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# Delaware Insider:

## Softening the *Revlon* Reasonableness Standard

By Peter J. Walsh, Jr. and Andrew H. Sauder

"Although the record before us reveals a board process that sometimes fell short of ideal, *Revlon* requires us to examine whether a board's overall course of action was reasonable under the circumstances as a good faith attempt to secure the highest value reasonably attainable." These are the words of the Supreme Court of Delaware, and they portend good news for directors selling a company, particularly when no competing bid has emerged. In *C&J Energy Servs., Inc. v. City of Miami Gen. Employees' and Sanitation Employees' Ret. Trust*, No. 655/657, 2014 (Del. Dec. 19, 2014), the Supreme Court of Delaware recently reversed a Court of Chancery ruling, striking down a preliminary injunction that: (1) enjoined a pending merger for 30 days, (2) required a committee of the selling corporation's board to actively solicit alternative bids for the corporation during that time, and (3) declared (contrary to the merger agreement) that the counterparty in the transaction could not consider the required solicitation to be a breach of contract. Along the way, the Supreme Court explained that the board's actions did not violate any duties it may have owed under the often-invoked *Revlon* standard of review.

### The Transaction

C&J Energy Services, Inc. (C&J) is an oilfield services provider and a publicly-traded Delaware corporation with a market capitalization of about $730 million. C&J's board has seven directors, five of whom are independent. Nabors is a Bermuda company that also provides oilfield services. In 2013, C&J's board explored strategic acquisitions, and authorized its CEO, a board member, to lead the search. In January 2014, an investment banker approached the CEO with the possibility of buying a division of Nabors that was engaged in oil field completions and productions services (Nabors CPS). That approach resulted in the challenged merger.

Under the terms of the merger agreement, C&J would acquire the Nabors CPS business. Significantly, to secure tax benefits with an estimated net present value of $200 million, Nabors would acquire majority ownership of the surviving company, which would be domiciled in Bermuda. To accomplish this result, a newly-created subsidiary of Nabors Industries Ltd. (Nabors) would hold the Nabors CPS business. C&J would merge with that subsidiary to create C&J Energy Services, Ltd. (New C&J). C&J's management team would manage the new company. C&J's former stockholders would own 47 percent of the equity in the new entity; Nabors would own 53 percent and receive about $938 million in cash.

To cushion the potentially harsh consequences of Nabors' majority ownership, C&J's board secured protections for C&J stockholders in the merger agreement, including:

(a) for five years, a requirement that two-thirds of New C&J's stockholders vote in favor of any bye-law amendment (Bermuda refers to bylaws as "bye-laws"), stock issuance, or sale of the company;
(b) a bye-law that all stockholders must receive equal consideration per share upon a sale of the company or major asset sale, and that this bye-law cannot be amended without unanimous stockholder vote;
(c) for five years (or until Nabors owns less than 15 percent of New C&J's shares), Nabors may not take certain actions to alter its stock ownership or enter into agreements to increase its voting power or change the board of directors;
(d) New C&J board members would be nominated by a three-member committee, two of whom would be current C&J directors;
(e) restrictions on Nabors' ability to sell its stock to third parties that could affect the control of New C&J; and
(f) any violations of standstill provisions in the merger agreement permits the termination of Nabors' management from the post-merger management team.

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Nabors also secured a "fiduciary out," so that C&J could negotiate with third parties in certain situations and could terminate the deal if a superior proposal emerged before closing. To exercise this right, C&J would have to pay a $65 million termination fee (2.27 percent of the deal value).

The deal was publicly announced on June 25, 2014, but was not expected to close before year-end 2014. The plaintiff, a retirement trust, brought a class action in the Court of Chancery seeking to enjoin the merger. No superior proposal ever emerged.

### The Court of Chancery's Decision

Before the Court of Chancery, the plaintiff argued that C&J's board failed to fully appreciate that it was entering into a change of control transaction. On a motion for preliminary injunction, the Court of Chancery credited this argument, and held in a transcript ruling that plaintiff made a "plausible" showing that C&J's board failed to satisfy *Revlon.* To remedy the alleged wrongdoing, the Court of Chancery entered an order enjoining consummation of the merger for 30 days. During that time, certain independent directors on C&J's board were required to solicit interest in the company, and the Court further declared that such a solicitation would not violate Nabors' contractually-secured right to have C&J refrain from actively seeking bids.

### The Supreme Court Opinion

The Supreme Court of Delaware accepted an interlocutory appeal of the ruling and expedited the appeal to permit consideration of the 30-day injunction. Sitting en banc, the Court reversed the Court of Chancery's order, ending the injunction. The Supreme Court held that the Court of Chancery failed to apply the proper standard for a preliminary injunction, misapprehended *Revlon*, and entered an impermissible form of preliminary injunction.

