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Delaware Court of Chancery Criticizes Board's Sale Process

In *Koehler* v. *NetSpend Holdings Inc.*, the Delaware Court of Chancery found that the directors of NetSpend likely breached their *Revlon* duty to obtain the highest price reasonably available for stockholders by pursuing a single-bidder strategy for selling the company. The board's lack of knowledge as to the company's value and related failure to contact potentially interested parties set it apart from other single-bidder cases such as *Plains Exploration*, a recent case where the court found a single-bidder sale process to be reasonable. Nevertheless, the Court declined to enjoin the merger because an injunction could risk the stockholders' opportunity to receive a substantial premium over the market price for their shares.

In 2012, the NetSpend board had engaged with two private equity firms who were interested in buying a bloc of stock from NetSpend's largest stockholder. In connection with that process, the two private equity firms signed standstill agreements and agreed not to seek a waiver of the standstill provisions. One of these firms had offered $12 per share for the minority bloc of stock. During this process with the private equity firms, Total Systems Services Inc. ("TSYS") approached NetSpend regarding an acquisition and NetSpend ceased discussions with the private equity firms. The NetSpend board initially maintained that the company was not for sale in an effort to obtain a more attractive bid from TSYS. However, once TSYS's bid became sufficiently attractive to negotiate merger terms, the NetSpend board decided not to seek other bidders because of concerns about confidentiality, and the process moved quickly. The NetSpend board requested a go-shop in the merger agreement, but ultimately agreed to a customary no-shop provision with a fiduciary-out termination right and 3.9% termination fee in exchange for a higher merger price. The transaction was structured as a tender offer with the result that the anticipated time between signing and closing was likely too short for unsolicited bidders to come forward.

The Court found that the NetSpend board likely breached their *Revlon* duties because:

- <u>The board did not seek bids from potentially interested parties and agreed – without understanding that they were doing so – to preclude bids from potentially interested parties</u> – Before the NetSpend board entered into the merger agreement with TSYS, it declined to approach the private equity firms recently considering a minority acquisition to test their interest in acquiring the company as a whole. The NetSpend board also did not waive the standstill agreements previously entered into with these firms to allow them to bid for the company. Instead, the merger agreement locked in these standstill agreements and ensured that the board could never know if the private equity firms were interested. The Court was especially troubled by the fact that the board was unaware of or did not consider and understand the implications of these don't-ask-don't-waive provisions.

- <u>The board did not conduct a market check or have sufficient independent knowledge of the company's value</u> – The Court found that, unlike other cases where single-bidder strategies had been approved, the NetSpend directors did not have a sufficiently robust understanding of the value of NetSpend to obviate a market check. As a result, the need for a market check was heightened, but not pursued.

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- The financial advisor's fairness opinion was "weak" – In the absence of a market check, the fairness opinion of the board's financial advisor was critical in providing the board with adequate knowledge that the price was the best the board could reasonably obtain. But the board's advisor provided only a "weak" fairness opinion, in the Court's view. The Court criticized the board's reliance on the financial advisor's analysis as a substitute for the knowledge gained from a market check because:
  - The premium analysis was uninformative, as the board believed the market price to substantially undervalue the company (believing the stock to be undervalued, the board had recently authorized stock repurchases);
  - The comparable companies and transactions analysis was uninformative, as most of the subject companies and deals were not similar to NetSpend or the proposed acquisition; and
  - Finally, the deal price was 20% below the range of fair values produced by the financial advisor's discounted cash flow analysis.

While the Court found the plaintiff had demonstrated a sufficient likelihood of success on the merits, the Court nevertheless declined to enjoin the merger because no other bidders for NetSpend had emerged. Of particular note, the Court had already enjoined the don't-ask-don't-waive provisions, allowing the two private equity firms to come forward, but neither had done so. Because there was no higher bid available or reasonably expected, the Court held that an injunction could unduly risk the stockholders' ability to realize a premium for their shares and, therefore, the balancing of the equities weighed against the issuance of an injunction. In addition, the Court indicated that damages would not be available to plaintiff at trial because the breaches of the directors' *Revlon* duties in this case would be breaches of the duty of care (for which the directors were exculpated by the NetSpend charter).

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