Client Alert

January 2013

The State of M&A Standstill Agreements in Delaware

Recent bench rulings in the Delaware Court of Chancery in *In re Complete Genomics* and *In re Ancestry.com* have cast the spotlight on so-called "don't ask/don't waive" provisions in standstill agreements. In the first ruling, Vice Chancellor J. Travis Laster enjoined the enforcement of a "don't ask/don't waive" standstill agreement in a manner that questioned their overall validity, at least where a target board has recommended a particular transaction to its stockholders. In the second ruling, Chancellor Leo E. Strine, Jr., concluded that "don't ask/don't waive" provisions are not per se invalid under Delaware law. He found on a preliminary record, however, that the plaintiffs had a reasonable probability of success in proving that the target board breached its duty of care. In addition, he ruled that the failure to disclose the existence of the "don't ask/don't waive" provisions was likely a breach of the directors' duty of disclosure.

Taken together, these developments have several practical consequences for M&A parties. In particular, target boards will need to be informed of how "don't ask/don't waive" provisions operate and how they are being deployed to maximize stockholder value in an auction. Target companies may also need to be prepared to disclose the existence of "don't ask/don't waive" provisions in their proxy statements.

Background on Standstill Agreements and "Don't Ask/Don't Waive" Provisions

Standstill agreements have long been a part of public company M&A transactions.[1] Among other things, they allow a target to control the sale process, protect against misuse of confidential information, and create leverage for target companies in conducting an auction. Their benefit has previously been recognized by Delaware courts:

> When a corporation is running a sale process, it is responsible, if not mandated, for the board to ensure that confidential information is not misused by bidders and advisors whose interests are not aligned with the corporation, to establish rules of the game that promote an orderly auction, and to give the corporation leverage to extract concessions from the parties who seek to make a bid.[2]

More recently, at a hearing in the 2011 *Transatlantic* litigation, the Court of Chancery appeared dismissive of an argument that a target company cannot enter into a merger agreement that requires a potential topping bidder to enter into a standstill agreement as a condition to holding discussions or negotiations with the target company and receiving confidential information.[3]

---

[1] A standstill agreement generally prohibits a potential bidder from taking various actions, including submitting an unsolicited takeover proposal, buying shares of the target, or conducting a proxy contest, without the target company's prior consent.

[2] *In re The Topps Co. S'holders Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007).

[3] *See In re Transatlantic Holdings, Inc. S'holders Litig.*, C.A. Nos. 6574-CS & 6776-CS, Status Conference and Motion to Expedite, trans. at 22-26 (Del. Ch. Aug. 22, 2011) (observing that the target board had retained the ability to negotiate with topping bidders, but the target "had to do it in the certain way").

Nevertheless, courts have recognized that standstill agreements have the potential for abuse. In *In re Topps*, for example, the court determined that a standstill agreement was being used inequitably and enjoined its enforcement.[4]

"Don't ask/don't waive" provisions are sometimes included in standstill agreements. They typically prohibit the potential bidder from publicly or privately requesting a waiver of the standstill covenants. Their primary purpose is to induce a bidder to submit its "best and final offer" by eliminating any further opportunities to bid. In theory, a bidder that knows there will not be any further rounds of bidding should put its best foot forward knowing there is no "second bite" at the proverbial apple. "Don't ask/don't waive" provisions should also induce a bidder's "best and final offer" by increasing the likelihood that, if the offer is accepted, there will not be any topping bids, at least from the other bidders participating in the sale process.

While "don't ask/don't waive" provisions are not new, they have drawn scrutiny in the past year even before *Complete Genomics* and *Ancestry.com*. At a settlement hearing last year in *In re Rehabcare Group, Inc.*, for example, Vice Chancellor Laster said, "[i]t is weird that people persist in the 'agree not to ask' in the standstill" and asked "[w]hen is that ever going to hold up if it's actually litigated, particularly after *Topps*."

