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# Auction Theory And Standstills: Dealing With Friends And Foes In A Sale Of Corporate Control

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AUCTION THEORY AND STANDSTILLS:  
DEALING WITH FRIENDS AND FOES IN A SALE  
OF CORPORATE CONTROL

CHRISTINA M. SAUTTER\*

*Abstract*

*A fundamental issue in Delaware mergers & acquisitions (M&A) law is the extent to which a target company's board of directors may restrict a sales process to extract value from bidders and grant a "winning bidder" certain deal protections to protect a transaction from being overbid. Standstill agreements are one such form of deal protection. Standstills prevent bidders from making or announcing a bid for the target without the target's consent both during the sales process and for a period after the sales process is completed and the target has executed an agreement with a "winning bidder." Recent 2011 and 2012 Delaware Court of Chancery rulings have placed a new spotlight on the use of standstill agreements in M&A*

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*deals and specifically in change of control transactions. In particular, these cases highlight the restrictiveness of some standstills and open up discussion as to how restrictive a standstill may be without violating a target company board of directors' duty to maximize stockholder value.*

*This Article makes a unique contribution because it is the first paper to apply auction theory in critiquing and evaluating the need for standstills in M&A transactions. Auction theory utilizes economics to design optimal bidding procedures and revenue-enhancing auctions. The application of auction theory to standstills is particularly well suited as the execution of a standstill is often cited as resulting in increased value during the sales process. Using auction theory and recent Delaware case law as a foundation, this Article provides a new framework for the use of standstills. It argues that to the extent standstills provide an entry into the due diligence and general sales processes, standstills may help to enhance value. Moreover, the promise of standstill restrictions continuing post-signing may aid in incentivizing bidders to submit their highest offers during the pre-signing sale process. But the use of more restrictive standstills like those in which a bidder agrees not to request a waiver and a target agrees in advance not to waive a standstill (or Don't Ask, Don't Waive (DADW) standstills) should turn on whether strategic or financial bidders are involved in the process as well as the amount of pre-signing shopping of the target engaged in by the board. This Article provides a new framework for dealmakers and for courts taking into consideration those factors. Among other things, this framework suggests that if dealmakers are to continue their use of DADW standstills, that they be paired with a minimal fiduciary out and with a staggered termination fee.*

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## INTRODUCTION

A fundamental tension in mergers and acquisitions law exists between a selling company's board of directors' duty to maximize stockholder value in a sale of control and the board's ability to restrict the sales process and grant a "winning bidder" certain covenants to protect the transaction from being overbid.<sup>1</sup> Standstill agreements are one such way the board of a selling company, the target, restricts the sales process and discourages overbids.<sup>2</sup> In particular, standstills prevent bidders who are participating in the sales process from making or announcing a bid for the target without the target's consent both during the sales process and for a period after the process is complet-

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<sup>1</sup> See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (describing a board of directors as "auctioneers charged with getting the best price for the stockholders at a sale of the company"); *Omnicare Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) (describing board of directors' authority to grant deal protection to a "winning bidder").

<sup>2</sup> The target and its financial advisor generally require auction participants execute a confidentiality agreement before gaining access to the target's nonpublic information. Alexander S. Gorbenko & Andrey Malenko, *Strategic & Financial Bidders in Takeover Auctions* (2010) (manuscript at 7), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1559481](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1559481). The standstill can be a separate standalone document or, more typically, appears as a provision in the confidentiality agreement. *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 WL 2783101, at \*8 n.43 (Del. July 10, 2012). The terms standstill, standstill agreement, and standstill provision will be used interchangeably in this Article.

ed and the target has executed an agreement with a “winning” bidder.<sup>3</sup>

Standstills help the target to control the sales process and ensure bidders do not preempt the process by making offers directly to the target’s stockholders or by otherwise bidding before the target is ready to receive offers.<sup>4</sup> Moreover, pre-signing, standstills may help a board to satisfy its duty to maximize stockholder value, or its *Revlon* duties, as standstills may “provide the [target board] leverage to extract concessions from the parties who seek to make a bid.”<sup>5</sup> Because most standstills do not expire upon the target’s execution of a definitive agreement with a “winning” bidder, most standstills are intended to prevent later overbidding between the signing and closing of the contemplated transaction (the pre-

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<sup>3</sup> *Martin Marietta*, 2012 WL 2783101, at \*8.

<sup>4</sup> William G. Lawlor, *Taming the Tiger: Difficult Standstill Agreement Issues for Targets*, 7, 7 (July-Aug. 2007), published in *Deal Lawyers*, available at <http://www.dechert.com/library/C&SLawlor-TamingtheTiger.pdf>. (providing standstills “provide[] a stable environment in which the sale process can be managed and controlled by the target.”).

<sup>5</sup> *In re Topps Co. S’holders Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007).. In a 2011 case dealing with a standstill waiver, Chancellor Strine reiterated this view saying,

I mean, it is pretty well understood that part of what you can do as a first-in bidder who is actually binding yourself to buy a company is get some deal protections that insure that, you know, you won’t be topped lightly; that there aren’t free riders; and then make the target board make certain determinations before they get out of a merger agreement.

*In re Transatlantic Holdings, Inc. S’holders Litig.*, Civ. Action Nos. 6574-CS & 6776-CS, 22 (Del. Ch. Aug. 22, 2011).

closing period).<sup>6</sup> In this way, targets and winning bidders use standstills as a form of deal protection device pre-closing. For these reasons, standstills have been called “the [mergers and acquisitions] equivalent of a schoolyard ‘time-out.’”<sup>7</sup> In other words, standstills keep friendly bidders friendly and prevent those bidders from becoming foes either to the target or to the winning bidder. Despite the intended benefits of standstills, like any deal protection device, standstills are not without drawbacks. Because a target board’s *Revlon* duties do not end at the execution of a definitive agreement but instead continue until the stockholders vote on the proposed transaction, standstills potentially hinder the board from complying

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<sup>6</sup> Christina M. Sautter, *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, 37 DEL. J. CORP. L. (forthcoming 2013) (manuscript at 982), *available at* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2020828](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2020828) (describing the conflict that exists between a board’s duty to maximize stockholder value and its ability to grant deal protection provisions); Robert E. Spatt, *The Four Ring Circus-Round Sixteen: A Further Updated View of the Mating Dance Among Announced Merger Partners and an Unsolicited Second or Third Bidder*, 40 (Feb. 17, 2012), *available at* [http://www.stblaw.com/google\\_file.cfm?TrackedFile=4B46116604D6E9D896B179&TrackedFolder=585C1D235281AED996A07D5F9F9478AB5A90188899](http://www.stblaw.com/google_file.cfm?TrackedFile=4B46116604D6E9D896B179&TrackedFolder=585C1D235281AED996A07D5F9F9478AB5A90188899) (discussing intended goal of standstills is to prevent deal jumping).

<sup>7</sup> *Proxy Battle Time-Out: Standstills Give Boards a Breather*, [http://currents.westlawbusiness.com/Articles/2009/07/20090731\\_0005.aspx?cid=&src=](http://currents.westlawbusiness.com/Articles/2009/07/20090731_0005.aspx?cid=&src=) (April 9, 2009); Lawlor, *supra* note 4, at 7.



with its *Revlon* duties.<sup>8</sup> More specifically, standstills prevent bidders from making overbids and may prevent boards from considering overbids even if the overbid provides more value than the deal with the “winning bidder.”<sup>9</sup> Moreover, there is always a risk a target board may use a standstill to improperly favor one bidder over another or to otherwise entrench itself in office.<sup>10</sup>

Recently, the Delaware courts have issued several decisions commenting on the restrictiveness of some standstills and their potential interference in the satisfaction of a board’s *Revlon* duties.<sup>11</sup> As a result, there has been a

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<sup>8</sup> STEVEN M. DAVIDOFF, *GODS AT WAR: SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLSION* 236 (2009) (explaining that under *Revlon* a target “must keep itself up for sale . . . up to the shareholder vote on the transaction”); *Omnicare*, 818 A.2d at 938 (“The directors of a Delaware corporation have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced.”).

<sup>9</sup> *In re Celera Corp. S’holder Litig.*, Civ. Action No. 6304-VCP, 54 (Del. Ch. Mar. 23, 2012) (describing board’s inability to consider higher offers made by bidder who is subject to a standstill); *see also* Paul Povel & Rajdeep Singh, *Takeover Contests with Asymmetric Bidders*, 19 REV. FIN. STUD. 1399, 1402 (2006) (“[Deal protection] devices make the target less attractive to rejected bidders, thereby reducing their incentive to top up the winning bid.”).

<sup>10</sup> *Topps*, 926 A.2d at 91.

<sup>11</sup> *See, e.g.*, *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 WL 2783101 (Del. July 10, 2012); *In re Ancestry.com Inc. S’holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012); *In re Celera Corp. S’holder Litig.*, Civ. Action No. 6304-VCP (Del. Ch. Mar. 23, 2012); *In re Rehabcare Group, Inc. S’holders Litig.*, C.A. No. 6197-VCL (Del. Ch. Sept. 8, 2011); *In re Topps Co. S’holders Litig.*, 926 A.2d 58 (Del. Ch. 2007).

surge in the attention being paid to standstills by practitioners.<sup>12</sup> But, to date, scholars have yet to address the dichotomy standstills raise between aiding and hindering value maximization. I have previously touched upon this dichotomy by using past Delaware case law to analyze how the Delaware courts are likely to address particularly

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<sup>12</sup> See, e.g., Steven M. Haas, *“Don’t Ask, Don’t Waive” Standstill Agreements under Attack*, 26 INSIGHTS 29 (Dec. 2012); Sarkis Jebejian & Daniel E. Wolf, *An Ounce of Prevention – Some Guidance for Target Boards*, Kirkland M&A Update, 2 (Jan. 14, 2013), available at [http://www.kirkland.com/siteFiles/Publications/MAUpdate\\_011413.pdf](http://www.kirkland.com/siteFiles/Publications/MAUpdate_011413.pdf); Trevor S. Norwitz, Igor Kirman, & William Savitt, *“Don’t Ask, Don’t Waive Standstills” Revisited (Rapidly)*, CLS BLUE SKY BLOG (Jan. 9, 2013), available at <http://clsbluesky.law.columbia.edu/2013/01/09/dont-ask-dont-waive-standstills-revisited-rapidly/>; William Savitt, *Don’t Ask, Don’t Waive Standstills*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Dec. 18, 2012, 8:51 a.m.), available at <http://blogs.law.harvard.edu/corpgov/2012/12/18/dont-ask-dont-waive-standstills/>; Gary E. Thompson & Steven M. Haas, *The State of M&A Standstills In Delaware*, Hunton & Williams Client Alert (Jan. 2013), available at [http://www.hunton.com/files/News/b91c8716-e69d-4ef1-b510-c3810f99af9d/Presentation/NewsAttachment/ee1368dafab8-489e-9652-c3a423539c68/DE\\_MA\\_Standstill\\_Agreements.pdf](http://www.hunton.com/files/News/b91c8716-e69d-4ef1-b510-c3810f99af9d/Presentation/NewsAttachment/ee1368dafab8-489e-9652-c3a423539c68/DE_MA_Standstill_Agreements.pdf); Peter J. Walsh, Jr., Janine M. Salomone, & David B. DiDonato, *Delaware Insider: “Don’t Ask, Don’t Waive” Standstill Provisions: Impermissible Limitation on Director Fiduciary Obligations or Legitimate, Value-Maximizing Tool?*, 2013 Jan. Bus. L. Today 1.

restrictive standstills.<sup>13</sup> My analysis assumed, however, the continued existence of standstills as they are currently being utilized in most mergers and acquisitions (M&A) transactions and did not address the fundamental issues of the extent to which boards may use standstills to restrict the sales process or protect an executed deal.<sup>14</sup> This Article addresses these fundamental issues by applying auction theory to critique and evaluate the role of standstills in M&A transactions. Auction theory utilizes economics to design optimal bidding procedures and revenue-enhancing sales processes. The application of auction theory to standstills is particularly well suited as targets require the execution of standstills based on the theory that standstills help to increase value during the sales process. Despite dealmaker' assumption that standstills are revenue enhancing scholars have not used auction theory to examine standstills and test this assumption until now.

