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Key Delaware Trend in 2014: Increasing Deference to Directors' Decisions—But Not "Anything Goes"

(This memorandum is an expanded version of the article on this subject that was recently published in the Fried Frank M&A Quarterly for the 4th Quarter 2014.)

A foundational premise of Delaware jurisprudence has been the courts' deference to decisions made by independent and disinterested directors. Over the last year, the Delaware courts have continued a trend in their opinions toward *increased* judicial deference to the decisions of independent and disinterested directors. Thus, for example, the Delaware Supreme Court's seminal *MFW* decision provides a roadmap to business judgment review even of controller transactions (which used to be reviewed under an entire fairness standard).

Other than *MFW,* however, the courts have *not* changed the fundamental ground rules for review of a sale process. Thus, as in the past:

- Courts will defer to decisions made by directors who are independent, disinterested, informed, and engaged, and motivated primarily to obtain the best transaction reasonably available for shareholders (and not motivated by defensive, entrenchment or personal objectives).
- Even in the context of review under a heightened scrutiny standard, courts will not challenge a decision made by directors on the basis that it is not the best decision under the circumstances (or the decision that either the court or a "smarter" board would have made), so long as the decision was within a range of reasonableness.
- In that regard, a board need not necessarily auction the company and may rely on "passive shopping" alone through a post-signing "viable market check" (i.e., the ability of interested parties to submit post-signing competing bids so long as there is a fiduciary out and only modest deal protection devices).
- Moreover, the courts will find a breach by directors of the duty of loyalty based on bad faith (which is conduct for which director liability is not exculpated) only in the context of an "extreme set of facts" (i.e., decisions so unreasonable that the only conceivable explanation for them would be an improper motive).
- However, transactions involving conflicts of interest will continue to be subject to heightened scrutiny or entire fairness rather than deference—unless the transaction falls within the parameters established by the *MFW* decision and its progeny (in which case the transaction would be reviewed under the business judgment rule).

What *has* changed is the lens through which the courts view (and thus apply) these ground rules. In each case, the courts appear to be according *greater* deference to directors' decisions than in the past—even reaching frequently to issue a decision, or to comment in dictum, for the apparent purpose of underscoring their commitment to this increased deference. It appears that the courts generally have tended to:

- Be less discerning in finding that directors were independent, disinterested, informed, and engaged;
- Be more expansive in their view of the range of reasonableness;
- Put less emphasis on the need for substantiation of the reasonableness of a board decision based on an evaluation of the particular facts and circumstances;
- Be less ready to find that a non-majority stockholder may be a controller;
- Be more ready to apply a lower standard of review whenever possible (i.e., business judgment rule rather than heightened scrutiny or entire fairness); and
- Dismiss fiduciary duty claims against directors more often at the pleading stage of litigation (so long as the board was independent and there was no conflict of interest or, if there were a conflict, the *MFW* guidelines were followed).

The courts' increased deference to directors' decisions will provide independent boards with more flexibility in crafting a sale process. However, increased deference does *not*, of course, mean "anything goes"—and particularly so in the case of facts that suggest a defensive or entrenchment motive or other conflict of interest of, or lack of engagement by, the directors.

Notwithstanding the recent trend of increased deference to directors—a trend that we expect will continue—it is notable that the courts' decisions in 2014, as in the past, have included lengthy recitations of the specific fact situations involved. In each case, while the court did not emphasize or even expressly rely on them, there were numerous factors supporting a finding of reasonableness (such as evidence of the independence and engagement of the board, there being no defensive or entrenchment motive, and the underlying transaction or specific decision at issue making business sense).

In a supplemental letter decision issued by the Chancery Court in the *Family Dollar* case (on Jan. 5, 2014, denying the plaintiffs' request for an interlocutory appeal), Chancellor Bouchard rejected the argument that the Chancery Court's decision in that case—to uphold the directors' decision to engage in a single bidder process and refuse to negotiate with a competing bidder—was inconsistent with precedent that required that the reasonableness of a board's sale process decisions be established. The Chancellor emphasized in the supplemental ruling the many facts that had supported the reasonableness of the Family Dollar board's decisions.

