found that the board of directors had adequate information about the market, agreed to deal protection devices that did not have a preclusive effect, and acted appropriately during the merger process. The Chancery Court also stated that “reasonable minds may differ” about what constitutes a fair price and found that the plaintiffs did not show that the board of directors breached its *Revlon* duties by unreasonably accepting an inadequate price.

Conclusion

The Chancery Court’s determination that *Revlon* duties apply in transactions involving an even mix of cash and stock consideration provides important guidance in an area with a wide range of uncertainty. Nevertheless, it still remains uncertain whether *Revlon* will be applicable in transactions involving cash consideration greater than 33% but less than the 50% applicable in the Smurfit-Stone merger. It is also unclear whether the Delaware Supreme Court will adopt the Chancery Court’s analysis and ruling.

A complete copy of the *Smurfit-Stone* case can be found [here](#).

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