

# Delaware Chancery Court Upholds “Sign And Consent” Transaction And Board Process

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On September 30, 2011, Vice Chancellor Noble issued an opinion in *In re OPENLANE, Inc. Shareholders Litigation*<sup>1</sup> that reiterated the permissibility of using a “sign and consent” structure for obtaining stockholder approval of a merger. The *OPENLANE* decision is also noteworthy as Vice Chancellor Noble declined to grant injunctive relief despite the fact that many of the efforts typically undertaken by a target company’s board of directors in a sale process were not utilized in the transaction at issue.

*OPENLANE* demonstrates that the restrictions against a fully locked-up merger set forth in the 2003 *Omnicare*<sup>2</sup> decision do not bar stockholders from locking up a transaction through written consents immediately after the execution of a merger agreement. The *OPENLANE* decision further confirms that a board can satisfy its *Revlon*<sup>3</sup> duties under appropriate circumstances even when its actions do not conform to customary practices in the change of control context.

## Background

*OPENLANE, INC.* (“*OPENLANE*” or the “Company”) is an automotive marketing company that derives most of its revenues from selling “off-lease” vehicles. The Company’s common stock traded on the OTC Pink Sheets, and its eight-person board of directors included its chief executive officer and two directors affiliated with the Company’s private equity investors. The directors (or entities affiliated with the directors) held over 59 percent of the Company’s stock, and the 16-person group consisting of the Company’s directors and executive officers held over 68 percent of the Company’s stock.

In the winter and spring of 2010, the Company’s management discussed with Montgomery & Company LLC (“Montgomery”), the Company’s financial adviser, potential interest in the Company from strategic acquirers and solicited input on strategies regarding a potential market outreach. By April 2010, the Company’s board of directors was anticipating a decline in the number of vehicles coming off lease, which would significantly and negatively impact the Company’s business. In May 2010, the Company formally engaged Montgomery to undertake a market outreach to a limited number of strategic acquirers, including KAR Auction Services, Inc. (KAR) and a strategic acquirer (“Company A”).

During this process, KAR informed the Company that it was unable to make an offer to acquire the Company, and Company A offered to acquire substantially all of the Company’s assets for approximately \$90 million. The Company rejected Company A’s proposal, and in September 2010 it terminated its formal engagement of Montgomery for the purpose of performing a market outreach process.

At a meeting held in December 2010, the board conducted a strategic review to evaluate the Company’s competitive position and its strategic alternatives, and Montgomery made an informal presentation of certain financial analyses it had per-

formed. On January 10, 2011, representatives of the Company met with representatives of Company A, and during this meeting Company A expressed interest in re-engaging in discussions regarding a strategic transaction. Shortly thereafter, the Company received an offer from Company A to acquire the Company for \$50 million in cash, a \$50 million five-year note and shares of Company A’s stock valued by Company A at \$100 million in the aggregate. *OPENLANE* rejected this offer, and its counteroffer was rejected by Company A.

In February 2011, Montgomery identified 31 potential financial buyers of the Company, as well as eight potential strategic buyers, but the record does not indicate if any potential buyers on that list other than KAR, Company A and another company (“Company B”) were approached. In May 2011, following a meeting between representatives of the Company and representatives of KAR, the Company received an indication of interest from KAR that proposed a preliminary purchase price in the range of \$200 million to \$210 million plus positive working capital. The board discussed this proposal and – after considering the potential damage to the Company if it became widely known that the Company was considering a sale and its assessment that only a strategic acquirer could purchase the Company at a favorable valuation – directed management to engage Montgomery to contact a limited number of strategic acquirers, including KAR, Company A and Company B. After discussions with Company A and Company B, in which such companies declined to make or improve upon their earlier proposals, the Company and KAR signed an indication of interest in June 2011, which included a 30-day exclusivity period.

Following further negotiations between KAR and the Company, the board unanimously approved an all-cash merger transaction whereby KAR would acquire the Company for approximately \$210 million. The merger agreement between the parties contained a stringent no-solicitation provision without a “fiduciary out.” The merger agreement also followed the “sign and consent” model under which there was no explicit stockholder agreement to approve the transaction, though if a majority of *OPENLANE*’s stockholders did not approve the transaction by 11:59 p.m. on the day following the execution of the merger agreement, either party could terminate the merger agreement without penalty. The Company received consents approving the merger agreement from a majority of stockholders the day after signing.

Throughout the sale process, Montgomery provided the board with advice regarding the value of the Company, though it never provided the board with a formal fairness opinion.

In September 2011, a stockholder filed a class action lawsuit seeking to preliminarily enjoin the transaction on the basis, among other matters, that the sales process undertaken by the board was flawed and in violation of *Revlon* and *Omnicare*. Specifically, the complaint alleged, among other matters, that the Company’s board breached its fiduciary duties because the board only contacted three potential buyers, failed to perform an adequate market check, did not receive a fairness opinion and relied on



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scant financial information when approving the merger. In addition, the plaintiff argued that the board agreed to improper deal protection devices in violation of *Omnicare*.