The competing premises underlying the courts' approach of greater deference are these:

- On the one hand, the animating principle of Delaware law has always been judicial deference to the decisions made by independent, disinterested, and sufficiently informed and engaged decision makers. There is seemingly no reason for the courts to substitute their own judgments for those of independent directors who have no conflict and are trying to fulfill their duties.

- On the other hand, a perception of automatic or overbroad deference to board decisions may undermine the constructive discipline that the courts and practicing lawyers for decades have imposed on parties engaged in an M&A process. There is potentially much to lose if M&A participants perceive that an "anything goes" approach has been substituted. We do not believe that such an approach is intended by the courts' recent decisions.

Additional development or refinement of the trend of deference, as well as the other themes from 2014 identified below, await the Chancery Court's further post-*MFW* jurisprudence and the reaction of the Supreme Court. It remains to be seen whether, and to what extent, the courts may now find that a board acted reasonably when it agreed to provisions that previously the court would have found to be problematic. In this new paradigm, increased deference has apparently moved the guidepost for the extent to which a court, in evaluating a board's sale process decisions, will require substantiation of the reasonableness of the decisions based on the particular circumstances. However, the contextual facts of the case will, of course, continue to be critical. Importantly, even if a board is independent, disinterested, informed, and engaged, if the sale process decisions it makes are outside the bounds of what could be considered reasonable, or the facts suggest that the directors had an entrenchment or defensive motive or other non-shareholder-focused motive, the transaction could well be enjoined.

The following themes were emphasized in the courts' 2014 decisions:

- ***Controller status***. A non-majority stockholder generally will not be viewed as a controller unless he or she "literally dominated the boardroom" with respect to the decision at issue. (We note the uncertainty that must be present in a court's effort to determine that domination was the reason for a board's decision in any given case.)

- ***Director independence***. A director will not be deemed non-independent merely by virtue of having been nominated by a particular party or having arranged to continue as a director of the surviving corporation in a transaction. The following will be viewed as positive factors supporting the presumption of a director's independence:

    - in the case of a director who is associated with a controller, that the controller is not conflicted with respect to the transaction being considered;

    - in the case of a director-stockholder who negotiates post-transaction employment with the surviving corporation while the transaction is being negotiated, that the personal gains to be achieved through the employment would be less valuable to the director than the gains to be realized by the director on his or her shares from negotiating the highest available merger price; and

    - that the director owns, or was nominated by a stockholder that owns, a significant equity stake in the company (as the court will view his or her interests as being aligned with those of the stockholders).

- ***Director liability***. Directors face personal liability only for breaches of the duty of loyalty (since liability for breaches of the duty of care is exculpated). The courts have continued to hold that a breach of the duty of loyalty on the grounds that directors had an improper motive will be found only in the case of an "extreme set of facts". Notably, however, the courts have also continued to hold that, when entire fairness review applies, claims for breach of the duty of care will not be dismissed at the pleading stage, but, rather, only after a fully developed factual record that establishes whether the transaction was "entirely fair"—that is, that the price and the process were fair. Thus, when entire fairness applies, even independent and disinterested directors facing breach of duty of care claims could face protracted litigation even though (in light of exculpation) it is unlikely that they would be found to have liability. It will be interesting to see whether this precedent relating to independent and disinterested directors will be reversed in light of the courts' apparently increased general inclination for early dismissal of litigation.

Key Delaware Decisions of 2014

MFW:

(Mar. 14, 2014) **Delaware Supreme Court will apply the business judgment rule to going private transaction when unwaivable conditions for independent special committee and minority stockholder approval are in place at the outset of the process.** The courts' approach to going private transactions significantly shifted with the *MFW* decision. While, in the past, a transaction involving a controller on both sides of the transaction would have been reviewed under the more stringent entire fairness standard, *MFW* now provides a roadmap for business judgment review of controller transactions. If a controller transaction is subject from the outset of the process to unwaivable conditions that the transaction be approved by an independent, fully functioning special committee of directors and the informed vote of a majority of the minority stockholders, then business judgment review will apply. (Notably, in a case of first impression in New York, the Appellate Division, First Department, in its holding in *Kenneth Cole* (Nov. 20, 2014), adopted the same approach, bringing New York in line with Delaware.)

