

M&A Update

***Revlon*: Motive, Market Checks and Injunctions**

December 24, 2014

In two separate December 19th decisions, the Delaware Supreme Court and the Delaware Chancery Court declined to enjoin stockholder votes with respect to pending mergers for alleged violations of the target board's *Revlon* duties. The decisions affirmed longstanding Delaware caselaw providing that "there is no 'single blueprint' for directors to obtain the highest value reasonably attainable" for its stockholders in the satisfaction of its *Revlon* duties, "so long as they choose a reasonable route to get there." The decisions offer boards nuanced guidance on how to satisfy *Revlon* duties in the context of a sale of corporate control.

Background

In *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust*, C&J Energy Services, Inc. entered into an agreement to acquire a subsidiary of Nabors Industries Ltd. for a mix of cash and stock totaling nearly \$3 billion. For tax reasons, Nabors will retain 53% of the combined entity's equity. C&J negotiated several minority protections (including the ability to share pro rata in any future sale of the company, board seats and standstill restrictions on Nabors). C&J also obtained a passive "fiduciary out" and the right to terminate the agreement for a modest termination fee to enter into a superior transaction. C&J stockholders sued for an "unusual" 30-day preliminary injunction to require that C&J actively shop the company before the stockholder vote on the Nabors transaction. The Chancery Court found it plausible that the C&J Board had breached its *Revlon* duties, and ordered the board to solicit other bids. The Delaware Supreme Court, however, overturned the injunction.

In *In re Family Dollar Stores, Inc. Shareholder Litigation*, each of Dollar General, Inc. and Dollar Tree, Inc. engaged in contemporaneous discussions with Family Dollar Stores, Inc. regarding a potential acquisition of Family Dollar. Dollar Tree agreed to acquire Family Dollar for a mix of cash and stock, valued at approximately \$76 a share. The transaction agreement included a passive "fiduciary out." Dollar General subsequently offered to acquire Family Dollar for a higher price, ultimately \$80/share, but Family Dollar determined that the offer was subject to substantial antitrust risk. Dollar General sued to enjoin the vote on the Dollar Tree merger, claiming that Family Dollar breached its *Revlon* duties by not informing Dollar General that it was in negotiations with Dollar Tree prior to signing the merger agreement with Dollar Tree and by not engaging with Dollar General regarding its higher offer. The Chancery Court declined to issue an injunction.

Takeaways

Both decisions reiterate that there is “no specific route that a board must follow” to satisfy its *Revlon* duties. Careful analysis of each opinion reveals similar guidance on how boards should undertake to satisfy their *Revlon* duties in the context of a change of control transaction.

1. Courts are Reluctant to Second-Guess a Well-Informed Board Acting in Good Faith. Each of these decisions makes clear that a court will be reluctant to second-guess a target board’s reasonable judgment in the context of a change of control transaction absent a basis to question its motivations. The Delaware Supreme Court noted that a court must determine “whether the directors made a *reasonable* decision, not a *perfect* decision.” In determining that a preliminary injunction was inappropriate in each case, both courts focused on the high level of information provided to, and deliberation undertaken by, the board in connection with its evaluation of the transaction, the independence of the board’s directors, and the alignment of economic interests between the members of the board in their capacity as significant stockholders of the company and the other stockholders of the company. Furthermore, each court found that no debilitating entrenchment motivation of the board or management existed, relying in large part on the fact that such individuals would not have a significant role with the combined company going forward, or if they would, that such individuals did not negotiate the material terms of such employment until late in the negotiations after all of the material deal terms were agreed upon.
2. An “Active” Market Check is Not Always Required to Fulfill *Revlon* Duties. In both *C&J* and *Family Dollar*, the court determined that an active pre-signing market check is not required to fulfill a board’s *Revlon* duties, particularly if a pre-signing check is rejected following reasonable consideration by the board and the board has the ability to conduct a passive post-signing market check. Indeed, the Chancery Court noted in *C&J* that as long as “the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so,” a board should be free to “pursue the transaction it reasonably views as most valuable to stockholders.”
3. Balance of the Equities Favors a Vote When Shareholders are Informed. While the Delaware Supreme Court in *C&J* acknowledged that after-the-fact monetary damages are an “imperfect tool,” each court found that the issuance of a preliminary injunction delaying the stockholder vote and requiring the target company to enter into discussions with alternative bidders was inappropriate under the circumstances. The decisions highlight the Delaware courts’ reluctance to enjoin a vote of the stockholders where the stockholders are fully informed, not coerced and have the ability to reject the proposed transaction in favor of an alternative transaction that has been presented directly to the stockholders or continuing as a stand-alone company. Indeed, the Delaware Supreme Court noted that “when a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its stockholders a fully informed, uncoerced opportunity to

vote to accept the deal, we cannot conclude that the board likely violated its Revlon duties.”

4. Mandatory Injunctions Should Not Be Awarded Without a Full Record. In *C&J*, the Delaware Supreme Court held that the Chancery Court had overstepped its bounds in ordering a mandatory injunction that “blue-penciled” the merger agreement to divest Nabors of its contractual rights before a full record had been developed. Moreover, the Chancery Court made this determination absent any finding that Nabors committed any wrongdoing that warranted the stripping of its bargained for rights, while obligating Nabors to continue to comply with the other terms of the merger agreement. The Delaware Supreme Court further criticized the Chancery Court’s decision by noting that the issuance of a mandatory injunction at such time and on such record far surpassed the traditional use of preliminary injunctions to keep the *status quo* pending the outcome of a full trial.
5. Minority Protections May Impact the Applicability of Revlon Duties. In *C&J*, the Delaware Supreme Court did not address the question of whether or not the minority protections negotiated by C&J brought the transaction outside the reach of *Revlon* duties, noting that the issue was a matter of first impression and that a ruling in this matter was time sensitive. Instead, the Court assumed that *Revlon* did apply for purposes of its decision. The Court did however acknowledge that contractual provisions that have the effect of limiting the power of the majority stockholder and that ensure that minority stockholders will share in the benefit of any future control premium may result in *Revlon* not applying to a transaction to which it otherwise would.

For a full copy of the *C&J Energy Services* opinion, click [here](#). For the *In re Family Dollar Stores, Inc. Shareholder Litigation* opinion, click [here](#).

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