



Corporate Governance Group

Client Alert

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DELAWARE COURT CITES BOARD'S "IMPECCABLE KNOWLEDGE" OF TARGET'S BUSINESS IN DECLINING TO ENJOIN MERGER UNDER *REVLON*

Also distinguishes Omnicare in refusing to strike down use of "no-solicitation" covenant following stockholder approval of merger by majority written consent

Recently, in *In re OPENLANE, Inc. Shareholders Litigation*,¹ the Delaware Court of Chancery credited a target board of directors' "impeccable knowledge" of the target's business in determining whether the board satisfied its *Revlon*² duties in approving a sale of the company. The Court denied the plaintiffs' request for a preliminary injunction, holding that although the Board's decision-making process – which included only a limited market check of potential strategic (but not financial) buyers and eschewed obtaining a fairness opinion – "was not a model to be followed," it was a reasonable one given the Board's knowledge of the company's business and prospects. Further, the Court, distinguishing *Omnicare*,³ upheld use of a full no-solicitation clause following execution of a majority written consent by stockholders owning more than 60% of its outstanding stock.

Background

OPENLANE, Inc. is an internet-based, business-to-business automotive remarketing company which derives 90% percent of its revenues from selling "off-lease" vehicles. Its board of directors included the CEO and two directors affiliated with private equity firms. The members of the board and the company's executive officers together owned approximately 68% of OPENLANE's outstanding stock.

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¹ C.A. No. 6849-VCN (Del. Ch. Sept. 30, 2011).

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

³ *Omnicare vs. NCS Healthcare*, 818 A.2d 914 (Del. 2003).

In April 2010, the board anticipated a decline in the number of vehicles coming off lease that would significantly and negatively impact OPENLANE's business. Consequently, Montgomery & Company LLC was retained as financial advisor to reach out to a limited number of strategic acquirers. In January 2011, OPENLANE received an offer from an unnamed strategic acquirer ("Company A") for \$50 million in cash, a \$50 million five year note and 2.5 million shares of Company A's stock valued at approximately \$40 per share. OPENLANE rejected the offer and proposed a counteroffer that was rejected by Company A.

In February, Montgomery identified 31 potential financial buyers and 8 potential strategic buyers. However, in May, after receiving an indication of interest from KAR Auction Services proposing a purchase price of approximately \$210 million, OPENLANE commissioned Montgomery to perform a limited market check of only a few strategic buyers, including KAR, Company A and another unnamed company ("Company B"). The board also made KAR a counteroffer of \$230 million, which was rejected.

Following discussions with Company A, Company B and KAR, in June OPENLANE signed an indication of interest with KAR granting KAR a 30-day exclusivity period. Then, in August, following further negotiations between the parties, the board unanimously approved a merger with KAR for \$210 million – without seeking a fairness opinion from Montgomery. On August 15, the two companies signed a merger agreement that contained a full no-solicitation clause and provided that \$26 million of the purchase price would be held in escrow for 18 months to protect KAR against various contingencies, including any awards that might be obtained by OPENLANE stockholders asserting statutory appraisal rights. The Merger Agreement also provided that if a majority of OPENLANE's stockholders did not consent to the transaction within 24 hours, the board was entitled to terminate the agreement without penalty. Although there apparently was no voting agreement between any stockholder and KAR, the next day, a majority of OPENLANE's common and preferred stockholders signed a written consent approving the merger.

Plaintiff William Treadway brought a class action lawsuit on behalf of a group of OPENLANE stockholders, seeking to preliminarily enjoin the transaction on the basis that the board breached its fiduciary duties by failing to undertake an adequate process contrary to *Revlon*. Specifically, plaintiff complained that the board "only contacted three potential buyers, failed to perform an adequate market check, failed to receive a fairness opinion ... and relied on scant financial information in approving the Merger." Plaintiff also alleged that the members of the board were motivated to approve the KAR merger for improper reasons, namely the acceleration of their stock options and, in the case of the CEO, an agreement with KAR that he would continue to serve as CEO following the merger. Further, plaintiff contended that the flawed process led to a deal which "failed to maximize shareholder value, in part, because of the Escrow Agreement." Finally, plaintiff claimed that the board breached its fiduciary duties by agreeing to "improper deal protection devices" contrary to *Omnicare*, particularly that "the no-solicitation clause and the lockup of the shareholder vote through the combined voting power of OPENLANE's directors and executive officers are 'preclusive and coercive' in the absence of a fiduciary out provision."⁴

⁴ Plaintiff's additional claim that the board breached its duty of disclosure by omitting material information from its proxy materials was mostly mooted through subsequent supplemental disclosures.

