



Selling *Revlon*: The intersection of *Revlon* duties and 363 sales in bankruptcy

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In 1986, the Delaware Supreme Court created the *Revlon* doctrine when it affirmed a lower court decision to enjoin transactions between Revlon, Inc. and Forstmann Little & Co. designed to avoid a hostile takeover of Revlon (*Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*). The *Revlon* decision determined that, under the duty of care owed by corporate directors, once a board determines its company is for sale, it must 'maximize . . . the company's value at a sale for the stockholders' benefit,' adding that the directors' 'role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.' The court further noted that directors breached their duty of loyalty when they entered into the "auction-ending" contract with Forstmann Little.

In his article on the *Revlon* doctrine and the competing corporate law principals of authority and accountability underlying the gatekeeping function of the board of directors during an acquisition (Fordham Law Review), Professor Stephen Bainbridge of UCLA argues that once a target board of directors enters "Revlon-land", its sole *Revlon* duty is to obtain the best deal for the shareholders.

Professor Bainbridge says that a target board enters Revlon-land through one of three checkpoints: (1) when a corporation initiates an active bidding process seeking to sell itself or to effect a reorganization involving the break-up of the company; (2) when the target board abandons its long-term strategy and seeks the break-up of the company in response to a bidder's offer; and (3) when approval of a transaction results in a sale or change of control.

His observations on the fiduciary duties owed by a target board upon entering Revlon-land may be instructive on the fiduciary duties owed by a board of directors during the sale of a company in bankruptcy pursuant to section 363 of the Bankruptcy Code.

***Revlon* considerations to be made during bankruptcy**

While Professor Bainbridge does not specifically discuss the role of the board of directors during bankruptcy, his analysis of the way courts view certain corporate decision-making processes may be applied to an in-court process as well.

In bankruptcy, issues regarding *Revlon* type fiduciary duties arise in the context of a sale of assets pursuant to Section 363 of the Bankruptcy Code, the process related thereto and negotiation of terms such as break-up fees (a fee paid to a prospective purchaser if the seller terminates the proposed transaction), no-shop clauses (clauses that preclude the active shopping of the business by the seller once an agreement in principle is reached between a prospective purchaser and a seller) and window shop provisions (provisions that allow limited active solicitation for a superior deal once an agreement in principle is reached between a prospective purchaser and a seller, but that may provide such prospective purchaser notice and an opportunity to match or top any new proposal). In bankruptcy, courts generally agree that officers

and directors continue to owe fiduciary duties after the petition date. The fiduciary duties that officers and directors of a bankrupt entity owe are essentially the same as those owed by officers and directors of an entity that is not in bankruptcy (i.e., the duty of loyalty, the duty of care and the duty of good faith). In fact, bankruptcy courts have held that state corporate governance principles continue to apply in bankruptcy.

Thus, the intent of *Revlon* – to maximize the company’s value for the benefit of the shareholders – continues in bankruptcy, because a debtor is required to demonstrate that it is obtaining the highest or otherwise best price for the assets that are to be sold. Bankruptcy courts have held that in order to receive approval of a proposed sale of assets, the debtor will need to demonstrate to the bankruptcy court that the preferred purchase price is the highest and best offer. Further, in the bankruptcy court sales process, incentives are often needed 'to encourage the making of bids,' especially a “stalking horse” offer (an initial bid on the assets of a bankrupt company that will be used as the starting price to be paid for such assets), which may then be “shopped around” to attract higher offers.' Accordingly, bankruptcy courts applying the *Revlon* doctrine will do so to protect the debtor’s creditors and shareholders by ensuring that actions taken by a debtor will maximize the value received in exchange for the debtor’s assets. For example, in evaluating break-up fees, bankruptcy courts generally examine whether the fee is marked by self-dealing or manipulation; whether the fee hampers, rather than encourages, bidding; and whether the fee is reasonable in relation to the proposed purchase price.

As a result, when negotiating stalking horse purchase agreements, it is important to consider the impact of bankruptcy law as well as state corporate governance principles on both the provisions negotiated in the sale process and the actions the board of directors takes with respect to that process.

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