

Chancery Court Provides Guidance on ‘Don’t Ask, Don’t Waive’ Standstill Provisions

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In two recent rulings, the Delaware Court of Chancery has provided important guidance on how so-called “don’t ask, don’t waive” standstill provisions — which can be utilized to encourage bidders to provide their best-offer bids during an auction — will be viewed in future litigation in Delaware. While the use of such provisions is necessarily guided by the fiduciary obligation of a target company board to obtain the best price reasonably available in an auction, the Chancery Court has recognized that “don’t ask, don’t waive” provisions can be an appropriate and effective tool in maximizing shareholder value in a board-run auction process.

“Don’t ask, don’t waive” provisions have become increasingly common in M&A standstill agreements as a way of incentivizing competing bidders to make their most attractive bids during an auction. By their terms, such provi-

sions prohibit bidders from either publicly or privately requesting that a target company waive the terms of a standstill agreement entered between the bidder and the target. Target companies in an auction increasingly use these provisions to restrict bidders from low-balling initial offers in the hopes of later negotiating a deal or going hostile, or from sitting out an auction and using the participating bidders as stalking-horses. These provisions may thus maximize value for stockholders by forcing bidders to present their best price during an auction and by according finality to the auction process.

On November 27, 2012, Vice Chancellor J. Travis Laster issued a bench ruling in *In re Complete Genomics Shareholder Litigation*, C.A. No. 7888-VCL, enjoining the enforcement of a “don’t ask, don’t waive” provision in a standstill agreement. In *Complete Ge-*

nomics, the company explored a sale of the company and entered into several confidentiality agreements with standstills, some of which had “don’t ask, don’t waive” provisions. The court analogized the “don’t ask, don’t waive” provision to an impermissible “no-talk” provision in a merger agreement, which prevents a target company from discussing alternative transactions with third parties. The court found that the Complete Genomics Inc. board impermissibly limited its ability to discharge its ongoing statutory and fiduciary obligations by agreeing to such a provision. Specifically, the court found that the board limited its ability to evaluate competing offers, to disclose material information and to make a meaningful recommendation to stockholders on a merger. Importantly, however, the court did not hold that all “don’t ask, don’t waive” provi-

sions are per se invalid. Instead, the court questioned only the enforceability of such provisions where a sale agreement with another party has been announced and the target has an obligation to consider competing offers.

On December 17, 2012, Chancellor Leo E. Strine Jr. issued a bench ruling in *In re Ancestry.com Shareholder Litigation*, C.A. No. 7988-CS, in which the court declined to enjoin a stockholder vote on the basis of a “don’t ask, don’t waive” provision in a standstill agreement and permitted the stockholder vote to go forward after the company made additional disclosures, including disclosures related to the use of the provision. There, the target company’s board conducted an auction to sell the company and entered into several standstill agreements with potential bidders that included “don’t ask, don’t waive” provisions. Strine found that “don’t ask, don’t waive” provisions are not per se invalid, and also found that these provisions, when used properly, can be “value-maximizing” tools for a board engaged in an auction process. Specifically, Strine recognized a “well-motivated seller” may use these provisions “as a gavel” to impose finality in an auction and thereby maximize stockholder value by eliciting the highest bids from auction participants. In other words, a company “can use this tool to gain credibility so that those final-round bidders know the winner is the winner, at least as to them.” At the same time, Strine emphasized that these were

“potent” provisions that would be subject to close judicial scrutiny, including with respect to whether the company extracted additional value from a winning bidder from use of the provisions and whether a target company will grant a waiver from a losing or nonparticipating bidder.

These rulings suggest that “don’t ask, don’t waive” standstill provisions are and will continue to be recognized under Delaware law as permissible tools in sales transactions when used in the appropriate circumstances. These provisions can be used by boards of target companies as a means of incentivizing bidders to come forward with their highest bids as part of a structured, orderly auction process. Further, standstill agreements with these provisions can give added comfort to target boards that a determination to commence a sales process will not lead to a hostile process. However, both decisions suggest that these provisions may not be enforceable when used by boards in ways that inhibit value-maximization for stockholders and, thus, will be subject to close scrutiny by the courts.

Accordingly, target companies should carefully consider whether a “don’t ask, don’t waive” provision is appropriate for its sales process. If such a provision is implemented, the target board should carefully oversee its use, including whether continued enforcement of a “don’t ask, don’t waive” provision will prevent a company from receiving a topping offer after an agreement has been reached. The board should

also be cognizant that it may need to justify in future litigation its deliberations and actions with respect to implementation and enforcement of these provisions. In sum, these decisions suggest that while “don’t ask, don’t waive” provisions are both permissible and appropriate tools that may be used by boards as a tool for obtaining the best value reasonably available for stockholders, their use and enforcement must be continually and carefully evaluated to respond to the circumstances of a dynamic auction and sales process.

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