Since *MFW*, there has been uncertainty as to, when the *MFW* guidelines are followed, the type and extent of the claims that will be necessary for the court to reject dismissal of a case at the pleading stage. A footnote in the *MFW* opinion indicated that any pleadings alleging "any reasonably conceivable set of facts" that call into question the price, process or disclosure would survive dismissal at the pleading stage—and that the pleadings in *MFW* (alleging, essentially, simply that the price seemed too low) would have survived dismissal. Thus, it was uncertain what the decision's actual impact would be. The Chancery Court's post-*MFW SynQor* decision by Vice Chancellor Laster (described below), if followed, suggests that the impact will be significant. *SynQor*, which the Vice Chancellor described as a "close case", did not, in our view, follow the approach indicated in the *MFW* footnote, but, instead, dismissed claims at the pleading stage that appeared to be reasonably specific and compelling. Further clarification must await review of the issue by the Delaware Supreme Court.

Howard-Anderson:

(Apr. 8, 2014) **Court appears to apply a broader standard for what may constitute bad faith by directors in a sale process.** The Chancery Court held that directors and officers could incur personal liability for a breach of the duty of loyalty if they acted unreasonably in conducting a sale process *and* allowed an "improper motive"—i.e., interests other than the pursuit of the best value reasonably available—to influence their decisions. (Directors face personal liability for bad faith, as conduct constituting a breach of the duty of loyalty is not exculpated.) The court expressly rejected arguments—which were based on the Delaware Supreme Court's articulation of "bad faith" in *Lyondell*, which since then has been the standard generally applied by the Delaware courts—i.e., that directors could only be found to have acted in bad faith if it were determined that they had an intention to do harm, had consciously disregarded their known duties, and had utterly failed to obtain the best price reasonably available. The decision appears to broaden the focus of the *Lyondell* bad faith standard—from an emphasis on the *actions* that directors and officers did or did not take (i.e., did they "utterly disregard" their known duties?) to the *thoughts* that were or were not in their minds at the time (i.e., were they motivated by "primarily non-corporate concerns"?). In our view, while the decision establishes that "improper motive" is a factor in establishing bad faith or a disloyal action, importantly, the opinion must be read in the context of the courts' consistent view that it takes an "extreme set of facts" to establish bad faith. Of course, an improper motive may only be deduced either from a director's direct personal interest in a transaction or by inference from the actions taken by the director.

In *Howard-Anderson*, in the context of a summary judgment proceeding and enhanced scrutiny review, there were material issues of fact suggesting that decisions made by the directors and officers in the sale process may have fallen outside the "range of reasonableness". Without any rational shareholder-based explanation for the directors' and officers' apparent strong preference for one bidder over another, the only interest the court ultimately credited as having the potential to explain the preference was a tangible personal financial interest of the officers because they were likely to be employed by one bidder and not the other. Thus, the court dismissed the claims against the directors but not the claims against the officers.

The decision, while applying a seemingly broader bad faith standard, in its application of the facts, in our judgment, reinforces the court's basic approach that only an extreme set of facts will establish a breach of the duty of loyalty. Nonetheless, it may be difficult for defendants to obtain dismissal at the pleadings stage of litigation—particularly in the case of officers, who, unlike directors, are not exculpated for breaches of the duty of care, so a credible allegation of any possible breach may require further investigation.