## The Court’s Decision

**Revlon Claim:** The court addressed the plaintiff’s *Revlon* claim by noting that the enhanced scrutiny triggered under *Revlon* requires: (1) a judicial determination regarding the decision-making process employed by the directors, including the information on which the directors based their decision, and (2) a judicial examination of the reasonableness of the directors’ actions in light of the circumstances then existing.

With respect to the inquiry into the board’s decision-making process, the court held that, although the board’s process was not a model to be followed in every circumstance, the record revealed that the board undertook an adequate decision-making process. The court noted the following factors in support of this conclusion:

- the board performed a targeted market check over the course of approximately one year, and “seriously pursued” transactions with two legitimate strategic buyers;
- the board received financial information from Montgomery, which the board used to help it make the decision to enter into the merger agreement;
- the board knew the Company’s business “very well” as the Company was “managed by” and not “under the direction of” the board. Two directors co-founded the Company in 1999 and the remainder of the board was either involved in the Company or affiliated with a company that was invested in *OPENLANE*. Most of the directors had been on the board for a number of years, all of which supported the court’s determination that the board had an “impeccable knowledge” of the Company’s business;
- the board regularly held meetings, including nine meetings between December 2010 and August 2011; and
- because two of the directors were affiliated with private equity firms and the board had “impeccable knowledge” of the Company’s business, the board knew whether financial buyers would be interested in the Company.

With respect to the inquiry into the reasonableness of the board’s actions, the court found the board’s actions to be reasonable in light of the then-existing circumstances. The court noted the following factors in support of this conclusion:

- the board anticipated a decline in the number of off-lease vehicles in 2011 and 2012, and quite logically wanted to sell the Company before that decline had a material impact on its business;
- given the board’s impeccable knowledge of the Company’s business and the size of the Company (which made it easier for the board to understand the Company’s business), it was reasonable for the board to approve the transaction without conducting an extensive market check or receiving a fairness opinion; and
- since the board held over 59 percent of the Company’s stock, and the 16-person group of the board and the Company’s executive officers held over 68 percent of the Company’s stock, the board had more to lose or gain from a change of control transaction than the other stockholders, which therefore supported the notion that the board would be motivated to get the best price reasonably available for all stockholders.

**Omnicare Claim:** Under *Unocal*,<sup>4</sup> a board’s decision to adopt defensive measures that “lock up” a merger requires the board to demonstrate that (1) it had reasonable grounds for believing a danger to corporate policy and effectiveness existed and (2) its defensive response was reasonable in relation to the threat posed. Moreover, under *Omnicare*, stockholder voting agreements negotiated as part of a merger agreement, which guarantee stockholder approval of the merger, coupled with a merger agreement that lacked a fiduciary out and contained a “force-the-vote” provision, constitute a coercive and preclusive device that is not reasonable in relation to the threat posed.

With respect to inquiry into the threat identified by the board, the court noted that the record suggested there were few suitors for the Company and if the Company waited too long to consummate a transaction, its business could significantly decline (at least in the near future), which would presumably prevent it from consummating a transaction comparable to the transaction with KAR. The plaintiff made no allegations to counter these facts.

Turning to the inquiry into the reasonableness of the board’s actions in relation to the threat posed, the court acknowledged that although *Omnicare* may be read to require a “fiduciary out” in every merger agreement, it does not automatically follow that every merger agreement without a “fiduciary out” should be enjoined.

Unlike the transaction at hand in *Omnicare*, the court held that the acquisition of the Company by KAR was not a *fait accompli*. Although the merger agreement contained a no-solicitation clause, the court found that there was no evidence of a stockholders’ voting agreement entered into as part of the merger. The court acknowledged that, given the board’s control of the Company’s stock, approval by a majority of the Company’s stockholders was a “virtual certainty.” However, the court held that if stockholders wished to submit consents soon after the board approved a transaction, then the stockholders were free to do so since nothing in the DGCL requires any particular period of time between a board’s authorization of a merger agreement and the necessary stockholder vote. The preliminary record suggested that only after the board approved the merger agreement was the requisite stockholder’s consent obtained.

Therefore, the court reasoned, nothing in the merger agreement forced a transaction on the Company’s stockholders nor deprived them of the right to receive alternative offers. The court went on to note that if a majority of the Company’s stockholders did not consent to the merger agreement within 24 hours of its execution, the board could have terminated the merger agreement without having to pay any termination fee. As such, the court rejected the plaintiff’s lockup argument because stockholders holding a majority of shares, acting with the same incentives as other stockholders, consented to the merger – the merger was thus a matter of majority rule by stockholders who were under no obligation to act in any particular way.

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

<sup>2</sup> *Omnicare v. NCS Healthcare*, 818 A.2d 914 (Del. 2003).

<sup>3</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1986).

<sup>4</sup> *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

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