In applying auction theory to standstills, this Article makes a unique contribution to M&A legal scholarship by providing answers to some fundamental questions presented by every sale of corporate control. Part I of this Article describes auction theory as it relates to the M&A sales process. Part II details a target board's fiduciary duties in the context of a sale of corporate control and explores the typical sales processes used by public companies. Part III details Delaware cases addressing the need for and possible enforcement of various standstills. Part

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<sup>13</sup> See generally Sautter, *supra* note 6. In *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, I specifically address a target board's ability to consider a third party superior offer made in contravention of a standstill; a board's promise not to waive a standstill; and a board's ability to grant a "winning" bidder the right to enforce a previously executed standstill against a "losing" bidder. See *id.*

<sup>14</sup> *Id.* at manuscript at 60.

IV uses auction theory and recent Delaware cases to develop a new framework for dealmakers and courts, taking into consideration whether strategic or financial bidders are involved in the sales process as well as the amount of pre-signing shopping done by the target board. Among other things, this new framework suggests that if dealmakers are to continue using certain more restrictive standstills, that they pair them with a minimal fiduciary out and staggered termination fee.

### I. AUCTION THEORY & STANDSTILLS

There is a substantial body of literature on auction theory generally and an increasing amount of literature on auction theory in the M&A context. Little of this literature specifically focuses on deal protection devices and none of it specifically addresses the use of standstills in the auction process. This Article addresses this gap and uses auction theory to propose a new framework for the use of standstills in change of control transactions.

Academics have used auction theory to attempt to design sales processes that produce optimal revenue maximizing auctions.<sup>15</sup> Auction theory is developing rapidly and is increasingly being looked to for assistance in practical applications, but current auction theory is by no means complete.<sup>16</sup> One practical application that may have the greatest impact is in the M&A field, which undoubtedly contains one of the largest markets for auctions. Given the size of any typical M&A transaction and corporate fiduciary duties, there are few areas that could benefit more from an optimal sales process. If auction theory could be used to design optimal auctions in M&A transactions, then the outcome of the auction should be able to be

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<sup>15</sup> See generally Paul Klemperer, *Auction Theory: A Guide to the Literature*, 13 J. ECON. SURVEY 227 (1999) (discussing optimal auction design).

<sup>16</sup> *Id.* at 248.

controlled largely through the structure of the sales process. If designing an optimal sales process for any given intricate M&A transaction seems too good to be true at this point, it is because many factors can impact the results of any given auction.<sup>17</sup>

A. *Common Value versus Private Value Sales Processes*

One of the many factors impacting the ultimate results of a sales process is the type of bidders involved.<sup>18</sup> When financial buyers are the bidders in an auction, academics tend to define those auctions as common value auctions.<sup>19</sup> A common value auction is an auction in which all of the participants have the same or very similar value for the target.<sup>20</sup> This is the case with financial buyers because they “can exploit the same sources of gains (e.g., cost cutting, financial restructuring).”<sup>21</sup> Conversely, a private value auction is one in which each bidder has a certain value it is willing to pay but is not aware of the value other bidders are willing to pay.<sup>22</sup> Strategic, or trade, buyers are often interested in acquiring a target company to optimize possible unique synergies between the buyer and the target.<sup>23</sup> Thus, strategic buyers tend to have differing

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<sup>17</sup> *See id.* at 234-47 (discussing many factors that impact auctions).

<sup>18</sup> Povel & Singh, *supra* note 9, at 1399.

<sup>19</sup> Jeremy Bulow, Ming Huang, & Paul Klemperer, *Thresholds and Takeovers*, 107 J. OF POLITICAL ECON. 427, 427 (1999).

<sup>20</sup> J. Russel Denton, Note, *Stacked Deck: Go-Shops and Auction Theory*, 60 STAN. L. REV. 1529, 1535 (2008).

<sup>21</sup> Povel & Singh, *supra* note 9, at 1400.

<sup>22</sup> Paul R. Milgrom & Robert J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 ECONOMETRICS 1089, 1090 (1982).

<sup>23</sup> Povel & Singh, *supra* note 9, at 1400.

values for a target based on the value each individual strategic buyer places on those particular synergies.<sup>24</sup> Therefore, auction processes involving strategic bidders tend to be private value auctions.<sup>25</sup> In addition, if the target's management has teamed up with a financial buyer to engage in a management-led buyout ("MBO") then the MBO team likely has better information regarding the target's value than the typical financial buyer.<sup>26</sup> In such case, the bidding process would be more similar to the private value auction.

The types of bidders involved in an auction impacts the auction results because strategic and financial bidders tend to value targets "in systematically different ways."<sup>27</sup> Generally, strategic bidders are more likely to pay more "for smaller targets that have substantial internal cash reserves and that undertake significant research and development activities."<sup>28</sup> Conversely, financial bidders are more likely to pay more relative to market value for underperforming companies and "are insensitive" to other factors like the target's size.<sup>29</sup>

The differing valuations between strategic and financial bidders arise from the differences in information within and between these general types of bidders who "are not always equally well informed" as well as from the type of information upon which each group tends to rely.<sup>30</sup> In fact, "a key feature of auctions is the presence of asymmetric information. (With perfect information most

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<sup>24</sup> Denton, *supra* note 20, at 1535.

<sup>25</sup> Povel & Singh, *supra* note 9, at 1400.

<sup>26</sup> *Id.* at 1399.

<sup>27</sup> Gorbenko & Malenko, *supra* note 2, manuscript at 4.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> Povel & Singh, *supra* note 9, at 1400; Gorbenko & Malenko, *supra* note 2, manuscript at 4.

auction models are relatively easy to solve).”<sup>31</sup> Of course, strategic bidders and buyers engaged in an MBO have asymmetric information because each bidder uses their own private information to value the object of the auction.<sup>32</sup> That is, these types of bidders have superior information on the target either due to their status as insiders or due to how they value the company based on particular synergies. In fact, strategic bidders “are less tied to publicly observable characteristics” like financial statements or market indicators so that the end result is that each strategic bidder’s valuation of the target is “unique.”<sup>33</sup>

Financial bidders can also have asymmetric information.<sup>34</sup> While their actual value of the object is the same, at least theoretically after the fact, each bidder has different private information about what the value actually is.<sup>35</sup> For example, in the case of a corporation, while the value of the underlying assets should produce the same returns for any financial buyer in the long run, the bidder’s valuation estimates of those future returns may differ. But, as Professors Alexander Gorbenko and Andrey Malenko explain in their manuscript, *Strategic and Financial Bidders in Takeover Auctions*, financial bidders’ valuations tend to be based “on observable factors, captured by the information about the targets available from the market and financial statements.”<sup>36</sup> Thus, the end result is that, unlike strategic bidders, financial

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<sup>31</sup> Paul Klemperer, *Auction Theory: A Guide to the Literature*, 13 J. ECON. SURVEY 227, 248, 229 (1999).

<sup>32</sup> Denton, *supra* note 237, at 1535.

<sup>33</sup> Gorbenko & Malenko, *supra* note 2, manuscript at 4.

<sup>34</sup> See Povel & Singh, *supra* note 9, at 1405 (stating that financial bidders may nevertheless have superior information).

<sup>35</sup> Klemperer, *supra* note 15, at 229-30.

<sup>36</sup> Gorbenko & Malenko, *supra* note 2, manuscript at 4.

bidders' valuations "tend to be similar to each other and rather exchangeable from a target's point of view."<sup>37</sup>

Even granting these distinctions in the real world of dealmaking, the classification of one type of auction as a pure common value one or a pure private value one is not necessarily accurate. Actual bidders rarely have identical valuations for an auctioned object nor are their valuations completely uncorrelated.<sup>38</sup> As Professor Subramanian recognized in his book, *Negotiauctions*, "[e]ven with a seemingly pure private-value asset, there is a significant common-value element."<sup>39</sup> Thus, information will not be perfectly symmetric between all buyers because, even if they are all using the same information about the target company, each bidder evaluates that information differently. In these situations involving asymmetric bidders, Professors Povel and Singh argue that "more biased procedures" should be used in the sale process, including deal protection devices.<sup>40</sup>

### B. *Information in the Sales Process*

The unique interpretation of information each bidder brings to the sales table impacts the question of whether standstills enhance the bidding process. This uniqueness is especially relevant because, as discussed above, standstills are inextricably tied to the provision of information. Numerous auction theorists have explored the role of information in the sales process. Professors Bulow and Klemperer have found that "contrary to our usual instinct that auctions are profitable because they are efficient, *it is*

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<sup>37</sup> *Id.*

<sup>38</sup> Peter Crampton & Allen Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J. L. ECON. & ORG. 27, 29 (1991).

<sup>39</sup> GUHAN SUBRAMANIAN, NEGOTIAUCTIONS 93 (2010).

<sup>40</sup> Povel & Singh, *supra* note 9, at 1417.



*precisely the inefficiency of the auction – that entry into it is relatively ill-informed and therefore leads to a more random outcome – that makes it more profitable for the seller.*<sup>41</sup> Once bidders have entered the auction, Professors Boone and Mulherin have found there is a fine line targets must walk in revealing proprietary information to bidders. In particular, receiving proprietary information causes bidders to be more certain about their valuation of the company and in turn causes bidders to bid more.<sup>42</sup> At the same time, however, a target’s provision of confidential information can “reduce the inherent value of the selling firm” because losing bidders can “gain competitive advantages.”<sup>43</sup> As a result, a seller’s management of the sales process to limit the number and kind of bidders and otherwise manage the process to reduce information costs can “actually create value.”<sup>44</sup>

Some have argued, based on the Revenue Equivalence Theorem or the logic of marginal revenue versus marginal cost, that even by taking into account asymmetric information an optimal auction, in theory, can be created.<sup>45</sup> This particular theorem states that the auction type does not influence the revenue produced by an auction regardless of the information each bidder has.<sup>46</sup> Under the theorem, “all the ‘standard’ auctions . . . yield the same ex-

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<sup>41</sup> Bulow & Klemperer, *supra* note 59, at 1546.

<sup>42</sup> Audra L. Boone & J. Harold Mulherin, *Is There One Best Way to Sell a Company? Auctions Versus Negotiations and Controlled Sales*, 21 J. APPLIED CORP. FIN. 28, 33 (2009).

<sup>43</sup> *Id.*; see also *Auctions in the M&A Process*, FINANCIER WORLDWIDE (Nov. 2007); available at [http://www.boozallen.com/media/file/Auctions\\_in\\_the\\_M%26A\\_Process.pdf](http://www.boozallen.com/media/file/Auctions_in_the_M%26A_Process.pdf). (“The seller in an auction risks opening itself up to tactical investigation by competitors.”).

<sup>44</sup> *Id.* at 28.

<sup>45</sup> Klemperer, *supra* note 15, at 232-33.

<sup>46</sup> *Id.* at 232.

pected revenue under the stated conditions, as do many non-standard auctions.”<sup>47</sup> However, this theory “applies very generally,” and rests on a number of assumptions, including that bidders are risk neutral; that bidders’ private information is independent of competitors’ private information; and that bidders’ private values are drawn from a common distribution.<sup>48</sup> But, more recent developments have suggested that standard auctions cannot be optimal in the presence of bidder asymmetry, and an increase in bidder asymmetry can hurt the seller if it uses a standard auction.<sup>49</sup>

Even if optimal auctions could be created by varying these assumptions<sup>50</sup>, many other factors can influence the outcome of an auction that most models have not been extended to completely account for.<sup>51</sup> These factors include the entry costs and number of bidders; ability of bidders to collude; and the divisibility of the unit for sale in the auction (or multi-unit auctions).<sup>52</sup> The idea of a multi-unit auction or the divisibility of a business into separate units is generally not examined in auction theory literature.<sup>53</sup> However, this singular focus may be misplaced when using auction literature to interpret M&A transactions because of the large indivisible number of assets comprising a business. Of the literature that does focus

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<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> Povel & Singh, *supra* note 9, at 1403.

<sup>50</sup> *See* Klemperer, *supra* note 15, at 234-36 (finding generally that optimal auction can be created in some cases regardless of assumptions).

<sup>51</sup> *See id.* at 238-47 (discussing implications of various factors on results of Revenue Equivalence Theorem making creation of efficient optimal auctions difficult).

<sup>52</sup> *Id.* at 238-47.

<sup>53</sup> *Id.* at 240 (“Most auction theory . . . restricts attention to the sale of a single indivisible unit.”).

on multi-unit auctions, the “main message . . . is that it is very hard to achieve efficient outcomes.”<sup>54</sup> Furthermore, most existing auction literature only allows for the case of either private value or common value bidding environments, that is, an auction that only contains either financial or strategic buyers, but not both.<sup>55</sup> But the likelihood of the presence of such distinct classifications is not realistic.