SynQor:

(Aug. 27, 2014) **Court applies business judgment review in a controller transaction meeting the *MFW* prerequisites—even though plaintiffs' allegations raised apparently substantial questions about the price, process and disclosure.** Rather than adopting the approach described by the Supreme Court in the *MFW* footnote (discussed above), the Chancery Court, applying *MFW* in a ruling from the bench in *Swomley v. Schlecht ("SynQor"),* dismissed at the pleading stage a challenge to a private company controlling stockholder merger, notwithstanding that the plaintiffs' objections to the price, process, and disclosure relating to the transaction appeared to be more specific and compelling than the pleadings in *MFW* that the Supreme Court had indicated in the footnote would have survived dismissal. The plaintiffs' pleadings in *SynQor* had included allegations that there were substantive problems with the bankers' work and flaws in the special committee's valuation of the company. Although the court acknowledged that the pleadings indicated that some "questionable decisions" had been made by the SynQor board and executives and that it was a "close case," the court held that, as the transaction had been subject from the outset to approval by a special committee and a majority-of-the-minority stockholder vote, under *MFW* the defendants were entitled to the business judgment rule standard. Under that standard, the court ruled, the defendants were entitled to dismissal of the case at the pleading stage (absent evidence that they had been grossly negligent). Because the transaction met the *MFW* requirements, plaintiffs' "real remedy" had been to seek appraisal, the court said. Thus, based on *SynQor*, if it is followed, even relatively specific and compelling allegations as to price, process, and disclosure may not necessarily survive dismissal at the pleading stage under an *MFW*-sanctioned business judgment review. As noted, clarification must await further decisions by the Chancery Court as well as review of the issue by the Delaware Supreme Court.

Nine Systems:

(Sept. 4, 2014) **Court confirms that, under entire fairness, the review of price and process is a unitary review—and specifies that the process can be found to have been unfair even if the price was fair.** The decision underscores the integrated nature of fair price and fair process under an entire fairness standard of review of a controller transaction. In connection with a recapitalization that the controller and its designee-directors oversaw and benefited from, and in which the minority stockholders' equity positions had been significantly diluted, the Chancery Court found that, under an entire fairness review, the defendants had breached their fiduciary duties because the process had been "grossly inadequate" even though the price had been fair. The finding that the price was fair was based on the court's view that the minority stockholders' shares had no value before the challenged recapitalization transaction and therefore the holders were not entitled to any compensation for being diluted. The court's finding that the process was "grossly inadequate" was based on the combination of: a lack of reliable projections; the board's ignorance of the valuation methodology utilized by its financial advisor (who was indirectly an investor) and of the basis for the valuation; the decision not to have any input from the sole independent director or from an independent financial advisor; the financial advisor's valuation being "back of the envelope"; details about key terms of the recapitalization—including who was receiving the convertible preferred stock and on what terms—not being disclosed to the other stockholders; and, the one independent director, who became a plaintiff, not being advised of developments or "informal" board meetings. The decision departs from a recent Chancery Court precedent in which the court held that so long as the price was fair, the court would not provide a remedy for an unfair process.

Cornerstone:

(Sept. 9, 2014) **Although disinterested directors face liability only for non-exculpated activities (i.e., only for duty of loyalty violations), when entire fairness applies, they may nonetheless face protracted litigation.** The *Cornerstone* take-private was not structured to qualify for business judgment review under the *MFW* standards. The specific issue before the Chancery Court was the pleading standard in a motion to dismiss brought by disinterested directors charged with a breach of fiduciary duty in connection with a controller transaction. The defendant directors argued that particularized pleadings are required that, if true, raise an inference that the directors breached a non-exculpated duty. The court stated that such a pleading requirement would make sense, but nonetheless denied the motion to dismiss, citing Delaware Supreme Court precedent that, when entire fairness applies, a determination whether directors will be exculpated can be made only after a fully-developed factual record and a determination as to whether the transaction was entirely fair. Thus, unless a take-private transaction is structured to meet the requirements of *MFW* for obtaining business judgment review, even independent, disinterested directors who are protected under a company's exculpation provisions (and, even more so, officers, who are not covered by exculpation provisions) may face protracted litigation. The question arises whether, given the courts' apparent general inclination for early dismissal of litigation challenging M&A transactions, *Cornerstone* will be overruled.