Then, in March 2012 in *In re Celera Corp.*, Vice Chancellor Donald F. Parsons commented on the effect of a "don't ask/don't waive" provision when combined with a broad "no-shop" covenant in a merger agreement:

> Plaintiffs have at least a colorable argument that these constraints collectively operate to ensure an informational vacuum. Moreover, the increased risk that the Board would outright lack adequate information arguably emasculates whatever protections the No Solicitation Provision's fiduciary out otherwise could have provided. *Once resigned to a measure of willful blindness, the Board would lack the information to determine whether continued compliance with the Merger Agreement would violate its fiduciary duty to consider superior offers*. Contracting into such a state conceivably could constitute a breach of fiduciary duty.[5]

As part of the settlement in *Celera*, the target waived the "don't ask/don't waive" provisions and thus, according to the court, "invited back to the bargaining table the four bidders arguably most likely to make a superior offer." Vice Chancellor Parsons made clear, however, that he was not ruling on the ultimate legality of a "don't ask/don't waive" provision.[6]

The Two Recent Bench Rulings

Complete Genomics

On November 27, 2012, in *In re Complete Genomics*, Vice Chancellor Laster preliminarily enjoined enforcement of a standstill agreement that contained a "don't ask/don't waive" provision. He stated that, in his view, such provisions were a "bidder-specific no-talk clause."[7] He explained that the provision

[4] *See Topps*, 926 A.2d at 91.

[5] *In re Celera Corp. S'holder Litig.*, C.A. No. 6304-VCP, mem. op. at 53-54 (Del. Ch. Mar. 23, 2012) (emphasis added).

[6] *Id.* at 54 (stating that such a ruling "should be made, if ever, only on the merits of an appropriately developed record").

[7] A "no-talk" clause prevents a target company from holding any discussions with a topping bidder. In *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999), the Court of Chancery found that the plaintiffs had a reasonable probability of success in proving that a target company's board of directors had breached its fiduciary duties in agreeing to a "no-talk" clause. The court ruled that "no-talk" provisions "are troubling precisely because they prevent a board from

"impermissibly limited" the directors' "statutory and fiduciary obligations" to evaluate a competing offer and provide a current and candid recommendation to stockholders with respect to a proposed transaction. He further stated that "no talks" and "don't ask/don't waive" provisions "interfere with the target's ability to determine whether to change its merger recommendation because they absolutely preclude the flow of incoming information to the board."

Complete Genomics also held that the plaintiff had met its burden of establishing irreparable harm because, in the absence of a preliminary injunction, the board of directors might never know whether the counter-party wanted to submit a topping bid. The court also emphasized the "targeted" nature of the injunction, which affected only the standstill agreement and not the merger agreement or tender offer.

Importantly, *Complete Genomics* was not a situation where the counter-party to the standstill agreement was trying to communicate with the target company or its stockholders to facilitate a topping bid. To the contrary, the counter-party was not a party to the litigation, did not seek the injunction, and had not otherwise suggested it might make a topping bid. These facts, combined with the court's analysis discussed above, suggested a potentially broad prohibition against "don't ask/don't waive" provisions, at least where a board had made a recommendation with respect to a particular transaction.[8]

Ancestry.com

Less than a month after *Complete Genomics*, Chancellor Strine addressed "don't ask/don't waive" provisions in *In re Ancestry.com*. Referring to the "emerging issue of December of 2012," he stated that such provisions are not invalid *per se* under Delaware law. Moreover, he advised that *"[p]er se* rulings where judges invalidate contractual provisions across the bar are exceedingly rare in Delaware, and they should be."

Chancellor Strine went on to suggest that "don't ask/don't waive" provisions can be used as a "gavel" in running an effective auction. He explained that they might be used by boards "to gain credibility so that those final-round bidders know the winner is the winner, at least as to [those who participate in the auction]." In particular, he suggested that a "well-motivated seller" could use a "don't ask/don't waive" provision to "impress" upon bidders that the sale process is "meaningful," that "there is really an end to the auction for those who participate," and "therefore, you should bid your fullest because if you win, you have the confidence of knowing you actually won that auction at least against the other people in the process."