Nonetheless, at least one proposal has been made by Professors Povel and Singh setting forth a “simple and realistic” optimal selling procedure to incorporate these asymmetries that could be particularly applicable to M&A transactions.<sup>56</sup> This sequential selling procedure model “requires commitment to its rules, and deal protection devices [to] help the target cement this commitment.”<sup>57</sup> At the same time commitment to the rules in a M&A sales process may be too much to hope for. As Professor Subramanian has pointed out,

Auctions in the real world are messy. The rules are unclear and constantly changing. Price is just one of the many terms to be decided. The seller is not a passive participant after establishing the rules of the game. All of these real-world factors violate the fundamental assumptions on which much of auction theory is based.

In the present state of auction theory, even if Professors Povel and Singh’s model allowed for an optimal selling procedure, it could not do so alone. Some other structural protection device would be needed to ensure the best bidding process.

### *C. Standstills in the Sales Process*

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<sup>54</sup> *Id.* at 243.

<sup>55</sup> Povel & Singh, *supra* note 9, at 1400.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 1425.

One structural protection device used in the vast majority of sales is the standstill. Standstills generally prevent potential buyers from engaging in activity that may be considered hostile to the target.<sup>58</sup> More specifically, “a standstill agreement will prohibit a hostile bid in any form, including a tender offer to acquire stock control of the other contracting party and/or a proxy contest to replace all or some of its directors.”<sup>59</sup> Although standstills can be standalone agreements, most appear as a provision in a confidentiality agreement. Despite the close affiliation between standstill agreements and confidentiality agreements, the two agreements serve vitally different functions.<sup>60</sup> More specifically, the confidentiality agreement is intended to prevent the use or disclosure of nonpublic information whereas the standstill is intended to regulate the manner in which a party may gain control over the target.<sup>61</sup> Along these lines, “[s]tandstill prohibitions do not require, or in any way, depend upon, a contracting party’s use or disclosure of the other party’s confidential nonpublic information.”<sup>62</sup> At the same time, the main purpose of including a standstill in a confidentiality agreement is to prevent “the buyer [from] hav[ing] an informational advantage over other prospective bidders resulting from its review of confidential information.”<sup>63</sup> Along these lines, standstills give “teeth” to confidentiality agreements which alone may not be enough to estab-

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<sup>58</sup> *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 WL 2783101, at \*8 (Del. July 10, 2012).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> WILLIAM J. CARNEY, *MERGERS & ACQUISITIONS* 157 (3d. 2011).

lish insider trading liability under current federal securities laws.<sup>64</sup>

Standstills have been described as the “cost of entry” into discussions with a target.<sup>65</sup> In fact, some, if not most, targets will refuse to proceed with negotiations if the bidder refuses to execute the standstill.<sup>66</sup> The standstill “serves as a kind of litmus test, an indication of a bidder’s true intentions.”<sup>67</sup> A bidder can “try to modify the standstill as much as [it] can” but by executing the standstill

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<sup>64</sup> Ryan M. Davis, Note, *Trimming the “Judicial Oak”*: *Rule 10b5-2(B)(1), Confidentiality Agreements, and the Proper Scope of Insider Trading Liability*, 63 VAND. L. REV. 1469, 1486 (2010) (“[This Note] finds that liability cannot be based on confidentiality agreements alone, for although the [United States] Supreme Court has been willing to stretch the duty requirement in the past, the Court has always required more than a duty to keep information in confidence.”).

<sup>65</sup> Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L. J. 621, 660 (2003).

<sup>66</sup> See Nicole E. Clark, *Preliminary Agreements*, in DOING DEALS 2009: UNDERSTANDING THE NUTS & BOLTS OF TRANSACTIONAL PRACTICE, at 80-81 (PLI Corp. L. & Practice Grp., Course Handbook Series No. 18777, 2009) (stating target generally asks bidder to execute standstill in exchange for confidential information); Meryl S. Rosenblatt, *Letters of Intent and Exclusivity, Confidentiality and Standstill Agreements*, in DRAFTING CORPORATE AGREEMENTS 2002-2003, at 237 (PLI Corp. L. & Practice Grp., Course Handbook Series No. B0-01K0, 2002-2003) (noting target may require standstill to ensure buyer remains committed to transaction and to prevent buyer from pursuing hostile alternative).

<sup>67</sup> BRUCE WASSERSTEIN, *BIG DEAL: MERGERS AND ACQUISITIONS IN THE DIGITAL AGE* 689 (2000).

the bidder is forsaking its “ability to launch an unsolicited offer.”<sup>68</sup>

Because standstills work to restrict bidders, the length of these restrictions can become a significant issue during negotiations. Typically, “auction-style standstill agreements last only one or two years, on the basis that the confidential information to be provided to the bidders will have useful currency for only a relatively short time.”<sup>69</sup> Standstills can be longer than a year, even up to five years, but generally, standstills “with expirations between six months and one year are not uncommon; although, one year may be the norm.”<sup>70</sup> For example, one commonly negotiated aspect of a standstill is whether the standstill will include a fall-away provision. One practitioner described a fall-away provision as an “escape hatch” for a buyer.<sup>71</sup> A fall-away provision provides the standstill restrictions would no longer apply if another bidder not bound by a standstill makes an offer for the target or if the target executes a definitive acquisition agreement with another bidder.<sup>72</sup> A target may resist this provision fearing it may prevent the bidder from submitting its best offer during the pre-signing sales process.<sup>73</sup> But targets

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<sup>68</sup> Subramanian, *supra* note 70, at 662.

<sup>69</sup> Lawlor, *supra* note 4, at 11.

<sup>70</sup> Sautter, *supra* note 6, manuscript at 22-23.

<sup>71</sup> *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 PENN ST. L. REV. 615, 636 (2012).

<sup>72</sup> *Id.*

<sup>73</sup> William Savitt, *Don't Ask, Don't Waive Standstills*, The Harvard Law School Forum on Corporate Governance and Financial Regulation (Dec. 18, 2012, 8:51 a.m.), *available at* <http://blogs.law.harvard.edu/corpgov/2012/12/18/dont-ask-dont-waive-standstills/> (“Sellers usually resist fall-aways both to prevent bidders from holding back and to induce

often end up agreeing to the fall-away as a way of moving along the sales process.<sup>74</sup> Moreover, targets recognize the possibility may provide more value ultimately.<sup>75</sup> Nevertheless, some practitioners argue that whether a target should agree to a fall-away standstill is context specific.<sup>76</sup> For example, if the target has decided that it is definitely for sale and “is going to run a process that’s definitely going to end in a sale” a target may be more willing to agree to a fall-away.<sup>77</sup> As is evident from the foregoing, whether a standstill falls away is often a matter of some debate.

Another matter of some debate among practitioners is the viability and enforceability of Don’t Ask, Don’t Waive (or “DADW”) standstills. These standstills prevent a potential bidder who had executed a standstill from requesting a waiver of the standstill

## II. FIDUCIARY DUTIES AND M&A SALE PROCESSES

In analyzing standstills and their related sub provisions, auction theory cannot be considered in a vacuum, as there are other significant considerations in the context of a sale of a publicly traded, Delaware corporation. Namely, a well-developed body of Delaware case law governing a target board’s fiduciary duties significantly influences such sales. Moreover, there is the practical consideration regarding the processes by which targets *actu-*

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them, by promising certainty, to put their best offer on the table.”).

<sup>74</sup> *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 PENN ST. L. REV. 615, 636 (2012).

<sup>75</sup> *Id.* (“At the end of the day, if you have what you think is the highest price in an auction, it’s not a bad thing that [the bidder] wants to come in and put more money on the table.”)

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

*ally* go about selling themselves. This section first details the fiduciary duties applicable to a target board's actions in a sale of corporate control. Then the following sections describe the various sales methods upheld by Delaware courts and available to a target board. The role of standstills in each sale method is emphasized.

#### A. *Fiduciary Duties in a Sale of Corporate Control*

The seminal Delaware Supreme Court case of *Revlon v. MacAndrews & Forbes Holdings, Inc.* provides that once a sale of corporate control becomes inevitable, “a board's primary duty becomes that of an auctioneer responsible for selling the company to the highest bidder.”<sup>78</sup> Since this holding the Delaware Supreme Court has recognized that “no single blueprint exists” for a board to satisfy its *Revlon* duties.<sup>79</sup> The courts have acknowledged that not every sale requires a full-blown auction process but rather the board of directors of a selling corporation must meet “a reasonableness standard.”<sup>80</sup> Moreover, in selecting an acquirer and in rejecting other offers, boards are not bound to make that decision solely based on the price being offered. Instead, the target board may consider a variety of factors, including the offer terms and feasibility, financing, the likelihood of consummation of the proposed transaction, and “the bidder's identity, prior background

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<sup>78</sup> *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1986).

<sup>79</sup> *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989).

<sup>80</sup> *Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL at 6 (Del. Ch. Jan. 24, 2011); *see also Barkan*, 567 A.2d at 1286 (“*Revlon* does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest.”).



and other business venture experiences.”<sup>81</sup> Just because a company is in *Revlon*-mode, does not prevent a target’s board “from offering bidders deal protections, so long as its decision to do so was reasonably directed to the objective of getting the highest price, and not” a self-dealing goal “to tilt the playing field towards a particular bidder for reasons unrelated to the stockholders’ ability to get top dollar.”<sup>82</sup>

### B. *M&A Sales Processes*

The Delaware courts have upheld a variety of sale methods as meeting the reasonableness standard. This section explores the typical sales methods used in a sale of corporate control and upheld by the Delaware courts: a classic public auction, pre-signing market canvass, negotiated acquisition, and post-signing market checks. Although this Article addresses each of these sale methods on an individual basis, many targets may use a combination of two or more of these methods in any one transaction.

#### 1. *Classic Full-Blown Auction*

The classic full-blown auction is generally thought to be the easiest way for a board to ensure satisfaction of its fiduciary duties pre-signing.<sup>83</sup> Not only is a classic auc-

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<sup>81</sup> *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1282 n.29 (Del. 1988).

<sup>82</sup> *In re Toys “R” Us, Inc. S’holders Litig.*, 877 A.2d 975, 1000-01 (Del. Ch. 2005).

<sup>83</sup> See WASSERSTEIN, *supra* note 56, at 746 (“A wide-ranging auction generally maximizes value, particularly since the ‘best buyer’ on paper is not always the party who eventually pays the highest price.”); Samuel C. Thompson, § 5:5 *The Delaware Law Governing Fiduciary Duties in M&A*, in *MERGERS, ACQUISITIONS, AND TENDER OFFERS*,

tion thought to be the easiest way to prove compliance with fiduciary duties but, as Professors Jeremy Bulow and Paul Klemperer found in a recent study, “the straightforward, level-playing-field competition that an auction creates is *usually* more profitable for a seller than a sequential process.”<sup>84</sup> However, in another study of 400 takeovers of U.S. corporations during the 1990s, Professors Audra Boone and Harold Mulherin found that there were not substantial differences between the wealth effects resulting from auctions versus those resulting from negotiations.<sup>85</sup> Despite finding that auctions were not

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5-201 (PLI April, 2012) (recognizing best way to sell publicly held companies may be through “active and fair auction[s]” and stating “[a]ctual market testing through an auction may be more beneficial than relying solely on investment bankers to assess valuation”); *Auctions in the M&A Process*, FINANCIER WORLDWIDE (Nov. 2007); *available at* [http://www.boozallen.com/media/file/Auctions\\_in\\_the\\_M%26A\\_Process.pdf](http://www.boozallen.com/media/file/Auctions_in_the_M%26A_Process.pdf). (“The basics of what sellers are looking for in an auction remain the same: maximum price, high certainty of completing the transaction and management’s preferred buyer.”). *See also* Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops – The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525 at 576 (2008) (hereinafter, “*Go-Shops*”) (noting Delaware courts consider public auctions or pre-signing targeted market canvasses to be value maximization procedures).

<sup>84</sup> Jeremy Bulow & Paul Klemperer, *Why Do Sellers (Usually) Prefer Auctions?*, 99 AMER. ECON. REV. 1544, 1545 (2009).