KKR Financial:

(Oct. 14, 2014) **Court indicates that the business judgment rule would apply in a non-controller transaction even if the directors approving the transaction were *not* independent, so long as the transaction was approved by the disinterested stockholders. (Also, court finds a private equity firm with total managerial control, as well as ties to most of the directors, is not a controller).** In *KKR Financial*, the court held that a private equity firm that had total managerial control of a portfolio company (through a management agreement), but owned only 1% of the stock, was not a controller—and that, therefore, the court would apply the business judgment rule (rather than entire fairness) in evaluating the board's decision to approve a going-private transaction with the firm. The court emphasized that the firm's having nominated directors and having other ties with them, and the firm's management control, did not change the fact that the board could vote as it chose. In dictum, Chancellor Bouchard indicated his view that business judgment review would apply in a non-controller transaction even if the directors who approved the transaction had *not* been independent, so long as the transaction was approved by disinterested, non-coerced stockholders in a fully informed vote. We note that, as the business judgment rule is premised on a judgment by an independent and disinterested board, it is not entirely clear what the application of the business judgment rule to decisions by *non*-independent directors means. This opinion also is an example of the Chancery Court's recent penchant for making announcements of important principles in dictum.

Crimson Exploration:

(Oct. 24, 2014) **Court indicates that the business judgment rule would apply to a possibly controlled corporation if the major stockholder had the same interest as the other stockholders in maximizing the merger price. (Also, court finds a 34% stockholder with employees on the board was probably not a controller.)** In *Crimson Exploration*, the Chancery Court, applying a narrow definition of control, found that a 34% stockholder was probably not a controller-- although the stockholder had designated a majority of the board and of senior management, and had 3 of its employees serving as directors (on a 7-person board). In the context of a non-controller transaction, the court evaluated the transaction under the business judgment rule and dismissed fiduciary duty claims against the board at the pleading stage. The court ruled that business judgment review would apply *whether or not* the stockholder had been a controller because the stockholder was not conflicted in the transaction but, rather, had the same interest the other shareholders did in the merger price being as high as possible.

Sanchez:

(Nov. 25, 2014) **Court finds two directors were not controlling stockholders because they did not control the decision at issue; and defers to a business decision that plaintiffs argued was so "facially unfair" as to indicate it could not have been the product of a valid business judgment.** A committee of three directors of Sanchez Energy that the Chancery Court found to have been independent and disinterested approved the company's purchase of assets from Sanchez Resources, a corporation that was controlled by the other two directors of Sanchez Energy. Plaintiffs argued that the two directors were also controlling stockholders of Sanchez Energy and that therefore the transaction should be reviewed under the entire fairness standard. The directors owned a total stake of 21.5%. Plaintiffs alleged that Sanchez Energy was a shell company, with no employees or operations, which had been created by the two directors for the sole purpose of accessing the public equity markets, and that the two directors maintained control (including through one of the two directors, who was the CEO of Sanchez Energy and president of the firm that provided management services to Sanchez Energy). The court found that the two directors had not exerted "actual control" over the board's decision on the transaction at issue and so were not controlling stockholders in this context. The plaintiffs also had argued that the transaction (in which Sanchez Energy was paying about $2,500 per acre for land for which Sanchez Resources paid only $184 per acre a few years earlier) was facially so unfair as to have clearly not been the product of a valid business judgment. The court rejected that argument, suggesting that the difference in prices could be explained by development of the property, as well as different market conditions and levels of risk.

Comverge:

(Nov. 25, 2014) **Court dismisses sale process claims at the pleading stage, even though reviewed under enhanced scrutiny—despite a "negative premium" deal and "debatable" decisions by a board with no negotiating leverage. (Court does not dismiss claims relating to the termination fee, however.)** Under an enhanced scrutiny review of the merger between Comverge and a private equity and venture capital firm, the Chancery Court dismissed, at the pleading stage, plaintiffs' claims challenging the target company directors' sale process. However, the court refused to dismiss the plaintiffs' claims that the termination fee—of at least 13%, when taken together with the favorable conversion rate on notes issued by the target company to the acquiror—precluded the possibility of post-signing topping bids. The court reached its sale process decision in the context of a "negative premium" deal price; a board that, although independent and disinterested, completely lacked negotiating leverage (as it had been "outmaneuvered" by the acquiror, who had purchased a pre-existing target company note under which the holder could force the company into bankruptcy by accelerating the debt and (ii) gave the holder the right to block any sale of the company); and evidence of other parties being potentially interested in acquiring the company at higher prices.