Nevertheless, based on the preliminary record before the court, Chancellor Strine was critical of the subject "don't ask/don't waive" provisions in at least three respects. First, he expressed concern that Ancestry.com's directors, senior managers, and investment banker may not have known of the provisions or fully understood their "potency." Second, he found that the stockholder-plaintiffs had a reasonable probability of success in showing that the "don't ask/don't waive" provisions were not used "in keeping with the duty of care that's required of directors during a *Revlon* process." In particular, he suggested that the company should have waived the provisions prior to entering into a definitive merger agreement since the buyer had not requested an assignment of the company's rights to enforce them.[9]

---

meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party." The court further stated that the directors "simply should not have completely foreclosed the opportunity to [have discussions with third parties], as this is the legal equivalent of willful blindness, a blindness that may constitute a breach of a board's duty of care; that is, the duty to take care to be informed of all material information reasonably available."

[8] For additional discussion of *Complete Genomics*, see Steven M. Haas, *"Don't Ask/Don't Waive" Standstill Agreements under Attack*, INSIGHTS, Dec. 2012 at 29.

[9] *See Ancestry.com* at 25 ("And when Permira was signed up, Permira did not demand an assignment of [the standstills]. And the board and its advisors did not waive it in order to facilitate these bidders which had signed up the standstills being able to make a superior proposal. I think that probabilistically is a violation of the duty of care.").

Finally, Chancellor Strine found that the stockholder-plaintiffs had a reasonable probability of success in proving a disclosure violation because the existence of the "don't ask/don't waive" provisions had never been disclosed to Ancestry.com's stockholders.[10] "[T]he electorate," he wrote, "should know that with respect to the comfort they should take in the ability to [receive] a superior proposal, they should understand that there is a segment of the market ... that ... cannot take advantage of that." As a result, he decided to enjoin the transaction unless the company made the supplemental disclosures, which it promptly did.

Implications

Complete Genomics and *Ancestry.com* are bench rulings that necessarily lack the detail and analysis that generally accompany a memorandum opinion. In fact, Chancellor Strine, who has previously cautioned litigants about relying on bench rulings, stated that "[b]ench rulings are limited rulings," "time pressured," and "shouldn't make broad law." Thus, while *Ancestry.com* rejects the notion that "don't ask/don't waive" provisions are *per se* invalid, further word on their use will have to come in future litigation.

Nevertheless, these rulings raise considerable issues for practitioners. First, M&A parties should expect continued scrutiny from courts and plaintiffs' counsel of standstill agreements. As reflected in *Ancestry.com*, a target company may need to explain how "don't ask/don't waive" provisions operated as a "gavel" in a particular sale process. This may require more "hard thinking" about how to conduct an auction.

Second, target companies should be prepared to disclose the existence of "don't ask/don't waive" provisions. As noted above, *Ancestry.com* found that the stockholder-plaintiffs likely stated a claim for a disclosure violation for failing to inform stockholders about their existence.

Third, practitioners need to consider the extent to which directors are briefed on the existence of standstill agreements and how they operate during a sale process. In fulfilling their duty of care, directors need to understand the consequences of subjecting potential bidders to "don't ask/don't waive" provisions. Historically, this level of detail may not always have reached the board of directors.

Fourth, buyers are likely to seek an assignment of a target's rights under existing standstill agreements. Alternatively, buyers may request that merger agreements include a "no-waiver" clause prohibiting the target from waiving any standstill agreements. Unfortunately, *Ancestry.com* did not discuss how such an assignment or no-waiver clause might be reviewable under *Unocal* as a "deal protection." In any event, in the absence of an assignment or no-waiver clause, *Ancestry.com* may lead target boards of directors to waive any "don't ask/don't waive" provisions (and possibly standstill agreements generally) in connection with entering into any definitive agreement.

Contacts

Gary E. Thompson
gthompson@hunton.com

Steven M. Haas
shaas@hunton.com

[10] As a technical matter, the target company waived the "don't ask/don't waive" standstill provisions prior to the court's ruling, but after the litigation had been commenced. The company did not disclose to its stockholders, however, that the "don't ask/don't waive" provisions had existed or been waived.