<sup>85</sup> Audra L. Boone & Harold Mulherin, *How are Firms Sold?*, LXII J. OF FINAN. 847, 871 (2007) (hereinafter, *How are Firms Sold?*).

necessarily better at maximizing stockholder value as negotiations, Boone and Mulherin found that half of the 400 takeovers studied result from an auction process.<sup>86</sup> Thus, the auction process is certainly a popular form of sale even if business scholars debate whether it is more beneficial to stockholders than negotiations.

Generally, the auction begins with the preparation of an offering memorandum describing in detail the target's business.<sup>87</sup> At the same time the offering memorandum is being prepared, the target's financial advisor devises a list of potential purchasers.<sup>88</sup> The financial advisor then contacts the potential purchasers and those potential buyers who express a potential interest in the target are required to execute a confidentiality agreement before being given the offering memorandum and, in some cases, other information.<sup>89</sup> In most deals, the confidentiality agreement will contain a standstill.<sup>90</sup> Thus, auction participants enter the auction process without first determining the value of the company and without knowing what other bidders will bid.<sup>91</sup> It is this lack of knowledge that

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<sup>86</sup> *Id.* at 869.

<sup>87</sup> WASSERSTEIN, *supra* note 56, at 746.

<sup>88</sup> *Id.* at 746; *see also* Robert G. Hansen, *Auctions of Companies*, 39 *ECON. INQUIRY* 30, 30 (2001) (stating that potential bidder list likely includes "competitors, suppliers, customers, and acquisition oriented conglomerates or leveraged buyout houses").

<sup>89</sup> WASSERSTEIN, *supra* note 56, at 746.

<sup>90</sup> *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 *PENN ST. L. REV.* 615, 636 (2012) (stating confidentiality agreements typically contain standstill provisions).

<sup>91</sup> Bulow & Klemperer, *supra* note 59, at 1545. As prominent investment banker, Bruce Wasserstein, explained, "[t]he auction format naturally creates tension—especially the blind auction in which bidders are not told how many other parties they are competing against. . . . If the auc-

Professors Bulow and Klemperer contend enhance value maximization in an auction.<sup>92</sup>

At a predetermined date pursuant to the target's bidding procedures, the interested bidders are required to submit a preliminary, nonbinding indication of interest.<sup>93</sup> These indications of interest "will either be a number or range of numbers that are supposed to represent bidders' first approximations of their estimates of value of the target."<sup>94</sup> The target and its financial advisor usually then narrow the field of bidders based on the prices contained in the indications of interests and other factors.<sup>95</sup> At this point, the narrowed field of bidders is asked to participate

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tioneer is able and the integrity of the process is maintained, *even a single bidder* can be induced to enter a 'full' bid." WASSERSTEIN, *supra* note 56, at 748 (emphasis added).

<sup>92</sup> Bulow & Klemperer, *supra* note 59, at 1546 ("[C]ontrary to our usual instinct that auctions are profitable because they are efficient, *it is precisely the inefficiency of the auction – that entry into it is relatively ill-informed and therefore leads to a more random outcome – that makes it more profitable for the seller.*") (emphasis in original) ); *see also* Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Overpayment Problem*, 96 MINN. L. REV. 1018, 1041 (2012) ("First, since a target's real value is unknown at the time of the acquisition, 'habitually optimistic therefore likely to overestimate a target's value.' Second, managers may overpay because they are ignorant of bidding theory and are vulnerable to the 'winner's curse.' Thus, on average, for an asset whose value is unknown, the winning bid is the one that overestimates the value of the asset.").

<sup>93</sup> WASSERSTEIN, *supra* note 56, at 746.

<sup>94</sup> Hansen, *supra* note 20, at 31.

<sup>95</sup> WASSERSTEIN, *supra* note 56, at 747.

in a second round of bidding.<sup>96</sup> This is usually the point at which the target's management will hold presentations for the bidders, the bidders will receive access to either an online or physical data room to perform due diligence, and plant or site visits will occur.<sup>97</sup> In some cases, bidders will be expected to complete due diligence review before final bids are submitted.<sup>98</sup> Thus, the final bids will not be subject to satisfactory completion of due diligence.<sup>99</sup> In addition, the target will send the final bidders a sample purchase agreement that the final bidders will mark-up and return with their offers on the final bid date.<sup>100</sup>

The auction winner is chosen based in large part on the offer price but other factors, including the purchase agreement mark-up, can play a significant role.<sup>101</sup> For example, financing, antitrust issues, closing certainty, and reverse termination fees are just some of the factors that targets may consider in choosing an auction win-

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<sup>96</sup> *Id.*

<sup>97</sup> *Id.*; Hansen, *supra* note 20, at 31.

<sup>98</sup> WASSERSTEIN, *supra* note 56, at 747.

<sup>99</sup> *See id.* (noting that in certain instances bid winner is announced on final bid date).

<sup>100</sup> *Id.*

<sup>101</sup> *See id.* (stating “[p]rice often is the determining factor in an auction” and differentiating between bidders who have submitted “unfavorable contract” versus bidders who have submitted “clean” contract). *But see* Jack & Suzy Welch, *Why Joe Biden is Wrong About Private Equity Execs*, FORTUNE, JULY 2, 2012, at 42 (“Usually several firms are vying for the business, but it’s not accurate to assume that price is the sole determinant of who wins. Just as critical many times is a PE firm’s ability to bring contentious stakeholders to a shared vision of the future. The result is that private equity managers are experienced in the art of getting tough deals done.”).

ner.<sup>102</sup> Generally, these auctions are “sealed-bid” auctions, meaning that the bidders do not know the terms of the other bidders’ bids and the final bids remain final.<sup>103</sup> However, some auctions are “dripping wax” auctions in which the purportedly final bids are not actually final.<sup>104</sup> In such an auction, the “seller goes back to the few highest bidders, with the high bid used as leverage over the others in an attempt to force a raise. If successful, the new prices can be used against the former high bidder.”<sup>105</sup>

As Wasserstein has noted the success of an auction depends in large part on how the auction is run with an emphasis on the selective release of information during the auction process.<sup>106</sup> Although the information provided to bidders in the offering memorandum and through due diligence “is extensive, it is not complete.”<sup>107</sup> Thus, bidders will likely have asymmetric information largely based on how the bidders interpret the information provided to them in the due diligence period as well as based on the pre-existing information already in their possession.

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<sup>102</sup> See *In re Topps*, 926 A.2d at 72 (listing such elements as reasons to deny Upper Deck continued friendly negotiations); see also WASSERSTEIN, *supra* note 56, at 747 (“[O]ne bidder may offer a high price, an unfavorable contract, and no concrete details regarding financing. Another bidder might be willing to pay less, but offer a ‘clean’ contract and quick closure.”).

<sup>103</sup> WASSERSTEIN, *supra* note 56, at 747.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> See *id.* at 748 (“If the process is managed correctly, bidders will be pulled along by the desire for more data.”).

<sup>107</sup> Hansen, *supra* note 20, at 32. As Professor Hansen states, “Throughout the auction process, potential buyers may ask for information that the selling company will view as too confidential to reveal.” *Id.*

Although some scholars view public auctions as the best way to maximize stockholder value, there are certainly situations in which a public auction is not desirable. One such situation is when a board views an auction as placing the company at a competitive disadvantage.<sup>108</sup> For example, if a company conducts a public auction, the company risks losing employees, customers, and suppliers.<sup>109</sup> In addition, the company also runs the risk of being viewed by the market for corporate control as “damaged goods” if the auction is unsuccessful.<sup>110</sup> Thus, in the event of a failed auction, it may take some time for a com-

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<sup>108</sup> The Delaware Court of Chancery also recognizes the potential risks involved with a public auction. *See In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573, 597 (Del. Ch. 2010) (implying leaked auctions may upset target’s employee base); *In re MONY Group, Inc. S’holders Litig.*, 852 A.2d 9, 21 (Del. Ch. 2004) (recognizing benefits to single bidder approaches).

<sup>109</sup> *See In re Dollar Thrifty S’holder Litig.*, 14 A.3d at 597 (recognizing possible employee strife resulting from leaked auction); *Yanow v. Scientific Leasing, Inc.*, C.A. Nos. 9536, 9561, 1991 WL 165304, at \* 668-69 (Del. Ch. July 31, 1991) (stating board resisted auction or market canvass fearing adverse affect on target’s “relationships with its employees, customers and suppliers”); Steven M. Davidoff, *What the Sound and Fury Over Best Buy May Signify*, N.Y. TIMES DEALB%K (Aug. 23, 2012 12:42 p.m.), <http://dealbook.nytimes.com/2012/08/23/what-the-sound-and-fury-over-best-buy-may-signify/> (“Typically, targets are quite skittish about publicly talking about negotiations. The reason is that this type of back and forth is unsettling for the company’s employees and operations.”).

<sup>110</sup> *Auctions in the M&A Process*, FINANCIER WORLDWIDE (Nov. 2007); *available at* [http://www.boozallen.com/media/file/Auctions\\_in\\_the\\_M%26A\\_Process.pdf](http://www.boozallen.com/media/file/Auctions_in_the_M%26A_Process.pdf).

pany to successfully sell itself.<sup>111</sup> Furthermore, although potential bidders are required to execute confidentiality agreements before being provided with a confidential offering memorandum or commencing due diligence, companies also risk proprietary or sensitive information being disseminated to the public generally, and, in particular, to competitors.<sup>112</sup> In some cases, the target may have already been approached by a potential purchaser whose bid may be lost if the target board were to choose to engage in a full-blown auction.<sup>113</sup> Another common situation when targets choose to forgo a public auction is when there are a limited number of viable potential buyers. This is typically a result of the target's business type or on the financial situation.<sup>114</sup> For example, a multi-billion

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<sup>111</sup> See Thomas W. Van Dyke, Chapter 6: *Embarking on the Sale Process*, excerpted from *A Practical Guide for the Business Lawyer*, 2005, at 804 (detailing disadvantages of auctions, including length of time to sell company after failed auction).

<sup>112</sup> See also *Topps*, 926 A.2d at 62 (noting target's "legitimate proprietary concerns" about sharing information with competitor).

<sup>113</sup> See, e.g., *id.* at 70 (stating buyer's bid contingent on target not conducting public auction); (same); See *In re Dollar Thrifty S'holder Litig.*, 14 A.3d at 604 (stating target weighed risk of losing potential buyer if target conducted public auction); *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 119 (Del. Ch. 2007) (discussing risk of losing initial bidder if target engaged in public auction or risk initial bidder would pay less if response to auction was "underwhelming").

<sup>114</sup> See Boone & Mulherin, *supra* note 42, 32-34 ("[T]he costs of operating auctions often imply that limiting the sales process can induce more aggressive bidding by those allowed to participate in the process. . . . The argument for a managed sales process may well be even stronger in



dollar corporation may have a limited number of suitors due to the corporation's size or the industry in which it operates.<sup>115</sup> Hence a selling corporation may choose instead to engage in an informal auction process or to negotiate exclusively with one bidder.

## *2. The Pre-Signing Market Canvass and the Negotiated Acquisition*

Another alternative available to target companies is the pre-signing market canvass, or the informal auction. This is really a variation on the full-blown auction pro-

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corporate M&A, particularly in cases involving one or a few large corporate bidders with significant expected synergies with the seller.”); *Auctions in the M&A Process*, FINANCIER WORLDWIDE (Nov. 2007); available at [http://www.boozallen.com/media/file/Auctions\\_in\\_the\\_M%26A\\_Process.pdf](http://www.boozallen.com/media/file/Auctions_in_the_M%26A_Process.pdf). (“Generally, auctions drive value up if the buyer mix is robust . . . . A targeted approach may be warranted when there is obvious and limited universe of buyers...Whether or not an auction will be favoured over private negotiation will always depend on whether the seller is price-driven or motivated by other factors. Sometimes it's clear who is going to pay the most for an asset so there is no real need to run an auction.”)