Novell:

(Nov. 25, 2014) **Court dismisses at the pleading stage sale process claims relating to preferential treatment of a bidder, even though reviewed under enhanced scrutiny.** Plaintiffs challenged the preferential treatment that was accorded to one bidder over the others in a sale process. The court found some of the allegations "troubling", but held that, to support a bad faith claim, in the context of review under enhanced scrutiny, plaintiffs must support their claims not only with evidence showing that the board's actions were unreasonable but also with evidence that the directors were motivated by some improper purpose that made their conduct culpable. The court found that the board's failure to respond more quickly to the complaining bidder, prohibiting it from partnering with other potential bidders, and holding it to an unrelenting bidding schedule, all stemmed from a valid business decision that selling the whole company to a strategic buyer rather than a financial buyer (and to the chosen bidder in particular) would maximize value for shareholders. A director's sharing of confidential information about the board process with the favored bidder was viewed unfavorably by the court, but was deemed to be in furtherance of the board's proper purpose of obtaining a higher price from the bidder.

Zhongpin:

(Nov. 26, 2014) **Court applies entire fairness to a controller transaction in which other bids were effectively blocked by the controller. (Also, under unusual circumstances, the court finds that a 17% stockholder was probably a controller.)** In *Zhongpin*, the Chancery Court found, under an unusual set of circumstances, that the plaintiffs had pled sufficient facts to raise an inference that the company's founder, chairman and CEO (Zhu), was a controlling stockholder, even though he owned only 17% of the company's stock and had not controlled the directors' decision relating to his going-private bid. The court applied an entire fairness standard of review (as the controller stood on both sides of the transaction and the *MFW* prerequisites for business judgment review had not been met), and, at the pleading stage, did not dismiss the plaintiffs' complaint as the allegations suggested unfairness of the process and price for Zhu's going-private bid. Without citing the court's recent decisions in *KKR Financial* or *Crimson Exploration* (both of which had focused on whether the alleged controller had actually controlled the board's decision on the transaction at issue), the court did not base its decision on the issue of actual control by Zhu of the decision on his bid. Rather, the decision appears to have been based on the court's conclusion that the unusual degree to which Zhu was indispensable to the company as a practical matter had the same result as it precluded the special committee from functioning effectively. Without Zhu's cooperation (which he would not provide), the committee had no leverage to negotiate a higher price with Zhu and no ability to attract a competing bidder. In addition, the company itself had acknowledged in its 10-K that Zhu was the company's "controlling stockholder"; that his loss would have a material adverse effect on the company; and that it might not be possible to sell the company to anyone but him. Moreover, events had unfolded to prove those statements true—as the only competing bidder that emerged in the pre-signing market check conditioned its bid on Zhu's remaining as CEO, and not one of the 80 potential bidders contacted during the 60-day post-signing go-shop period expressed an interest in bidding (or even signed a nondisclosure agreement), even though the merger agreement provided that no termination fee would be payable during the go-shop period.

Family Dollar Stores:

(Dec. 19, 2014) **Court defers to directors' decisions under enhanced scrutiny review when *Revlon* duties apply—and specifies that a board need not negotiate with a competing bidder to improve the terms of the bid in the context of significant closing uncertainty for the competing bid.** The court deferred to a target board decision, after a single-bidder process, not to engage in negotiations with a competing bidder because there was significant uncertainty of closing due to the antitrust risk associated with the bid. The court refused to grant the plaintiffs' request that the court enjoin the stockholder vote on the proposed merger of Family Dollar with Dollar Tree until Family had negotiated in good faith with the competing bidder, Dollar General. The court concluded that Family had not breached its *Revlon* duty to maximize stockholder value when it decided not to negotiate with General to seek to improve the terms of a bid made by General after the merger agreement with Tree had been signed. Referencing the "fiduciary out" provision of the merger agreement, the court confirmed that a higher-priced bid that had significant uncertainty of closing was not necessarily a bid that was (or would be likely to lead to) a "superior offer that was likely to be completed on its terms". Family's legal counsel had advised it that the likelihood of antitrust clearance being obtained for the General bid (which included a commitment to divest up to a specified number of stores) was only 40%, while the likelihood for the Tree deal (which was a "hell or high water" deal, with Tree having committed to make all divestitures necessary) was 95%. The other factors supporting the board's decision were that there was "no hint" of a defensive or entrenchment motive by the board, the board had had earlier discussions with the competing bidder, the sale process was reasonable overall, and the competing bidder had the opportunity (but had made no attempts) to improve the terms of its bid. The court also deferred to the board's decision, before the merger agreement with Tree was signed, not to tell General that it was involved in a sale process.