The Court's Analysis

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

Price and Process – Revlon Claim

Independence of the Board

In response to plaintiff's claim that the directors "were motivated to approve the Merger for improper reasons," the Court noted that even if all eight directors held options that accelerated as a result of the merger, this was a "routine aspect of merger agreements" which, without more, "does not suffice to impugn the disinterestedness of the members of the Board." Further, the fact that the CEO, who was also a director, negotiated an employment agreement with KAR to continue as CEO post-merger did not affect the independence of the board as a whole. Not only were there no facts demonstrating that the CEO "dominated the other seven Board members,"⁵ but "the Board was aware of [the CEO's] possible employment after consummation of the transaction and was fully committed to the process."

Maximization of Stockholder Value

Next, the Court analyzed the adequacy of the Board's sales process under the *Revlon* standard. According to the Court, the enhanced scrutiny required by *Revlon* involves two prongs: "(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."

With respect to the *first prong*, the Court reiterated the principle that "there is no single path that a board must follow in order to maximize stockholder value, but directors must follow a path of reasonableness toward that end." However, the Court also noted that "if a board fails to employ any traditional value maximization tool, such as an auction, a broad market check, or a go-shop provision, that board must possess an impeccable knowledge of the company's business for the Court to determine that it acted reasonably." Although the Court noted that the "Board's decision-making process was not a model to be followed," it nevertheless concluded that plaintiff "failed to establish a reasonable likelihood that at trial the Board would not be able to show that its actions were adequate" under the first element of *Revlon*.

In support of this conclusion, the Court cited the following factors:

- The board did perform a targeted market check over the course of a year and "seriously pursued transactions with two legitimate strategic buyers."
- Although the board did not receive a fairness opinion, Montgomery did provide some financial information that was considered by the board in deciding whether to pursue the merger with KAR or another transaction.

⁵ For a discussion of a recent Delaware case in which the Court cited the impact of domination on the independence of directors, see our Client Alert titled "Delaware Court Finds That Intimidation Can Strip Otherwise Disinterested Board Members of Their Status as Independent Directors," dated October 26, 2011.

- OPENLANE was one “of those seemingly few corporations that is actually ‘managed by’ as opposed to ‘under the direction of’ its board of directors.” Two of the directors co-founded OPENLANE and the remainder were either invested in OPENLANE or affiliated with a company which was invested in OPENLANE.
- The board met regularly during the course of the process, including nine meetings between December 2011 and August 2011.
- Because two directors were affiliated with private equity firms and therefore “were likely to know whether financial buyers would be interested in OPENLANE and approximately how much those buyers would be willing to pay,” it was understandable why the board failed to pursue any financial bidders.
- And, perhaps most importantly, the board possessed “an impeccable knowledge of the company’s business.”

With respect to the *second prong*, the Court found the actions of the board to be reasonable “in light of the then-existing circumstances”:

- The board “anticipated a decline in the number of off-lease vehicles” in the next year, causing it to seek to complete a sale “before that decline had a material impact.”
- The board’s decision not to “pay a financial advisor to undertake an extensive market check or provide a fairness opinion” was reasonable in light of the facts that the directors were “well-versed in the company’s business” and the company was “a small public company with, historically, perhaps more in common with a private company.”
- Because the directors owned in the aggregate over 59% and, when combined with the executive officers, over 68% of OPENLANE’s outstanding stock, the “Board had more to lose or gain from a change of control transaction than any other OPENLANE shareholder,” suggesting that “the Board would be motivated to get the best price reasonably available for OPENLANE’s shareholders.”

