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Corporate Governance Group Client Alert: Delaware Chancery Court Denies Summary Judgment on *Revlon* Claims

Holds that target Board acted reasonably under the circumstances,
satisfying its *Revlon* duties

Recently, in *In re Plains Exploration & Production Company Stockholder Litigation*¹, the Delaware Court of Chancery denied the plaintiffs' request for a preliminary injunction and held that the target Board's decisions to (i) not form a special committee, (ii) allow the target's CEO to run the negotiations, (iii) not conduct a pre-signing market check and (iv) agree to various deal protections devices in the merger agreement, were in each case reasonable under the circumstances and satisfied the Board's *Revlon*² duties.

BACKGROUND

On December 5, 2012, after almost a year of on-again, off-again negotiations, Freeport-McMoran Copper & Gold Inc., an international mining company, entered into a merger agreement to acquire Plains Exploration & Production Company in exchange for a combination of cash and stock consideration. In a separate but related transaction, Freeport agreed to acquire McMoran Exploration Co., a company in which Plains Exploration owned approximately 31%, in exchange for cash and royalty trust interests in future production from certain exploration properties.

The discussions that led to the merger agreement's signing began in the first quarter of 2012, when the CEOs of Freeport and Plains Exploration began preliminary negotiations about combining Freeport, Plains Exploration and McMoran. In short order, each of Freeport and McMoran formed special committees of their boards to handle the negotiations process. Plains Exploration, however, determined to not form a special committee despite the fact that its CEO was expected to become Vice Chairman of Freeport and CEO of Freeport's oil and gas operations following the transaction.

¹ C.A. No. 8090-VCN (May 9, 2013).

² *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173 (Del. 1986).

The Plains Exploration Board also determined not to conduct a pre-signing market check as the Board "was content either to pursue Freeport's expression of interest or to go it alone as a stand-alone company".

In December 2012, after approximately nine months of negotiations, Freeport and Plains Exploration announced the execution of their merger agreement with a purchase price representing a 39% premium to the prior day's closing price and a 42% premium to the prior one-month average closing price. The merger agreement also contained various deal protections such as a no-solicitation clause combined with a fiduciary out provision that permitted the target Board to respond to unsolicited bids that were reasonably expected to lead to a superior proposal and a termination break-up fee equal to 3%.

The plaintiffs, who were public stockholders of Plains Exploration, moved to enjoin the merger. Plaintiffs asserted that the target CEO was conflicted because "he knew, as early as July 2012, that he would be retained by Freeport following the merger, and because he stands to receive \$120 million in Freeport stock upon completion of the merger." Plaintiffs also asserted that the target Board "abdicated their duties by, first, permitting" their CEO "to lead the negotiations, notwithstanding his conflict of interest and, second, by failing to oversee the negotiations at all." Finally, the plaintiffs contended that the target Board "breached its *Revlon* duties by, among other things, failing to (1) shop the Company, (2) seek a go-shop period, and (3) conduct a 'pre' or 'post' market check."

THE COURT'S ANALYSIS

The Court refused to grant plaintiff's motion for an injunction on all counts.

Overview of Revlon standard: Vice Chancellor Noble began his analysis by noting that under the *Revlon* standard, (i) a director's fiduciary duties in a change of control transaction such as the proposed merger require a director to "undertake reasonable efforts to secure the 'best value reasonably available to the stockholders'" and (ii) 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 by 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.'"

Lack of Target Board Special Committee Determined to be Reasonable: The Court held that the Board's decision not to form a special committee was reasonable because forming a special committee, the act of which "can serve as 'powerful evidence of fair dealing',...is not necessary every time a board makes a decision". In the Court's opinion, the plaintiffs failed to demonstrate that the CEO "dominated and controlled

the Board" or how seven of the eight Plains Exploration directors (*i.e.*, all of the directors other than the CEO) were not independent and disinterested. Accordingly, the Court concluded that the Board's decision not to form a special committee was reasonable under the circumstances.

CEO-Led Negotiations Determined to be Reasonable: Next, the Court concluded that the Board's decision to permit the CEO to spearhead the deal negotiations was "not inherently unreasonable either". The Court noted that while "a board cannot completely abdicate its role in a change of control transaction, Delaware law is clear that in certain circumstances it is appropriate to enlist the efforts of management in negotiating a sale of control". In this instance, even though the CEO may have been interested given his future potential employment with Freeport (of which the Board was fully aware and discussed), the Court concluded that the Board (i) "could have reasonably believed that [the CEO]...was in the 'best position to advance the interests of [Plains'] stockholders' because he had the 'most experience with and deepest knowledge of [Plains'] assets'", (ii) believed that the CEO's "significant ownership of Plains stock – which aligned his interests with those of stockholders generally – partially mitigated the conflict" and (iii) "properly managed the conflict by overseeing the negotiations".

No Market Check and Deal Protections Determined to be Reasonable: Discussing the Board's decision not to shop Plains Exploration prior to signing and the deal protection provisions in the merger agreement, the Court noted several factors in determining that these decisions were reasonable under the circumstances.

The Court stated that "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.'" Along these lines, the Court emphasized that (1) the record reflected how Plains Exploration was focused on either completing the Freeport proposed transaction or going forward as a stand-alone company, both of which "were financially attractive" options and (2) while "it is difficult from the record to assess whether the Board possessed impeccable knowledge³ of Plains' business, the directors' relevant expertise and experience support a reasonable inference that they were informed and competent to make an appropriate decision" as to "whether the proposed transaction is priced fairly". As is the case with any "single-buyer negotiation strategy", a target board in such situation is forced "to rely more extensively on its own knowledge and the

³ See our previous Client Alert entitled "Delaware Court Cites Board's 'Impeccable Knowledge' Of Target's Business In Declining To Enjoin Merger Under *Revlon*", which discussed the *In re OPENLANE, Inc. Shareholders Litigation* (C.A. No. 6849-VCN (Del. Ch. Sept. 30, 2011)) and how the Court of Chancery credited the target board of directors' "impeccable knowledge" of the target's business in determining whether the board satisfied its *Revlon* duties in approving a sale of the company.

knowledge of its financial advisor in determining whether the proposed transaction is priced fairly." As the defendant directors argued, and the Court did not disagree, because the directors had significant experience in the oil and gas industry, they "were fully capable of making an informed decision" in this context.

Finally, as for the impact, if any, that the merger agreement's deal protection provisions had on any post-signing market check, the Court noted that "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." The Court noted that the merger agreement contained a reasonable no-solicitation clause and fiduciary out provisions as well as customary "match rights" for Freeport. Moreover, the Court stated that the three percent termination fee was not "unreasonable" especially given the fact that termination fees in "excess of three percent have been deemed reasonable by this Court before". As a result, the Court concluded that any "serious bidder" would not be prevented from putting forth a higher bid. The Court did not directly address the lack of a go-shop period provision in this context.

CONCLUSION

The *In re Plains Exploration* decision demonstrates the Court of Chancery's willingness to grant a board of directors deference not to conduct a pre-signing market check – even in light of the enhanced scrutiny demanded by *Revlon*. The decision once again illustrates the highly fact-intensive nature of the *Revlon* analysis.

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