<sup>115</sup> In their research, Boone and Mulherin point to the \$23 billion Wrigley deal in 2008, pursued through one-on-one negotiations with Mars, and the 2008 Embarq deal with CenturyTel for \$5 billion, resulting from a field of five potential buyers in the telecom industry, as examples of why large companies are more likely to sell themselves in one-on-one negotiations rather than auctions. See Boone & Mulherin, *supra* note 42, at 32-34. See also Boone & Mulherin, *How Are Firms Sold?*, *supra* note 56, at 871 (2007) (finding that “the choice of an auction or a negotiation in a particular takeover is related to characteristics such as target size and industry”).

cess. In this type of sale process, the target, or its financial advisor, contacts a number of potential bidders to gauge their interest in the target.<sup>116</sup> The bidding process (if one does exist) is in “a less structured setting than that of a formal auction.”<sup>117</sup>

The pre-signing market canvass may help targets avoid the previously discussed costs involved in a “busted” auction as well as the costs involved in running a full auction. Moreover, a pre-signing market canvass may take place after a previously not-for-sale target company has been approached by a bidder or in situations, as discussed in the next section, where the target has negotiated initially with only one bidder. In any event, the interested potential bidders will be required to execute a confidentiality agreement, typically containing a standstill, before gaining access to the target’s private information.

Another form of sale process is the negotiated acquisition or sequential procedure. In this type of sale process, the target negotiates exclusively with one potential buyer.<sup>118</sup> Like in the other sale processes, the potential buyer will be required to execute a confidentiality agreement, generally containing a standstill, prior to receiving the target’s confidential information. If the initial potential buyer is willing to pay a high enough price, then the deal will sign without the target contacting other potential buyers.<sup>119</sup> In some scenarios, a potential buyer may condition its bid on the target not contacting any other potential buyers or otherwise performing a market canvass pre-signing.

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<sup>116</sup> Boone & Mulherin, *How Are Firms Sold?*, *supra* note 56, at 851.

<sup>117</sup> *Id.*

<sup>118</sup> Povel & Singh, *supra* note 9, at 1400.

<sup>119</sup> *Id.*

### 3. *Relevant Merger Agreement Deal Terms and Post-Signing Sales Activities*

Regardless of the sales method initially chosen however, because of a board's fiduciary duty to consider higher bids, an auction-like setting will likely result from the sales process, implicating auction theory considerations.<sup>120</sup> No matter if the target performs an auction or negotiates with only one bidder, the resulting definitive merger agreement will be publicly announced within a day or two of execution.<sup>121</sup> The merger agreement will likely contain a no shop provision paired with a fiduciary out. The no shop provision prevents the target company from soliciting offers between signing and closing.<sup>122</sup> But, the fiduciary out allows a target company's board of directors to negotiate with a third party who makes an unsolicited offer if the third party's offer is a superior one or if it is reasonably likely to become a "Superior Offer," as that term is defined in the merger agreement.<sup>123</sup> In addition, the fiduciary out allows the target company to terminate the existing agreement in favor a third party offer if the board determines it would be a violation of its fiduciary duties not to do so.<sup>124</sup> A typical prerequisite to the target providing information to, and negotiating with, the overbidder is that the overbidder must execute a confidentiality agreement with terms that are no less restrictive than

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<sup>120</sup> Denton, *supra* note 20, at 1533.

<sup>121</sup> Audra Boone & L. Harold Mulherin, *Do Termination Provisions Truncate the Takeover Bidding Process?*, 20 REV. FIN. STUD. 461, 475 (2007).

<sup>122</sup> Christina M. Sautter, *Rethinking Contractual Limits on Fiduciary Duties*, 38 FLA. ST. U. L. REV. 55, 72-73 (2010).

<sup>123</sup> *Id.* at 73.

<sup>124</sup> *Id.*

the initial acquirer's confidentiality agreement.<sup>125</sup> Thus, because the initial acquirer's confidentiality agreement generally contained a standstill, the over-bidder's confi-

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<sup>125</sup> See Denton, *supra* note 20, at 1539-40 (noting that go-shops typically require "any third-party bidder to sign an 'Acceptable Confidentiality Agreement' with the seller in order to have access to any material nonpublic information" in analyzing a typical go-shop provision, which defined "Acceptable Confidentiality Agreement" as "(i) any confidentiality agreement between the Company and any such Person existing as of the date of this Agreement and (ii) any confidentiality agreement entered into after the date of this Agreement that contains provisions that are no less favorable in the aggregate to the Company than those contained in the Confidentiality Agreement"); Robert Little, Travis Souza & Rachel Harrison, *No-Shops & Fiduciary Outs: A Survey of 2012 Public Merger Agreements*, DALLAS BAR ASSOCIATION (Dec. 11, 2012), <http://www.dallasbar.org/content/mergers-and-acquisitions-section> (finding, based on data from 53 public company merger agreements in 2012 with transaction values over \$1 billion, that in most merger agreements an acceptable confidentiality agreement with an alternative bidder is one that is "no less favorable" or "not less restrictive"). See also Status Conference and Motion to Expedite at 89, *In re Transatlantic Holdings, Inc. S'holder Litig.*, C.A. Nos. 6574-CS & 6776-CS (Del. Ch. Aug. 22, 2011) (discussing a provision in a merger agreement requiring third party bidders to sign a confidentiality agreement with a standstill no less favorable than the one between the parties to the merger, and noting that it is an "accepted norm of deal negotiation where a merger party insists that later arriving bidders who are going to have a chance play by certain rules that are as stringent as the rules that apply to them").

dentiality agreement will likely contain a standstill.<sup>126</sup> As will be detailed in Part V., the possibility exists a target board could use the standstill as a means of favoring the initial acquirer over the over-bidder.

Recently, parties have also begun to use go-shop provisions in some transactions.<sup>127</sup> Unlike a no shop provision, go-shop provisions allow a target company to actively solicit third party offers post-signing for a limited period of time.<sup>128</sup> Like the no shop, a typical go shop requires bidders to execute a confidentiality agreement with no less restrictive terms than the initial acquirer's confidentiality agreement meaning the bidder will be subject to a standstill.<sup>129</sup>

### III. CURRENT USE OF STANDSTILLS IN M&A TRANSACTIONS

Although standstills are ubiquitous in today's public company M&A deals, to date the Delaware courts have not extensively addressed the use of standstills. In fact, most of Delaware's guidance on the use of standstills in M&A transactions comes to us through dicta. This section summarizes those recent cases in which the Delaware Court of Chancery has commented on standstills. In addition, this section also includes a description of two non-litigated transactions in which standstills played a significant role in the sales process.

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<sup>126</sup> David Marcus, *Confis, standstills and courts* (Sept. 30, 2011), available at <http://www.thedeal.com/magazine/ID/041657/commentary/confis,-standstills-and-courts.php>

<sup>127</sup> Sautter, *Go-Shops*, *supra* note 83, at 554-55 (discussing use of go-shops).

<sup>128</sup> *Id.* at 557.

<sup>129</sup> *See, e.g., In re Topps*, 926 A.2d at 66 (recognizing bidder required to execute confidentiality agreement containing standstill during go-shop period).

A. *Topps & the Impact of Standstills on the Sales Process*

The Delaware Chancery Court's 2007 decision in *In re Topps Co. Shareholders Litigation* provides some helpful insight on the role and impact of standstills in a sale of corporate control.<sup>130</sup> That case involved a leveraged buyout of Topps Co.<sup>131</sup> The deal between the Michael Eisner-led buyout group and Topps ensured the retention of the majority of the company's key employees and senior management, including the CEO and Chairman's son-in-law who served as the company's President and Chief Operating Officer.<sup>132</sup>

Although a pre-signing auction or market canvass was unacceptable under Eisner's proposal, Eisner agreed to a go-shop provision.<sup>133</sup> Thus, the merger agreement "gave Topps the chance to shop the bid for 40 days after signing, and the right to accept a 'Superior Proposal' after that, subject only to Eisner's receipt of a termination fee and his match right."<sup>134</sup> The termination fee amounted to 3.0% of the transaction value during the go-shop period and 4.6% of the transaction value following the go-shop period.<sup>135</sup>

At the outset of the go-shop period, Topps's financial advisor "contacted 107 potential strategic and financial bidders, [of which] five expressed interest in Topps and began a due diligence review."<sup>136</sup> The only serious bidder who emerged during the go-shop period was Upper Deck,

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<sup>130</sup> 926 A.2d 58 (Del. Ch. 2007).

<sup>131</sup> *In re Topps*, 926 A.2d at 60-61.

<sup>132</sup> *Id.* at 60, 61, 73-74.

<sup>133</sup> *Id.* at 61, 70.

<sup>134</sup> *Id.* at 61.

<sup>135</sup> *Id.* at 66.

<sup>136</sup> *Id.*

a competitor of Topps.<sup>137</sup> Upper Deck's bid, which was submitted two days before the expiration of the go-shop period, was for \$10.75 cash per share, \$1 more per share than the Eisner proposal.<sup>138</sup>

The Topps board met after the go-shop period expired to determine whether Upper Deck was an "Excluded Party" under the terms of the Topps-Eisner merger agreement, which would have allowed Upper Deck and Topps to continue talks past the expiration of the go-shop period.<sup>139</sup> The Topps board decided Upper Deck was not an "Excluded Party" raising concerns regarding Upper Deck's ability to finance the deal as well as antitrust issues including the possibility antitrust authorities may delay or prevent the transaction and Upper Deck's failure to sufficiently assume the antitrust risk.<sup>140</sup> Upper Deck then made an unsolicited proposal and offered to divest key licenses if required to do so by antitrust regulators.<sup>141</sup> The Topps board again determined the unsolicited proposal was not a superior proposal raising similar concerns.<sup>142</sup> In addition and perhaps more importantly for purposes of this Article, the Topps board rejected Upper Deck's request to be released from the standstill agreement.<sup>143</sup> The standstill prevented Upper Deck from making public any information about its discussions with Topps and also prevented Upper Deck from launching a tender offer for Topps shares without the Topps board's permission.<sup>144</sup>

A group of Topps stockholders and Upper Deck moved for a preliminary injunction maintaining that by refusing

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<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* at 72.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.* at 90.

<sup>142</sup> *Id.* at 72-73.

<sup>143</sup> *Id.* at 62.

<sup>144</sup> *Id.*

to release Upper Deck from the standstill “Topps [was] denying its stockholders the chance to decide for themselves whether to forsake the lower-priced Eisner Merger in favor of the chance to accept a tender offer from Upper Deck at a higher price.”<sup>145</sup> Then Vice Chancellor Strine began his analysis of the case by acknowledging the “legitimate purposes” standstills can serve including “establish[ing] rules of the game that promote an orderly auction” and providing a target with “leverage to extract concessions from the parties who seek to make a bid.”<sup>146</sup> At the same time, Strine acknowledged a board could use standstills for illegitimate purposes like “favor[ing] one bidder over another, not for reasons consistent with stockholder interest, but because managers prefer one bidder for their own motives.”<sup>147</sup> Strine further recognized the Topps board’s reservation of the ability to waive the standstill if the board’s fiduciary duties required it to do so “was an important thing to do, given there was no shopping process before signing with Eisner.”<sup>148</sup> At the same time, the board had an obligation to use its contractual powers for appropriate purposes.<sup>149</sup>

By refusing to release Upper Deck from the standstill, the Topps board was preventing its stockholders from accepting a potentially higher offer and was preventing its stockholders from receiving information regarding the transaction.<sup>150</sup> Moreover, the refusal to release Upper Deck from the standstill prevented Upper Deck from attaining antitrust clearance.<sup>151</sup> As a result, Strine found Upper Deck “has shown a reasonable probability of suc-

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<sup>145</sup> *Id.* at 63.

<sup>146</sup> *Id.* at 91.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*



cess on its claim that the Topps board is misusing the Standstill” and that Topps board’s asking its stockholders to cash out and then foreclosing its stockholders from receiving Upper Deck’s offer was “likely, after trial, to be found a breach of fiduciary duties.”<sup>152</sup> Until quite recently, Strine’s decision in *Topps* was the leading case providing guidance on how dealmakers may use standstills during a sale of corporate control.

B. *Potential Enforceability of DADW Standstills After Topps*

Five recent transactions from 2011 and 2012 provide helpful commentary on the potential enforceability of DADW standstills. The first two cases, *In re Celera Corporation Shareholder Litigation* and *In re RehabCare Group, Inc. Shareholders Litigation*, arose in the context of the Delaware Chancery Court’s approval of settlements.<sup>153</sup> Thus, those cases simply provide dicta regarding the enforceability of DADW standstills. However, two significant rulings were issued in the final months of 2012 that considered DADW standstills in depth. In the third case, *In re Complete Genomics, Inc. Shareholder Litigation*, Vice Chancellor Laster invalidated a confidentiality agreement because it contained a DADW standstill.<sup>154</sup> In the fourth case, *In re Ancestry.com Inc. Shareholder Litigation*, Chancellor Strine found that the target board had breached the duty of care because of the way it employed a DADW standstill, not simply because the board did

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<sup>152</sup> *Id.*

<sup>153</sup> *In re Celera Corp. S’holder Litig.*, Civ. Action No. 6304-VCP (Del. Ch. Mar. 23, 2012); *In re Rehabcare Group, Inc. S’holders Litig.*, C.A. No. 6197-VCL (Del. Ch. Sept. 8, 2011).

