

## Corporate Finance/M&A - USA

### Delaware Supreme Court clarifies fiduciary duties in sale context

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#### Introduction

In a recent opinion<sup>(1)</sup> the Delaware Supreme Court reversed a Delaware Court of Chancery ruling enjoining a merger transaction between C&J Energy Services, Inc and Nabors Industries Ltd, holding that *Revlon* duties do not require a board to shop a corporation affirmatively and that a board can satisfy *Revlon* scrutiny by pursuing a reasonable sale process in good faith, implementing a "passive market check" and providing its stockholders with a full and informed opportunity to vote on the transaction.

#### Facts

The Supreme Court's decision arose from a complex corporate inversion transaction in which C&J merged into a Bermudan subsidiary of Nabors. Initially, the C&J board considered an acquisition transaction – including a possible acquisition of the Nabors subsidiary – but after evaluating its strategic options determined to merge into the Nabors subsidiary and reap an estimated \$200 million tax benefit. However, for the inversion to be effective, Nabors would need to own a majority of the new company. Thus, even though C&J was larger than the Nabors subsidiary into which it merged, Nabors would be the majority stockholder of the post-transaction company. Therefore, C&J negotiated for certain post-transaction rights for its stockholders, including:

- the right to designate four board members;
- a requirement that a sale of the new company (or a sale of its major assets) must result in *pro rata* per share payment to all stockholders; and
- a requirement that any sale, stock issuance or bylaw amendment be approved by at least two-thirds of the company's stockholders.

The C&J board also negotiated for a fiduciary out in order to permit consideration of potential topping bids.

C&J stockholders challenged the transaction, claiming that C&J's board was improperly conflicted and had breached its fiduciary duties by, among other things, failing to shop the company affirmatively. The Delaware Court of Chancery evaluated the board's conduct under *Revlon* and granted the plaintiffs' motion for a preliminary injunction after determining that it was "plausible" that the C&J board had failed to fulfill its *Revlon* duties. In so doing, the court issued a mandatory injunction enjoining the stockholder vote for 30 days and requiring the C&J board to shop the company affirmatively during that time period – despite the fact that the merger agreement contained an express no-shop provision and the court made no findings that Nabors was an aider and abettor.

#### Decision

The defendants filed an expedited appeal to the Supreme Court, which reversed the lower court's ruling. Chief Justice Strine, writing for the court, held that the lower ruling was improper because:

*"Revlon and its progeny do not set out a specific route that a board must follow when fulfilling its fiduciary duties, and an independent board is entitled to use its business judgment to decide to enter into a strategic transaction that promises great benefit, even when it creates certain risks."*

Thus, Strine reminded that *Revlon* does not require a selling corporation's board to shop the corporation actively before signing a definitive acquisition agreement. In so holding, he emphasised that *Revlon* "was largely about a board's resistance to a particular bidder and its subsequent attempts to prevent market forces from surfacing the highest bid". In contrast, the C&J board did not

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seek to prevent the emergence of another bidder and there was "adequate time for such a bidder to emerge". Thus, the C&J board – which had also negotiated for a fiduciary out and a reasonable termination fee – had conducted a permissible "passive market check".

The Supreme Court also concluded that although the Delaware Court of Chancery has broad equitable authority, it was improper to 'blue pencil' the merger agreement by imposing a mandatory injunction that required the C&J board to shop the company in violation of a no-shop clause. Because such an injunction is an extreme remedy, it must be based on undisputed facts or post-trial findings of fact. Here, the court held that the trial record did not support a mandatory injunction or any inference that Nabors aided and abetted a breach of fiduciary duties or otherwise acted improperly. The court also held that, because there was no reason to believe that the C&J stockholders were not adequately informed about the transaction, "the Court of Chancery should be reluctant to take the decision out of their hands".

## Comment

The Supreme Court's opinion re-emphasises existing Delaware case law that provides disinterested boards with broad latitude in making reasonable strategic choices in connection with sale transactions, especially where the selling board does not have a conflict of interest and has not improperly favoured a particular bidder. This opinion is also important in that it reinforces a recently emerging Delaware trend of approving single-bidder sale processes undertaken by disinterested, well-advised and fully informed boards, particularly with respect to premium transactions with customary deal-protection devices and where the stockholders have a fully informed opportunity to vote on the deal. Finally, this opinion shows the Delaware courts' reluctance to blue pencil agreements, particularly when it interferes with the bargained-for rights of an innocent counterparty.

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## Endnotes

(1) *C&J Energy Services, Inc v City of Miami General Employees' & Sanitation Employees' Retirement Trust*, No 655/657 (Del 2014).

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