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Delaware Court of Chancery Applies *Revlon* Standard to Half Cash, Half Stock Merger

On May 20th, the Delaware Court of Chancery denied a motion to enjoin preliminarily a merger in which the stockholders of Smurfit-Stone Container Corporation will receive 50% cash and 50% Rock-Tenn Company stock in exchange for their shares of Smurfit-Stone. In evaluating the plaintiffs' petition for injunctive relief, Vice Chancellor Parsons ruled that because the Smurfit-Stone stockholders will be cashed out of one-half of their interest in the corporation, the merger constitutes a "change of control" transaction under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, and thus is subject to *Revlon's* heightened standard of review that requires boards to obtain the best value reasonably available to their stockholders.

The *Revlon* standard of review typically applies in three scenarios: (1) where a board initiates an active sales process or business reorganization that involves a clear break-up of the company; (2) where, in response to an offer, the target abandons its long-term strategy and seeks an alternative transaction involving its break-up; and (3) where a transaction results in a sale or change of control. Plaintiffs here argued that the third scenario applies.

Generally, no change of control is deemed to take place in a pure stock-for-stock transaction, where a company's ownership shifts from one large, unaffiliated group of public stockholders to another. At the other extreme, heightened *Revlon* duties apply to an all-cash transaction because in such a situation, stockholders lose the opportunity to participate in the continuing corporation, including being "forever shut out from future profits generated by the resulting entity as well as the possibility of obtaining a control premium in a subsequent transaction." In *In re Smurfit-Stone*, the Delaware Court of Chancery considers the up-to-now unanswered question of whether *Revlon* applies in a transaction where the merger consideration consists of equal or near-equal parts stock and cash and concludes that such a transaction indeed constitutes a change of control, and thus *Revlon* duties apply.

Relying heavily on Vice Chancellor Lamb's reasoning in *In re Lukens* (which held that a merger transaction consisting of up to 62% cash was subject to *Revlon* because "for a substantial majority of the then-current shareholders, 'there is no long run'"), Vice Chancellor Parsons likewise ruled that while no Smurfit-Stone stockholder would be cashed out 100%, 100% of the stockholders "who elect to participate in the merger will see approximately 50% of their [...] investment cashed out ... [thus] there is no 'tomorrow' for approximately 50% of each stockholder's investment in [the company]." The fact that control of the combined entity would remain in a large pool of unaffiliated stockholders was not dispositive for that portion of the stockholders' investment that would be converted to cash. The Court did note that its application of *Revlon* in this situation is "not free from doubt" as there is no Delaware Supreme Court authority directly on point, however, companies contemplating any transaction that involves the cashing-out of a substantial portion of their stock should be aware of the possibility that *Revlon* duties may apply.

Notwithstanding the heightened *Revlon* standard of review, however, we note that the Court nevertheless found that the board's sale process met their fiduciary duties, again reiterating the fact that *Revlon* is satisfied by a reasonable sales process.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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