<sup>154</sup> Telephonic Oral Argument and the Court’s Ruling, *In re Complete Genomics, Inc. S’holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

so.<sup>155</sup> The Court of Chancery did not have an opportunity to weigh in on the fifth, Apollo's and KSL Capital Partners Management III, LLC's fight for Great Wolf Resorts. But, that deal provides an excellent example of the potentially erosive effects on shareholder value maximization that some standstills may have during the pre-closing period.

*1. RehabCare and the Questioned Viability of DADW Standstills Following Topps*

In late 2007 through early 2008, RehabCare Group, Inc. ("Rehabcare") and Kindred held preliminary discussions regarding Kindred's possible acquisition of RehabCare.<sup>156</sup> At that time, "Kindred submitted a preliminary indication of interest to acquire RehabCare at a price of \$25.00 per share, with half payable in cash and the other half in Kindred common stock."<sup>157</sup> But the discussions ended after the parties were unable to reach an appropriate valuation for RehabCare.<sup>158</sup> By the summer of 2010, however, RehabCare's situation changed, as its stock price "dropped significantly."<sup>159</sup> The RehabCare board met in August to review strategic alternatives, including "potential acquisition targets . . . and potential financial and strategic partners."<sup>160</sup> The board determined the only viable strategic acquirer for RehabCare

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<sup>155</sup> The Court's Ruling on Plaintiffs' Motion for Preliminary Injunction, *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012)

<sup>156</sup> RehabCare Group, Inc., Current Report (Form 8K) (May 12, 2011).

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

was Kindred.<sup>161</sup> In making that decision, the board considered “four other logical potential strategic acquirers of RehabCare and the various reasons that each such party would not be a likely acquirer.”<sup>162</sup> These reasons included, among others, public statements, prior business contacts, leverage constraints, recent significant acquisitions, and various regulatory and legal matters with respect to such third parties.”<sup>163</sup> However, the board was unsure about Kindred’s willingness to proceed with a transaction based on the previous failed discussions between the two parties.<sup>164</sup> The board directed its financial advisor to contact certain financial buyers to assess their interest in a potential transaction.<sup>165</sup> The board also decided not to contact strategic bidders based on the board’s analysis of those potential bidders’ willingness to engage in an acquisition with RehabCare as well as the board’s concern at sharing confidential information with competitors.<sup>166</sup>

Starting on October 1, 2010, CGMI contacted nine financial buyers, including parties referred to as Party A and Party B in the SEC disclosures.<sup>167</sup> The financial buyers “were selected based on their experience in the healthcare industry and their ability to finance a transaction of this size.”<sup>168</sup> Of the nine, eight executed confidentiality and standstill agreements preventing those parties from making unsolicited offers for RehabCare.<sup>169</sup> At the end of October, Kindred expressed an interest in engaging in a transaction but it did not formally submit a bid, Party A submitted a preliminary offer in a price range of

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<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

\$25.00 to \$27.00 per share and, on November 1, 2010, Party B submitted a preliminary offer at a price of \$27.00 to \$30.00 per share.<sup>170</sup> The other financial buyers did not submit offers and withdrew from the sales process.<sup>171</sup> The next day, the RehabCare board met and determined to not pursue discussions with either Party A or Party B, whose offers were insufficient.<sup>172</sup> On November 4, 2010, Kindred's CEO called RehabCare's CEO and expressed an interest in an all cash acquisition of RehabCare at a price range between \$32 and \$34 per share.<sup>173</sup> A couple of weeks later, Kindred and RehabCare entered into a confidentiality agreement, including reciprocal standstill provisions.<sup>174</sup> Discussions and due diligence continued through December.<sup>175</sup> On December 28, 2010, Kindred submitted a written offer of \$32.00 per share, payable \$27.00 in cash and \$5.00 in Kindred common stock.<sup>176</sup> RehabCare's board met and determined it would not accept Kindred's offer, viewing it as inadequate.<sup>177</sup>

About a week later, Kindred increased its offer price to \$35.00 per share.<sup>178</sup> Under the revised offer, \$26.00 was payable in cash and \$9.00 was payable in Kindred common stock.<sup>179</sup> The parties executed a merger agreement on February 7, 2011.<sup>180</sup> Following the merger announcement, a number of RehabCare stockholders brought class action suits against the RehabCare directors and Kin-

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<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

dred.<sup>181</sup> Those suits were consolidated and, on May 12, 2011, the parties reached a memorandum of understanding regarding a settlement.<sup>182</sup>

Under the settlement, the RehabCare and Kindred completely eliminated matching rights from the agreement, reduced their termination fee by 50 percent, and issued supplemental disclosures.<sup>183</sup> More importantly for purposes of this Article, they waived existing standstill provisions” and “sent letters to a number of financial sponsors waiving [the] provisions.”<sup>184</sup> The only issue before the court was the legal fees for the plaintiff’s counsel.<sup>185</sup> With respect to the DADW standstills, Vice Chancellor Laster commented as follows:

I do think it is weird that people persist in the "agree not to ask" in the standstill. When is that ever going to hold up if it's actually litigated, particularly after Topps? It's just one of those things that optically looks bad when you're reviewing the deal facts. It doesn't give you any ultimate benefit because you know that the person can get a Topps ruling making you let them ask, minimum, or can ask in a back channel way. Why would you hurt yourself in terms of the optics by asking for that? One of those strange things in life.<sup>186</sup>

Hence, at least in Vice Chancellor Laster’s opinion, even in the context of a more thorough sales process compared

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<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *In re Rehabcare Group, Inc. S’holders Litig.*, C.A. No. 6197-VCL, at 4 (Del. Ch. Sept. 8, 2011).

<sup>185</sup> *Id.*

<sup>186</sup> *Id.* at 46.

to the sales process conducted in *Topps*, DADW standstills may not be upheld during the pre-closing period.

## 2. *Celera and the Pre-Closing Period “Informational Vacuum”*

Several months after Vice Chancellor Laster’s statement in *RehabCare*, Vice Chancellor Donald F. Parsons, Jr. addressed a similar DADW standstill also in the context of a class action settlement, in *In re Celera Corp. Shareholder Litigation*. The roots of that case began in November 2009 when the board of directors of Celera Corporation, a healthcare company with three primary business units, started to consider potential strategic transactions for the company.<sup>187</sup> In early February, the Celera board instructed its financial advisor, Credit Suisse Securities (USA) LLC, and Celera senior management to engage in discussions with potential buyers regarding a sale of the whole company, its individual assets, or business units.<sup>188</sup> Credit Suisse and Celera’s CEO “contacted nine potential bidders, five of which performed at least some measure of due diligence on the Company by April 2010: (1) Illumina, Inc.; (2) Inverness Medical Innovations, Inc.; (3) Laboratory Corporation of America Holdings; (4) Qiagen, N.V.; and (5) Quest.<sup>189</sup> Each of the five companies who performed due diligence executed a confidentiality agreement containing a standstill preventing them from “making offers for Celera shares without an express invitation from the Board.”<sup>190</sup> The confidentiality agreements also included “a broadly worded provision

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<sup>187</sup> *In re Celera Corp. S’holder Litig.*, Civ. Action No. 6304-VCP, 3, 5 (Del. Ch. Mar. 23, 2012).

<sup>188</sup> *Id.* at 5-6.

<sup>189</sup> *Id.* at 6.

<sup>190</sup> *Id.*

preventing the signing parties from asking the Board to waive this restriction (the ‘[DADW] Standstills’).<sup>191</sup>

In mid-April, Quest made a nonbinding preliminary offer to acquire the company as a whole for \$10 cash per share.<sup>192</sup> Quest’s offer was conditioned on the execution of several employment agreements with Celera’s “key personnel” including the CEO.<sup>193</sup> In addition to the Quest offer, other parties made “lesser offers” and “one indication of interest from ‘Bidder C’” to acquire the company’s products division.<sup>194</sup> Following negotiations with Celera’s special committee, which was formed to oversee the sales process, on June 25 Quest increased its offer by 25 cents to \$10.25 per share.<sup>195</sup> The special committee determined \$10.25 was acceptable and authorized the CEO to negotiate her employment agreement with Quest.<sup>196</sup> However, after meeting with the CEO, Quest “withdrew from the merger citing the potential effects” of a negative study on one of Celera’s drugs, KIF6, that Quest learned of during negotiations with the CEO as well as “concerns regarding retention of the Company’s management following the consummation of the proposed transaction.”<sup>197</sup> Throughout the remaining six months of 2010, Celera continued to pursue strategic transactions but “no serious suitors emerged.”<sup>198</sup> During those six months, “Celera’s business was deteriorating, due in part to the publication of the negative KIF6 study in October.”<sup>199</sup>

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<sup>191</sup> *Id.*

<sup>192</sup> *Id.* at 7.

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> *Id.* at 7-8.

<sup>198</sup> *Id.*

<sup>199</sup> *Id.*

On January 27, 2011, Quest submitted an offer of \$7.75 per share to acquire Celera.<sup>200</sup> A few days later, Celera rejected an offer from Bidder C to acquire the company's products division, instead choosing to focus on the Quest offer.<sup>201</sup> Negotiations proceeded with Quest and eventually, in mid-February, Quest and Celera entered into a merger agreement.<sup>202</sup> Under the agreement, Quest would commence a twenty-day tender offer for Celera common stock at \$8 per share.<sup>203</sup> The agreement contained a no shop provision requiring Celera "to end any existing discussions, and not to solicit competing offers from, potential bidders other than Quest."<sup>204</sup> The agreement also contained a termination fee amounting to 3.5% of the transaction value, "but arguably as much as 10% of Celera's enterprise value."<sup>205</sup>

Following the merger announcement, a Celera shareholder brought suit alleging that the Celera board had breached its fiduciary duties by executing an agreement with Quest.<sup>206</sup> Celera and Quest negotiated a settlement with the lead plaintiff pursuant to which the termination fee would be reduced from \$23.45 million to \$15.6 million and the no shop provision would be amended so that bidders subject to the DADW provision of the standstill would be invited to submit bids.<sup>207</sup>

Vice Chancellor Donald F. Parsons, Jr. issued an opinion upholding the settlement agreement.<sup>208</sup> In the decision, Parsons stated he was not proclaiming DADW

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<sup>200</sup> *Id.* at 8.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.* at 17-19.

<sup>203</sup> *Id.* at 12.

<sup>204</sup> *Id.* at 13.

<sup>205</sup> *Id.*

<sup>206</sup> *Id.* at 15.

<sup>207</sup> *Id.*

<sup>208</sup> *Id.* at 54.



standstills unenforceable.<sup>209</sup> Moreover, Parsons recognized DADW standstills are prevalent in today's M&A world and stated that any opinion declaring such provisions unenforceable could only be made on an "appropriately developed record."<sup>210</sup> At the same time, Parsons stated the "[p]laintiffs have at least a colorable argument that these constraints collectively operate to ensure an informational vacuum."<sup>211</sup> Once the board is in an "informational vacuum," it would not have any information pursuant to which it could evaluate whether continuing to comply with the merger agreement terms would violate the board's fiduciary duties.<sup>212</sup> Thus, he explained, "[c]ontracting into such a state could constitute a breach of fiduciary duty."<sup>213</sup> Following Vice Chancellor Parsons' thought process it is difficult to imagine a DADW standstill that would not have the effect of placing the board in a change of control transaction in the same "informational vacuum."

### *3. Genomics and the Invalidity of DADW Standstills Preventing Even Private Indications of Interest*

A little over a year after considering the Rehabcare deal and opining on DADW standstills, Vice Chancellor Laster was given a better opportunity when the issue was placed squarely before him. On November 27, 2012, Vice Chancellor Laster issued a bench ruling in which he enjoined the enforcement of a DADW standstill—without any suggestion that the sales process was inadequate or

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<sup>209</sup> *Id.*

<sup>210</sup> *Id.*

<sup>211</sup> *Id.* at 53.

<sup>212</sup> *Id.* at 54.