### *Revlon* Allows Boards Broad Discretion to Negotiate a Deal

The Supreme Court held that C&J's board did not violate *Revlon*, which requires a board of directors to act reasonably to attain the highest price available when selling control of a corporation. Given the expedited nature of the appeal, the Court assumed *Revlon* applied to the transaction, but did not so decide. The Court highlighted three important features of *Revlon* jurisprudence: the principle that there is no single blueprint for a sale process, the importance of even a passive market check, and the value of an uncoerced stockholder vote. Before delving into these particular aspects of *Revlon*, the Court noted the relatively narrow circumstances from which the doctrine arose, observing that "as the years go by, people seem to forget 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."

As the Supreme Court explained, *Revlon* does not require a board to follow a particular model, such as conducting an auction for the corporation. Instead, courts applying *Revlon* must ask whether the directors made a reasonable decision (not a perfect one) to attain the best value. A board may choose a transaction that the board reasonably considers to be the most valuable to stockholders, so long as the chosen transaction provides an opportunity for other bidders to submit offers and permits the board the freedom to accept any such offer.

Based on these formulations, the Supreme Court disagreed with the Court of Chancery's holding that the C&J board's actions violated *Revlon*. Several factors animated this conclusion. First, the board possessed no improper motive to enter into a transaction with Nabors, and conducted a "passive," post-signing market check by providing for a reasonable period of time before closing to allow serious bidders to emerge. Second, the merger agreement contained a broad "fiduciary out," coupled with a reasonable termination fee. Finally, the Court emphasized that the stockholders would have a "fair chance to evaluate the board's decision for themselves," by way of a fully informed stockholder vote. In these circumstances, the Court observed, the Court of Chancery "should be reluctant to take the decisions out of [the stockholders'] hands." Accordingly, the Court concluded that the Court of Chancery had erred in its application of *Revlon.*

### Preliminary Injunction Standard

Another aspect of this opinion – perhaps of more interest to the litigator than the deal lawyer – dealt with the showing necessary to justify the injunction entered by the Court of Chancery.

A party seeking a preliminary injunction must demonstrate that it would suffer irreparable harm in the absence of the requested injunction, that the balancing of the equities justifies the requested relief, and that it has a reasonable likelihood of success on the merits of the claim. It is this final requirement that principally distinguishes the preliminary injunction standard from that governing temporary restraining orders, which requires only a colorable claim. A preliminary injunction, typically sought after a plaintiff obtains some discovery, requires a higher showing on the merits. Here, the Court of Chancery entered an injunction having found only that the plaintiff made a "plausible showing" of a likelihood of success on its duty of care claim.

The Supreme Court of Delaware was critical of this procedural shortcoming. The Court explained that a reasonable probability of success exists if the plaintiff demonstrates "that it will prove that it is more likely than not entitled to relief." A plaintiff who merely makes a "plausible showing" has not met the likelihood of success prong for preliminary injunctive relief. To its credit, the Court of Chancery noted that its preliminary finding was a "very close call."

### The Permissible Nature of Preliminary Injunctive Relief

Finally, the Supreme Court reiterated the correct procedural standard required for the issuance of mandatory injunctive relief. A typical injunction prohibits a person from taking some form of action. When a court enters "mandatory" injunctive relief, however, it is requiring a person or entity to undertake some *affirmative* act or conduct. Under Delaware case law, it is frequently observed that a court may not typically exercise its

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equitable powers to impose mandatory injunctive relief in the absence of undisputed facts, or until after trial. The Supreme Court held that the Court of Chancery overstepped its equitable powers by requiring the C&J directors to actively "solicit interest" during the 30-day injunction period.

The Supreme Court was similarly critical of the form of injunction to the extent it stripped Nabors, a third party, of its contractual rights. Nabors had secured C&J's agreement that its board would not actively shop the company. The Court of Chancery ruled that compliance with its order would not constitute breach of contract. But, as the Supreme Court instructed, an order "holding a party to its contractual obligations while stripping it of bargained-for benefits" should only be undertaken after trial and if the party participated in the alleged wrongdoing, for instance by aiding and abetting a breach of fiduciary duty.

## Conclusion

The Court struck down the injunction, observing: "To rely on this insufficient premise [of only a plausible showing of success on the merits] to issue a powerful mandatory injunction, when no rival transaction was available, and when the stockholders can reject the deal for themselves if they do not find its terms to be value-maximizing, was an error."

*C&J Energy* is an important read for all transactional lawyers advising clients whose deals may be subject to the *Revlon* standard of review. *Revlon* does not require boards to take any particular course of action in selling a company. A board need not conduct an auction, although circumstances may warrant this approach. And, even a "passive" market check may now suffice. Above all, one cannot over-emphasize the need for a fully informed vote of the stockholders, particularly when other aspects of the transaction are less than ideal.

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