

# Delaware Chancery Court Enjoins "Don't Ask, Don't Waive" Standstill Provision

"Don't Ask, Don't Waive" provisions have become common in standstill agreements used in M&A transactions. They prohibit a potential bidder from publicly *or privately* requesting that the target company waive the terms of the standstill agreement. In *In re Complete Genomics, Inc. Shareholder Litigation*, the Delaware Court of Chancery held that prohibiting a potential bidder from *privately* requesting a waiver of a standstill provision in a confidentiality agreement "impermissibly limited [the board's] ongoing and statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information, and make a meaningful recommendation to its stockholders." Put another way, according to the Court, a "Don't Ask, Don't Waive" provision "represents a promise by a fiduciary to violate its fiduciary duty, or represents a promise by a fiduciary that tends to induce such a violation."

## Background

The *Genomics* case involved a challenge by shareholders to a proposed merger between Complete Genomics Inc., a publicly-traded Delaware corporation, and BGI-Shenzhen, a Chinese company, alleging, in part, that the board of Genomics had breached its fiduciary duties by agreeing to the merger with BGI. The complaint sought to enjoin the enforcement of several provisions of the merger agreement.

Genomics, in the business of DNA sequencing technology, was not profitable and after several unsuccessful attempts to raise capital, in June, 2012, the board of Genomics announced publicly it was exploring strategic alternatives. Several parties who expressed interest signed confidentiality agreements, which included standstill provisions. The number of interested bidders gradually decreased to one party, BGI, and in September the board approved a merger agreement in which Genomics would be acquired by BGI.

## The Standstill Provision and the Merger Agreement

- During the auction process, Genomics entered into confidentiality agreements with nine parties. One of the confidentiality agreements with a bidder who did not win the auction contained a "Don't Ask, Don't Waive" provision.
- The merger agreement between Genomics and BGI prohibited any waiver, termination, modification, failure to enforce or release of the standstill provisions in the confidentiality agreements Genomics had signed with potential bidders.

## The Decision of the Chancery Court

### "Don't Ask, Don't Waive" Standstill Provision

- The Court enjoined Genomics from enforcing the standstill provision to prohibit a potential bidder from seeking *in a non-public manner* a waiver of the standstill. The Court found that this aspect of the "Don't Ask, Don't Waive" standstill provision was similar to a bidder-specific no-talk clause, which "not only prevents a party from soliciting superior offers or providing information to third parties, but also from talking to or holding discussions with third parties." Quoting *Phelps Dodge Corporation v. Cyprus Amax Minerals Company*, the Court found that "directors cannot willfully blind themselves to opportunities that are presented to them." The Court held that the board of directors has an ongoing fiduciary duty "to provide a current, candid and accurate merger recommendation. . . and to review and update its recommendation." The "Don't Ask, Don't Waive" standstill clause impermissibly interferes with this aspect of the board's fiduciary duty by "absolutely preclud[ing] the flow of incoming information to the board."
- The Court did not object to potential bidders being prohibited from *publicly* asking for a waiver, so long as they can make a *non-public* request to the board, which presumably would then take that request into account when evaluating whether to recommend the merger to its shareholders.

### Merger Agreement Prohibition on Waiving or Modifying Standstills

- The merger agreement at issue in the case contained a provision of a type often sought by bidders, that prohibited Genomics from waiving or modifying the standstill obligations undertaken by the other prospective bidders in the process leading up to the sale of the company. The Court denied the plaintiffs' request for an injunction preventing enforcement of that provision. That denial was based on the technical ground of ripeness, but the Court referred to the provision as potentially problematic.

### Other Points of Interest

- The Court reiterated that the fiduciary duty analysis is the same whether a target's board is making a recommendation in response to a tender offer in a two-step merger or for a merger in a single-step transaction.
- The Court reaffirmed the validity of targeted injunctions aimed at individual transaction features. Relying on precedent and the severability contract provision in the merger agreement, the Court determined that a targeted injunction was appropriate to limit the enforcement of a standstill provision without enjoining the transaction as a whole.

### No-shop Provisions and "Don't Ask, Don't Waive" - *In re Celera Corporation Shareholder Litigation*

- Earlier this year, in a ruling approving a class action settlement, the Chancery Court commented that the combined effect of a no-shop provision and a "Don't Ask, Don't Waive" provision could be problematic, though each provision viewed in isolation "arguably foster[s] legitimate objectives." In *In re Celera Corporation Shareholder Litigation*, the Court noted that a "Don't Ask, Don't Waive" provision prevents potential bidders known to be interested in the target from informing the board of their willingness to bid, and the no-shop provision prevents the board from inquiring into that same interest. This creates an "informational vacuum" for the board, relegating it to "a measure of willful blindness" and "arguably emasculat[ing] whatever protections" the fiduciary out provisions of the merger agreement otherwise would provide. According to the Court in *Celera*, entering into contracts with these combined terms "conceivably could constitute a breach of fiduciary duty."

## Takeaways

- The *Genomics* ruling does not necessarily mean that "Don't Ask, Don't Waive" provisions can never be applied to private requests from bidders. Such provisions conceivably can be an appropriate way to maximize shareholder value. As illustrated by *Genomics* and *Celera* though, the use of a "Don't Ask, Don't Waive" provision will receive intense court scrutiny.
- In our view, if a target board runs a widely publicized full auction with multiple sophisticated bidders and imposes auction rules that the board reasonably and in good faith believes will maximize shareholder value, that board should be able to contract away its ability to waive standstills. That should be the case especially if the board extracts additional value for this contractual concession. If a board imposes auction rules that lead bidders to believe they will not be given a chance to re-bid, those bidders should be more likely to put their best price on the table. Unfortunately, many market participants will be tempted to read *Genomics* and *Celera* as assuring them of a last look. Perversely, that could in turn lead to undisciplined auctions and therefore (in at least some cases) to lower prices being paid for the auctioned companies.
- None of this analysis affects interlopers who are new to the situation and did not sign confidentiality/standstill agreements. The only parties affected by the contractual provisions discussed here are those that volunteered to participate in the auction process.

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