<sup>213</sup> *Id.*

that a party restrained by the standstill desired to make a bid.<sup>214</sup>

The DADW standstill at issue was entered into by Complete Genomics and a third party during a sales process that began in May 2012.<sup>215</sup> During the process, forty-two parties were contacted and nine parties expressed interest and signed confidentiality agreements.<sup>216</sup> After receiving six proposals, the Complete Genomics board narrowed the field to two parties.<sup>217</sup> One of those parties, Party H, withdrew after the board declined its request for exclusivity.<sup>218</sup> The board continued to negotiate with the remaining bidder, BGI, and was able to reach a deal in September.<sup>219</sup> Party H later reentered the picture, uninhibited by any standstill provision, and submitted another bid on November 5.<sup>220</sup> However, the Complete Genomics board concluded that the bid, which only represented a 5% premium and carried greater antitrust concerns, did not constitute a superior proposal.<sup>221</sup> The injunction issued by Vice Chancellor Laster pertained to the DADW standstill entered into by Party J, who had only participated briefly in the sales process.<sup>222</sup> Party J's first expres-

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<sup>214</sup> Telephonic Oral Argument and the Court's Ruling, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

<sup>215</sup> Complete Genomics, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Sep. 25, 2012).

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> Telephonic Oral Argument and the Court's Ruling at 22-23, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012).

<sup>221</sup> *Id.*

<sup>222</sup> Telephonic Oral Argument and the Court's Ruling at 13, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No.

sion of interest came only a few weeks prior to July 31, the date which final proposals were due from Party H and BGI.<sup>223</sup> Although late to join, Party J was held to the same deadline.<sup>224</sup> However, on August 2 Party J indicated that it was not interested in pursuing a transaction, and had no further communications with the Complete Genomics board prior to the issuance of the preliminary injunction.<sup>225</sup> Party J neither sought the injunction nor was involved in the litigation.<sup>226</sup>

In the ruling, Vice Chancellor Laster started by analogizing bidder-specific no-talk clauses, which were invalidated in *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*,<sup>227</sup> to DADW standstills reasoning that both can similarly disable a board from making a reasonably informed decision.<sup>228</sup> While not ruling that DADW standstills were invalid per se, the fact that Complete Genomics had rec-

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7888-VCL (Del. Ch. Nov. 27, 2012); Complete Genomics, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Sep. 25, 2012).

<sup>223</sup> Complete Genomics, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Sep. 25, 2012).

<sup>224</sup> *Id.*

<sup>225</sup> Complete Genomics, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Dec. 7, 2012).

<sup>226</sup> Gary E. Thompson & Steven M. Haas, *The State of M&A Standstills In Delaware*, Hunton & Williams Client Alert (Jan. 2013), available at

[http://www.hunton.com/files/News/b91c8716-e69d-4ef1-b510-](http://www.hunton.com/files/News/b91c8716-e69d-4ef1-b510-c3810f99af9d/Presentation/NewsAttachment/ee1368dafab8-489e-9652-c3a423539c68/DE_MA_Standstill_Agreements.pdf)

[c3810f99af9d/Presentation/NewsAttachment/ee1368dafab8-489e-9652-](http://www.hunton.com/files/News/b91c8716-e69d-4ef1-b510-c3810f99af9d/Presentation/NewsAttachment/ee1368dafab8-489e-9652-c3a423539c68/DE_MA_Standstill_Agreements.pdf)

[c3a423539c68/DE\\_MA\\_Standstill\\_Agreements.pdf](http://www.hunton.com/files/News/b91c8716-e69d-4ef1-b510-c3810f99af9d/Presentation/NewsAttachment/ee1368dafab8-489e-9652-c3a423539c68/DE_MA_Standstill_Agreements.pdf)

<sup>227</sup> *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, C.A. No. 17398 (Del. Ch. Sep. 27, 1999).

<sup>228</sup> Telephonic Oral Argument and the Court's Ruling at 14-18, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

ommended the BGI transaction was influential in the decision.<sup>229</sup> Laster reasoned that the Complete Genomics board precluded the possibility of providing a current and candid recommendation through the DADW standstill agreement because it prevented the flow of information from Party J.<sup>230</sup> He found the agreement essentially embodied one to breach the duty of care to be informed of all material information necessary to make a reasonably informed recommendation.<sup>231</sup> Quoting section 193 of the Restatement of Contracts, Vice Chancellor Laster found a reasonable probability that the DADW standstill provision “represents a promise by a fiduciary to violate its fiduciary duty, or represents a promise that tends to induce such a violation.”<sup>232</sup>

Turning to the requirement of irreparable harm, he found that the situation could not be remedied even in absence of a bid from Party J, who would be required to “cavalierly breach its own promise” to present such a harm.<sup>233</sup> Harking back to bidder-specific no-talk clauses, the harm existed because incoming information from bidders would be prevented under any circumstance, regardless of whether Party J breached the standstill.<sup>234</sup> Thus, his concern focused on the harm caused by the board’s act of pre-emptively preventing communication altogether, not the harm that could result from another party being unable to bid.<sup>235</sup> Vice Chancellor Laster supported his reasoning by adding that a topping bid, presumably from Party H, was present but also went on to say that the rea-

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<sup>229</sup> *Id.* at 16-18.

<sup>230</sup> *Id.* at 18.

<sup>231</sup> *Id.*

<sup>232</sup> *Id.*

<sup>233</sup> *Id.* at 20.

<sup>234</sup> *Id.* at 23.

<sup>235</sup> *Id.*

soning would apply in absence of a topping bid.<sup>236</sup> Reflecting these concerns, the scope of the preliminary injunction only sought to ensure that the channels of communication were not closed: the order invalidated the provision of the standstill to the extent that it prevented Party J from making private requests for permission to submit bids and had no effect on such public communications.<sup>237</sup>

#### 4. *Ancestry.com and Legitimate Use of DADW Standstills for Value Maximizing Purposes*

Less than three weeks after Vice Chancellor Laster ruled on DADW standstills in *Complete Genomics*, Chancellor Strine weighed in, although expressing a very different view on the issue. In *Ancestry.com*, Chancellor Strine was critical of the manner in which the board used the DADW standstill, but otherwise sanctioned their general use as an auction tool for value-maximization purposes.<sup>238</sup>

The Ancestry.com sales process began in January 2012 when Party A, a private equity firm, contacted a representative of Spectrum Equity Investors to learn more about the company.<sup>239</sup> Spectrum, also a private equity firm, had made a minority investment in Ancestry.com in 2003, later partnered with management to purchase a majority interest, and helped to take the company public in 2009.<sup>240</sup> As of October 25, 2012, Spectrum owned a

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<sup>236</sup> *Id.*

<sup>237</sup> Complete Genomics, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Dec. 7, 2012).

<sup>238</sup> The Court's Ruling on Plaintiffs' Motion for Preliminary Injunction, *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

<sup>239</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>240</sup> Greg Roumeliotis & Nadia Damouni, *Ancestry in sale talks with three buyout firms: sources*, REUTERS (Sep. 10,

30.7% stake in Ancestry.com.<sup>241</sup> In February of 2012, the Ancestry.com board was informed of the potential interest expressed by Party A and decided to explore engaging a financial advisor.<sup>242</sup> On March 16, the board authorized discussions with Party A, subject to entry into a confidentiality agreement, which was executed by Party A later that day.<sup>243</sup> After meeting with Party A, a representative of Party A indicated an interest in exploring a transaction for a price between \$30 and \$32 a share.<sup>244</sup> The board determined to perform a market check to evaluate the indication of interest from Party A.<sup>245</sup>

On April 22, a representative of private equity firm Permira Funds contacted Ancestry.com management to discuss a potential transaction.<sup>246</sup> On May 15, the board formally approved Qatalyst as its financial advisor and authorized Qatalyst to begin conducting outreach to potential bidders.<sup>247</sup> From May 15 to May 24, Qatalyst contacted four potential strategic bidders and eight private equity firms including Party A and Permira.<sup>248</sup> On May 17, Permira executed a confidentiality agreement.<sup>249</sup> On May 21, Party C, also a private equity firm, executed a

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2012, 5:45 PM),  
<http://www.reuters.com/article/2012/09/10/us-ancestry-buyout-idUSBRE88915L20120910>.

<sup>241</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

<sup>244</sup> *Id.*

<sup>245</sup> *Id.*

<sup>246</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>247</sup> *Id.*

<sup>248</sup> *Id.*

<sup>249</sup> *Id.*

confidentiality agreement.<sup>250</sup> Party B and Party D, potential strategic acquirers, both declined to participate in the sales process.<sup>251</sup> On May 30 and 31, four additional private equity firms, Parties E, F, G, and H executed confidentiality agreements.<sup>252</sup> On June 6, Bloomberg News reported that Ancestry.com had retained Qatalyst as a financial advisor.<sup>253</sup> On June 14, Party J, a private equity firm, executed a confidentiality agreement.<sup>254</sup> Two potential strategic acquirers executed confidentiality agreements: Party I on June 4 and Party L on July 11, but neither ever submitted a proposal.<sup>255</sup>

On June 18, Party A reaffirmed its purchase price range \$31 to \$34 per share.<sup>256</sup> During the week of June 20 certain parties, all private equity firms, submitted preliminary proposals pursuant to a June 9 process letter.<sup>257</sup> Purchase prices ranged from \$31-\$38.<sup>258</sup> After the Ancestry.com board met to discuss proposals, Qatalyst notified the lowest bidders Party A, Party F, and Party H that they would not be invited to continue in the process.<sup>259</sup> Party G dropped out of the sales process on July 9.<sup>260</sup>

Party K, a private equity firm that first expressed interest on June 13, indicated a price range of \$33 to \$35 on June 25, and executed a confidentiality agreement on

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<sup>250</sup> *Id.*

<sup>251</sup> *Id.*

<sup>252</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>253</sup> *Id.*

<sup>254</sup> *Id.*

<sup>255</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>260</sup> *Id.*

June 28.<sup>261</sup> After a July 9 meeting, the board determined to invite Party C, Party J, and Permira to submit final bids.<sup>262</sup> However, on August 2 Party J ceased due diligence efforts, after substantially lowering its valuation range.<sup>263</sup> On July 24, an article was published in the New York Times reporting that Ancestry.com was possibly going private.<sup>264</sup> On August 6, Party C also lowered its valuation based on its due diligence, indicating a \$31 price as the sole equity sponsor and \$32 with a substantial equity partner.<sup>265</sup> On August 7, Permira followed suit, lowering its price to \$33 per share, contingent on an additional equity partner.<sup>266</sup>

The Ancestry.com board had several meetings over the next few weeks to discuss alternatives, including re-engaging Party A, who remained interested in pursuing a transaction, either as the sole purchaser or through a partnership with Permira.<sup>267</sup> Believing that a collaboration between Party A and Permira would lower Party A's standalone bid, the board authorized Permira and Party C to begin discussions.<sup>268</sup> However, the joint proposal from Permira and Party C was returned at a price of \$30 per share.<sup>269</sup> Party A later indicated that based on further due diligence, it would only be able to offer \$28 per

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<sup>261</sup> *Id.*

<sup>262</sup> *Id.*

<sup>263</sup> *Id.*

<sup>264</sup> *Id.*

<sup>265</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>266</sup> *Id.*

<sup>267</sup> *Id.*

<sup>268</sup> *Id.*

<sup>269</sup> *Id.*



share.<sup>270</sup> On September 10, Reuters published a story on the sales process.<sup>271</sup>

Over the next few weeks, the board told Party C that an offer at \$30 would not be acceptable and focused on assisting Permira with additional financing strategies.<sup>272</sup> On October 2, Bloomberg news published an additional report on the sales process.<sup>273</sup> The report discussed the difficulties seen in reaching a price, noting that private equity firms on both sides of the deal created tension and that Spectrum likely needed to sell to satisfy investment exit requirements typically imposed on private equity firms.<sup>274</sup> On October 3, Permira submitted a proposal for \$31 per share.<sup>275</sup> After further negotiations, Permira raised its bid to \$32, stating that it would not go any higher.<sup>276</sup> After making additional modifications, the merger agreement was executed on October 21.<sup>277</sup>

Litigation was filed challenging the propriety of the DADW standstills used in the process that were not previously mentioned in the SEC filings.<sup>278</sup> Ancestry.com reacted on December 11 and sent letters waiving the DADW provisions to allow parties to request standstill waivers.<sup>279</sup>

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<sup>270</sup> *Id.*

<sup>271</sup> *Id.*

<sup>272</sup> *Id.*

<sup>273</sup> *Id.*

<sup>274</sup> *Permira Back in Talks to Acquire Ancestry.com*, BLOOMBERG TV (Oct. 12), [http://www.bloomberg.com/video/perima-back-in-talks-to-acquire-ancestry-com-5FK0Ir\\_wSSiz6N8SAZA\\_WQ.html](http://www.bloomberg.com/video/perima-back-in-talks-to-acquire-ancestry-com-5FK0Ir_wSSiz6N8SAZA_WQ.html).

