

INSIGHTS

Delaware Supreme Court Reverses Injunction Requiring Thirty Day Go-Shop

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In a recent decision, the Delaware Supreme Court reversed the Court of Chancery's entry of a preliminary injunction that enjoined C&J Energy Services, Inc. ("C&J") from holding a stockholder vote on its proposed merger with Nabors Industries, Ltd. ("Nabors") for 30 days and required C&J to solicit alternative proposals. *C&J Energy Servs., Inc., et al. v. City of Miami Gen. Employees' and Sanitation Employees' Ret. Trust*, No. 655/657, 2014 (Del. Sup. Ct. Dec. 19, 2014). The Delaware Supreme Court held that the Court of Chancery misapplied the standard for injunctive relief and misapplied the *Revlon* standard governing change-of-control transactions by requiring C&J's board of directors to engage in an active solicitation process.

Case Summary

This lawsuit arose from the proposal of C&J, a Delaware corporation, to merge with Nabors, a Bermuda corporation. The proposed merger was structured as a tax inversion transaction. C&J would acquire a subsidiary of Nabors, but Nabors would retain a majority of equity in the surviving company, C&J Energy Services, Ltd., which would be based in Bermuda in order to take advantage of favorable tax rates. The merger agreement included a modest break-up fee representing 2.27% of the merger price and a "fiduciary out" provision that "enabled the [B]oard to terminate the transaction with Nabors if a more favorable deal emerged." Slip. Op. at 20, 32. The merger agreement also provided a number of protections to C&J's shareholders, including a five-year requirement of a two-thirds vote to amend bylaws, sell the company, or issue stock, and a requirement that if the company or its major assets were sold, shareholders would receive consideration of the same type and amount calculated on a per share basis.

Shareholders of C&J ("Plaintiffs") brought this action to enjoin voting on the transaction, arguing, among other things, that the Board was overly influenced by C&J's CEO, Joshua Comstock, who allegedly wished to acquire Nabors in order to secure a lucrative employment package for himself. Plaintiffs further claimed that the Board failed to fulfill its duties under *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) when it approved the transaction without engaging in an active market check. Under *Revlon*, when a board engages in a change-of-control transaction, it has a fiduciary duty to "achiev[e] the highest immediate value reasonably attainable." Slip. Op. at 27 (citing *Revlon*, 506 A.2d at 182).

On November 25, 2014, the Court of Chancery granted Plaintiffs' motion for a preliminary injunction, finding that the Board plausibly violated its *Revlon* duties by not affirmatively shopping the company. *City of Miami Gen. Employees' and Sanitation Employees' Ret. Trust v. C&J*

Energy Servs., No. 9980-VCN (Del. Ch. Nov. 25, 2014). The Court viewed it as a "major problem" that the Board did not approach the transaction as a sale process, but rather as a strategic transaction that it structured as an asset sale in order to receive tax benefits. The Court enjoined the stockholder vote for a period of 30 days and ordered C&J to solicit purchase proposals that were superior to the proposed Nabors transaction. The Delaware Supreme Court reversed the Court of Chancery's decision on December 19, 2014.

The Supreme Court's Reasoning

The Delaware Supreme Court held that the Court of Chancery misapplied both the standard for preliminary injunctions and the *Revlon* standard.

The Court began by clarifying that the standard to enjoin a corporate transaction requires more than a mere "plausible showing of a likelihood success on the merits ..." Slip. Op. at 26. Rather, to obtain a preliminary injunction, a party must show a "reasonable probability" of success on the merits; that is, "that [the plaintiff] is more likely than not entitled to relief." *Id.* at 26-27. This showing must be "particularly strong" when, as in this case, "no other bidder has emerged despite relatively mild deal protection devices." *Id.* at 26.

The Court also found that the Court of Chancery's decision to award an injunction was rooted in a misapplication of *Revlon* to require an active pre-signing solicitation process. The Court emphasized that "*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." *Id.* at 27. Although *Revlon* requires a company to conduct a market check, "[s]uch a market check does not have to involve an active solicitation, so long as interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal." *Id.* at 28-29. A court assessing a transaction under *Revlon* must ask whether a board made a "reasonable" decision, rather than a "perfect" decision. *Id.* at 28.

Applying *Revlon* to the facts at hand, the Court found that there was not a reasonable probability that the Board breached its duty of care. The Court emphasized that the Board was aware of the implications that the deal would have on voting control and took steps to mitigate the effects of this change in control. For example, the Board negotiated bylaws that restricted Nabors' ability to sell its shares or sell the company for a period of five years and that ensured all stockholders would receive pro rata consideration in any sale of the company or its assets. Additionally, the Court found that the Board was well-informed as to C&J's value and had no improper motive to enter into the transaction.

The Court further emphasized 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." *Id.* at 33. Here, "there were no material barriers that would have prevented a rival bidder from making a superior offer." *Id.* at 32. Indeed, not only did the agreement contain a "fiduciary out" provision, the deal was not expected to close for several months, leaving ample time for a competing bidder to emerge. The Court also stated that it was "contextually relevant" that C&J's shareholders would have "a fair chance" to evaluate the transaction themselves and to decide whether to accept its benefits and risks. *Id.* at 33-34. The Court noted that much of the information that Plaintiffs pointed to as evidence of the Board's alleged breaches was disclosed in publicly available documents.

Lastly, the Court held that the Court of Chancery employed the wrong procedural standard in deciding to issue an affirmative injunction that required C&J to solicit alternative proposals. To issue a mandatory injunction requiring a party to take affirmative action, the Court of Chancery must either hold a trial and make findings of fact, or rely only on undisputed facts. Here, the Court of Chancery issued a mandatory injunction on a paper record that merely convinced it that there was "plausible showing of a likelihood of success on the merits." *Id.* at 26. The Court emphasized that the granted relief essentially "force[d] Nabors to endure a judicially-ordered infringement of its contractual rights" because the merger agreement forbid C&J from actively soliciting alternative proposals. *Id.* at 35. Absent viable claims that Nabors had aided and abetted the Board's alleged breaches of fiduciary duty, it was improper for the Court of Chancery "[t]o blue-pencil an agreement to excise a provision beneficial to a third party like Nabors on the basis of a provisional record and then declare that the third party could not regard the excision as a basis for relieving it of its own contractual duties." *Id.* at 36.

Takeaways

This decision reinforces that *Revlon* does not create a blueprint that a board must follow in order to comply with its duty to achieve the highest value that is reasonably attainable. In particular, this decision clarifies that *Revlon* does not impose a requirement that a board affirmatively shop a company in order to conduct a reasonable sale process. In certain circumstances, a passive market check may suffice, particularly where, as here, an independent board has negotiated a "fiduciary out" and only modest deal protection measures are in place. Delaware courts are less likely to intervene where there are no barriers to the emergence of a competing bidder and there is sufficient time for a bidder to emerge.

This decision also highlights the high hurdle for a Plaintiff to enjoin a corporate transaction, particularly when no alternative transaction is available and the shareholders are free to reject the deal for themselves. Critically, as this decision illustrates, a board need not disregard a reasonable transaction that it believes maximizes shareholder value in order to search for an alternative deal.