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TRANSACTIONS

Delineating a board's duty to find the highest value

By Brian Lutz

One question that invariably arises in litigation challenging change of control transactions is whether the board of directors of the selling company took appropriate steps to obtain the highest value reasonably attainable for the company's stockholders — i.e., whether the board complied with its so-called "*Revlon* duties" under Delaware law.

In a decision that should provide guidance to directors engaged in M&A transactions and their advisors, the Delaware Supreme Court recently clarified that a board need not conduct an auction or active market check, even if negotiating with a single bidder, before agreeing to sell a company. *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust*, No. 655/657 (Del. Dec. 19, 2014). Rather, a board may, under appropriate circumstances, rely upon a post-signing "passive" market check, where the deal protection provisions do not prevent a rival bidder from making a superior offer.

On June 25, 2014, C&J Energy Services Inc. and Nabors Industries Inc. agreed to a merger of C&J with a division of Nabors, creating a new company that would be owned 47 percent by former C&J stockholders and 53 percent by Nabors. Prior to entering the deal, the C&J board did not engage in any market check for alternative bidders. The merger agreement contained a standard "fiduciary out" provision that would allow C&J to negotiate with third parties post-signing under certain circumstances, as well as a termination fee equal to 2.27 percent of the deal value that C&J would have to pay Nabors in the event that C&J entered into an alternative transaction.

C&J stockholders sued in the Delaware Court of Chancery challenging the transaction. The plaintiffs alleged, among other things, that the directors of C&J breached their fiduciary duties under *Revlon*. The plaintiffs also moved for a preliminary injunction to prevent a stockholder vote to approve the transaction. In a bench ruling following the preliminary injunction hearing, Vice-Chancellor Travis Laster found that the C&J directors appeared to have approached the transaction as an acquisition of the Nabors division rather than a change of control of C&J, and that they did not attempt to shop C&J. The vice-chancellor concluded that the plaintiffs had made a "plausible" showing that the directors breached their fiduciary duties by failing to attempt to shop the company. Thus, the trial court ordered C&J to solicit alternative acquisition proposals for a 30-day period, and enjoined any stockholder vote during that period.

In a unanimous decision by Chief Justice Leo Strine, the Delaware Supreme Court reversed.

Sales Process: The Supreme Court reaffirmed the Delaware law principle that "there is no single blueprint" for a board to fulfill its *Revlon* duties. In particular, "*Revlon* does not require a board to set aside its own view of what is best for the corporation's stockholders and run an auction whenever the board approves a change of control transaction." Rather, the Supreme Court noted that a board may "pursue the transaction it reasonably views as most valuable to stockholders, so long as the transaction is subject to an effective market check," which provides alternative bidders a "fair opportunity to present a higher-value alternative" and allows the board flexibility to accept such a deal. The market check requirement, according to the Supreme Court, does not mean that a board must actively seek alternative bidders before or after signing. Here, the Supreme Court concluded that the existence of the "fiduciary out" provision, which would allow the C&J board to consider alternative offers under certain circumstances post-signing, coupled with a "modest" termination fee and an almost five-month period before a stockholder vote on the proposed transaction, meant that there were no "material barriers" to alternative bids. The Supreme Court therefore concluded that the C&J board's conduct, including its "passive" market check, satisfied the board's *Revlon* duties.

The Supreme Court, in framing the contours of a board's *Revlon* duties, also emphasized the context in which the *Revlon* standard was developed: where a board resisted a sale to a particular bidder and erected subsequent barriers to prevent a higher bid. Given there were no facts suggesting that the C&J board had attempted to prevent any particular bid or the receipt of a higher alternative bid, and that the C&J stockholders would have the opportunity to vote on the transaction, the Supreme Court concluded that the chancery court had misapplied *Revlon* to require an active market check in all circumstances.

The Supreme Court further ruled that the chancery court had applied the wrong standard for issuance of a preliminary injunction, which required a reasonable probability of success on the claims, not a mere "plausible" ability to succeed. Moreover, the court criticized the chancery court for requiring C&J to engage in a "go-shop" process, which would have run counter to the merger agreement, noting that a party should be "strip-p[ed] … of bargained-for benefits" while being held to other contractual obligations only if it was "fairly required to do so" because the party "had, for example, aided and abetted a breach of fiduciary duty." Finally, the court concluded that the mandatory injunction issued by the chancery court should be issued only after a trial with findings of fact or on the basis of undisputed facts, and not on the basis of a preliminary record with factual disputes.

The *C&J Energy* decision will not end the debate over a board's *Revlon* duties. Every sale of control transaction presents unique facts and challenges, which require careful consideration by boards charged with pursuing the highest value reasonably attainable for stockholders. But *C&J Energy* — with its strong message that boards have significant discretion to structure a deal process, and there is no single course of conduct that a board must pursue in a change of control transaction — provides helpful guidance to boards and their advisors when fashioning a reasonable sales process.

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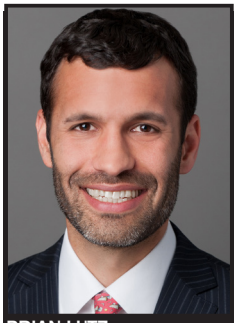

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