Importantly, in a supplemental letter ruling (issued Jan. 5, 2014, rejecting the plaintiffs' motion for an interlocutory appeal), Chancellor Bouchard emphasized that the decision was consistent with precedent, noting the numerous facts that supported a finding of reasonableness of directors' sale process decisions —although the court had not indicated in the initial decision that it relied on those facts. The letter ruling underscores the courts' commitment to a fact-based inquiry, and a consideration of the totality of the circumstances, even in the context of the courts' recent increased emphasis on increased deference to independent directors' decisions.

C&J Energy:

(Dec. 19, 2014) **Delaware Supreme Court upholds board's decision to engage in a single bidder sale process, with no active shopping of the company either before or after signing of the merger agreement—since there was a post-signing "viable passive market check".** The Delaware Supreme Court reversed the Court of Chancery's decision that enjoined a merger for 30 days and required that C&J be actively shopped during that time. The Supreme Court held that, even in a *Revlon* situation, because the directors were independent, disinterested, and engaged, the court should defer to the directors' decision that the best course was a single bidder process without active shopping of the company—relying on the post-signing "passive market check" (that would be accomplished through a fiduciary out and only a modest termination fee). In upholding the board's decision to engage in no active shopping of the company, even though *Revlon* duties applied, the Supreme Court noted that C&J's investment banker had advised it that the likelihood of there being other interested bidders was low, and also noted that the 2.2% termination fee was modest. However, in an apparent narrowing of the Supreme Court's 1989 *Barkan* decision, the Supreme Court did not emphasize these factors (or others, such as a credible threat by the bidder that it would not engage in an auction) as having been critical to the board in making its decision to sign a deal without any solicitation activity, nor critical to the Court in determining to uphold the board's decision. Rather, the Court mentioned these factors in passing and, instead, emphasized that Delaware courts will defer to the decisions made by an independent board as to what sale process would be most effective in maximizing value.

While the language of the opinion can be read to suggest that, even when *Revlon* duties apply, an independent board need not auction or actively shop the company in a sale process so long as there is a post-signing "passive market check", the contextual facts of the case must be part of the analysis. The opinion emphasizes deference to independent directors' decisions and ignores the detailed substantiation of the reasonableness of the directors' decisions that the courts previously have required. However, importantly, the facts of the case provided a strong foundation for the reasonableness of the board's decision—including that the investment bankers had advised that there was a low likelihood of there being other interested bidders; and that, according to the Supreme Court, the underlying transaction "indisputably" made business and strategic sense and there was "no hint" of a defensive or entrenchment motive by the board. Moreover, the reasonableness of the post-signing passive market check was supported by there being a broad fiduciary out; only a modest termination fee; and an extended period of time expected between signing and closing of the merger agreement (during which a competing bidder could have emerged and, in fact, none did). Notably, the transaction might not even have been subject to *Revlon* (as, among other reasons, about two-thirds of the merger consideration was in the form of equity) and the Court simply "assume[d] for the sake of analysis that *Revlon* applied."

The decision also apparently heightens the standard for the courts' enjoining a corporate transaction—that is, that it must be "more likely than not" (rather than merely "plausible") that directors breached their fiduciary duties. Further, the decision reaffirmed the ongoing reluctance of Delaware courts to "blue pencil" commercial agreements when board decisions are not judicially upheld, ruling that it would be appropriate to reduce the buyer's rights in a merger agreement only if "fair to do so"—such as if the affected party had aided and abetted a breach of fiduciary duty by the target board.

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