Escrow Agreement

While acknowledging that escrow agreements “are rare in deals for ‘public’ companies, probably because of the difficulty and expense of multiple stages of payment and perhaps because of shareholder expectations,” the Court found that the escrow agreed to by the OPENLANE board “does not necessarily violate any mandatory standard,” “is part of the ‘deal,’” provides “comfort to ... a buyer to pay more, again presumably a benefit to the selling shareholders,” and “was fairly disclosed to the shareholders” Thus, although perhaps “a bad idea” that could “cause problems in the future,” the escrow “was within the Board’s decision-making authority.”

⁶ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

Deal Protection Devices – Omnicare Claim

The Court began this part of its analysis by citing the two-prong *Unocal*⁶ test for assessing defensive measures adopted by a board, requiring that the board demonstrate that: (a) “it ‘had reasonable grounds for believing a danger to corporate policy and effectiveness existed’” and (b) “its defensive response was ‘reasonable in relation to the threat posed.’” The first prong “is essentially a process-based review,” requiring that the board demonstrate “good faith and reasonable investigation” leading to the articulation of “some legitimate threat to corporate policy and effectiveness.” As for the second prong, “[t]his inquiry involves a two-step analysis. The [Board] must first establish that the merger deal protection devices adopted in response to the threat were not ‘coercive’ or ‘preclusive,’ and then demonstrate that their response was within a ‘range of reasonable responses’ to the threat perceived.”

As for the threat faced by the board, the Court noted that “there were few suitors for OPENLANE” and the board’s perception “that if OPENLANE waited too long to consummate a transaction its business could significantly decline (at least in the near future), which presumably would prevent it from consummating a transaction comparable to the Merger.” As these factors were uncontested by plaintiff, the Court accepted them as a reasonable threat.

With respect to the second prong, the Court contrasted *Omnicare* – in which the merger was declared “an impermissible ‘*fait accompli*’” due to a majority stockholder lockup and a “force the vote” provision – with the fact that “although the [OPENLANE] Merger Agreement contained a no-solicitation clause, there, evidently, was no shareholders’ voting agreement entered into as part of the Merger.” Rather, “after the Board approved the Merger Agreement, the holders of a majority of shares quickly provided consents.” Moreover, in the Court’s view, “[t]he Merger Agreement neither forced a transaction on the shareholders, nor deprived them of the right to receive alternative offers. In fact, “if a majority of OPENLANE’s shareholders had not consented to the Merger Agreement twenty-four hours after the Board executed it, the Board could have terminated the Merger Agreement without having to pay any termination fee.” Thus, the only deal protection device “articulated” by plaintiff – the no-solicitation clause – was, in the Court’s view, “of little moment because within that twenty-four-hour period, the Board would have been able to back out if consents were not obtained or the deal could be concluded if the consents were obtained.” In other words, “[t]his may simply be a matter of majority rule by shareholders who were under no obligation to act in any particular way.”⁷

Conclusion

The *In re OPENLANE* decision demonstrates the Court of Chancery’s willingness to grant a board of directors deference to stray from the “norms” of conducting a pre-signing market check and obtaining an investment banker’s fairness opinion – even in light of the enhanced scrutiny demanded by *Revlon* – at least where the board possesses a significant equity interest and exhibits “impeccable knowledge” of the company’s business. While the OPENLANE board’s sale process is not a model generally to be followed, the decision does illustrate the highly fact-intensive nature of the *Revlon* analysis. Further, the decision reaffirms that, in those cases where a public company has majority stockholders who are permitted by the corporate charter to act by written consent, the Court of Chancery will distinguish *Omnicare* and not require “fiduciary outs” once stockholder approval has been obtained.

⁷ For a discussion of a previous Court of Chancery decision upholding a post-signing majority stockholder consent approving a merger in the face of an *Omnicare* challenge, see our Client Alert titled “*Omnicare of ‘Questionable Continued Vitality’?: Delaware Chancery Court Rejects Application of Controversial Case in Context of Same-Day Stockholder Vote to Approve Merger,*” dated September 15, 2008.

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