<sup>275</sup> Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012).

<sup>276</sup> *Id.*

<sup>277</sup> *Id.*

<sup>278</sup> Ancestry.com Inc., Current Report (Form 8K) (Dec. 19, 2012).

<sup>279</sup> *Id.*

On December 17, Chancellor Strine issued his ruling.<sup>280</sup> Strine was careful to take a fact based approach and not make a per se ruling, noting the limited precedential value of bench rulings generally before discussing *Complete Genomics* and *Celera*.<sup>281</sup> Strine contemplated that DADW standstills could be used consistently with a board's fiduciary duties, but only when used for a particular value-maximizing purpose.<sup>282</sup> More specifically, he stated that the "purpose has to be to allow the seller as a well-motivated seller to use it as a gavel, to impress upon the people that it has brought into the process the fact that the process is meaningful; that if you're creating an auction, there is really an end to the auction for those who participate."<sup>283</sup>

Strine went on to find that, had the board not waived the DADW provisions, it would not have been using the DADW standstill for a specific value-maximizing purpose because it was not used in the manner he set forth.<sup>284</sup> In fact, the Ancestry.com board and CEO were not even aware of the clause or its potency and it was not clear whether Qatalyst was informed either.<sup>285</sup> In light of the waiver, Strine's order merely required disclosure of the circumstances surrounding the use and waiver of the DADW provision.<sup>286</sup>

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<sup>280</sup> The Court's Ruling on Plaintiffs' Motion for Preliminary Injunction, *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

<sup>281</sup> *Id.* at 20-22 ("And the *Celera* case expressly went out of its way to say it's not making a per se rule. I think what *Genomics* and *Celera* both say, though, is Woah, this is a pretty potent provision.").

<sup>282</sup> *Id.* at 23.

<sup>283</sup> *Id.*

<sup>284</sup> *Id.* at 24-26.

<sup>285</sup> *Id.* at 24-25.

<sup>286</sup> *Id.* at 26.

5. *The Potentially Erosive Effects of Standstills on Value Maximization During the Pre-Closing Period*

In addition to the potential informational vacuum and communication issues caused by standstills pre-closing, if used improperly, standstills may have other potentially erosive effects on value maximization. For example, as Chancellor Strine recognized in *Topps*, target boards can use standstills to favor a “winning” bidder over others.<sup>287</sup> In addition, “winning” bidders will generally advocate for strict standstills as a form of deal protection device that can preclude “losing” bidders from any participation after signing.<sup>288</sup> Both of these scenarios became a reality in the 2012 sale of Great Wolf Resorts.

The sale of Great Wolf began in January 2011 when various private equity groups and potential strategic buyers approached Great Wolf representatives expressing interest in a potential transaction.<sup>289</sup> Between January and June, the company entered into five confidentiality agreements with strategic and financial parties, including Apollo.<sup>290</sup> At a June 22 meeting, the Great Wolf board began a more formal strategic review process and instructed its legal advisor “to review the five confidentiality agreements previously entered into with potential bidders and to negotiate amendments to such agreements as appropriate given the Company’s defensive profile.”<sup>291</sup> Following the meeting, Great Wolf revised several confidentiali-

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<sup>287</sup> *In re Topps*, 926 A.2d at 91.

<sup>288</sup> *Id.*

<sup>289</sup> Great Wolf Resorts, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Mar. 13, 2012).

<sup>290</sup> *Id.*

<sup>291</sup> *Id.*

ty agreements to include standstill provisions “for the protection of Great Wolf.”<sup>292</sup>

On July 27, Great Wolf’s Strategic Review Committee authorized Deutsche Bank to begin a formal process, and approximately 38 potential bidders, including strategic and financial parties, were contacted.<sup>293</sup> Deutsche Bank distributed confidentiality agreements to approximately 33 parties interested in a strategic transaction.<sup>294</sup> Between July 27 and December 23, Great Wolf entered into confidentiality agreements with 11 additional parties, including parties referred to in SEC filings as Party N and Party J, and continued to amend previously executed confidentiality agreements to include more restrictive standstill covenants.<sup>295</sup> Of particular note is that the Apollo-Great Wolf standstill remained far less restrictive than any agreement entered into by Great Wolf.<sup>296</sup>

As the sales process progressed, the field was narrowed to Party N, Party J, and Apollo.<sup>297</sup> After evaluating proposals, Great Wolf agreed to an exclusivity agreement with Apollo Management (the “Exclusivity Agreement”) on December 21 based largely on financing considerations and the fact that Apollo had conducted greater due diligence.<sup>298</sup> Yet, much additional negotiation was needed, and several successive extensions of exclusivity occurred before Great Wolf accepted an offer from Apollo priced at \$5 per share.<sup>299</sup> On March 12, 2012, the transaction, structured as a tender offer, was approved and executed

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<sup>292</sup> *Id.*

<sup>293</sup> *Id.*

<sup>294</sup> *Id.*

<sup>295</sup> Great Wolf Resorts, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Apr. 25, 2012).

<sup>296</sup> *Id.*

<sup>297</sup> *Id.*

<sup>298</sup> *Id.*

<sup>299</sup> *Id.*

by Apollo and Great Wolf.<sup>300</sup> The next day and also the very same day the transaction was publicly announced, Apollo commenced the tender offer, which was only scheduled to be open for 21 business days.<sup>301</sup>

The definitive agreement provided a strong deal protection scheme for Apollo.<sup>302</sup> The definitive agreement contained a no-shop provision and provided Great Wolf would not “terminate, waive, amend, modify or fail to enforce any existing standstill or confidentiality obligations owed by any Person to the Company or any of its Subsidiaries,” subject to limited exceptions.<sup>303</sup> Under the no-shop, Great Wolf was only permitted to entertain unsolicited bona fide written takeover proposals.<sup>304</sup> Great Wolf also agreed to “immediately cease and cause to be terminated any discussions or negotiations with any parties that may be ongoing with respect to any Takeover Proposal as of the date

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<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> Great Wolf Resorts, Inc., Current Report (Form 8-K), §1.5 (Mar. 13, 2012). The deal provisions included an irrevocable top up option giving Apollo the right, if it were to acquire over 50% of Great Wolf shares in the tender offer, to purchase enough new Great Wolf shares at \$5.00 to obtain 90% ownership to accomplish a short-form merger and a poison pill that would be triggered if any party other than Apollo accumulated more than 12.5% of Great Wolf’s shares. *Id.* Additionally, the deal allowed for \$7 million in total termination fees (as opposed to Apollo’s previously proposed \$30 million termination fee) and, in the event that a bidder should be able to overcome these obstacles, Apollo was granted matching rights. Great Wolf Resorts, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Mar. 13, 2012).

<sup>303</sup> Great Wolf Resorts, Inc., Current Report (Form 8-K, Exhibit 2.1), §6.5 (Mar. 13, 2012).

<sup>304</sup> *Id.*

of the Merger Agreement.”<sup>305</sup> In combination, the deal protections and reinforced standstill—created through an agreement made to the exclusion of the other parties—ensured that losing bidders would not even think about a bid.

After the merger announcement, Great Wolf’s shares began to trade well above the \$5 offer price from Apollo, shareholders began to publicly criticize the deal, and several lawsuits were filed.<sup>306</sup> Thereafter on April 4, despite Apollo’s iron-clad deal protection scheme, Great Wolf confirmed by press release the receipt of an unsolicited bid from KSL Capital Partners at a price of \$6.25 per share.<sup>307</sup> On April 5, in accordance with the definitive agreement, KSL and Great Wolf entered into a confidentiality agreement.<sup>308</sup> However, that agreement waived the standstill provisions with respect to the April 4 KSL Proposal and any future favorable proposals from KSL.<sup>309</sup> A bidding war ensued between Apollo and KSL until Apollo delivered the last blow with a \$7.85 offer, and an increase in termination fees to \$10.467 million, to which Apollo and Great Wolf agreed on April 20.<sup>310</sup>

The \$7.85 offer price represented a premium of 171% to the six-month average of Great Wolf’s share price prior to the announcement of Apollo’s original offer on March 12, 2012, a premium of 136% over the ninety-day average of Great Wolf’s share price prior to the announcement of the original offer, and a premium of 87% over Great Wolf’s

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<sup>305</sup> *Id.*

<sup>306</sup> Great Wolf Resorts, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Apr. 9, 2012).

<sup>307</sup> *Id.*

<sup>308</sup> *Id.*

<sup>309</sup> *Id.*

<sup>310</sup> Great Wolf Resorts, Inc., Current Report (Form 8-K, Exhibit 99.1) (Apr. 23, 2012).

closing stock price on the day prior to the announcement of the original offer.<sup>311</sup>

On April 25, an agreement in principle was reached in the litigation.<sup>312</sup> In connection with the settlement, Great Wolf agreed to make certain disclosures in its SEC filings and waive the standstill provisions with certain parties, including Party N, solely for the purpose of allowing those parties to deliver a confidential unsolicited bona fide written takeover proposal.<sup>313</sup> In addition to exposing the details of the standstill agreements and the poison pill mentioned earlier, the disclosures required by the settlement revealed that during the process Deutsche Bank may have had a material conflict of interest and Great Wolf may have been aware.<sup>314</sup> Luckily for the Great Wolf shareholders, the favorable treatment of Apollo, that granted excessive deal protections facilitated by the use of a standstill, did not ultimately prevent the highest offer from being made.

*C. Hollywood Video & the Potential Detrimental Impact of Standstills During Pre-Closing Market Checks*

In the context of a post-signing market check, the potential detrimental impact of requiring over-bidders to execute the same constrictive standstill to which the initial acquirer is subject may be best illustrated by events surrounding the sale of Hollywood Video. On December 10, 2003, the Hollywood board met to discuss strategic options after Mark Wattles, the founder, chairman, CEO, and second largest shareholder of Hollywood Entertainment, had been informed of various private equity firms

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<sup>311</sup> *Id.*

<sup>312</sup> Great Wolf Resorts, Inc., Solicitation, Recommendation Statements (Form SC 14D9) (Apr. 25, 2012).

<sup>313</sup> *Id.*

<sup>314</sup> *Id.*

that could potentially acquire Hollywood, including Leonard Green & Partners (LGP).<sup>315</sup> Wattles met with LGP, negotiations continued over the following weeks, and LGP signed a non-disclosure agreement containing a three-year standstill provision.<sup>316</sup> On February 19, 2004, LGP submitted a formal proposal to acquire 100% of Hollywood's stock for \$13 per share in cash.<sup>317</sup>

The following day, the Special Committee rejected the \$13 price as inadequate and decided not to solicit additional bidders, fearing the risks of material non-public information leaks or a failed transaction.<sup>318</sup> LGP then raised its offer to \$13.50 per share and proposed several ancillary agreements with Wattles.<sup>319</sup> After negotiations over the ancillary agreements, LGP raised its offer to \$14 per share and the merger agreement was executed on March 28.<sup>320</sup>

The merger agreement contained a no-shop provision with a fiduciary out.<sup>321</sup> Litigation ensued, resulting in a settlement requiring additional disclosures in the proxy statements, a reduction of the termination fee from \$26.5 million to \$21.2 million, and that Wattles' shares would not be counted in voting on the merger.<sup>322</sup> After LGP expressed doubt about whether the financing condition of the merger agreement could be satisfied, the merger agreement was amended on October 13 to reduce the

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<sup>315</sup> Hollywood Entertainment Corp., Preliminary Proxy Statement (Form PREM14A) (Apr. 23, 2004).

<sup>316</sup> *Id.*

<sup>317</sup> *Id.*

<sup>318</sup> *Id.*

<sup>319</sup> *Id.*

<sup>320</sup> *Id.*

<sup>321</sup> *Id.*

<sup>322</sup> Hollywood Entertainment Corp., Current Report (Form 8-K) (Jul. 8, 2004).



price from \$14 to \$10.25, and eliminate the termination fee and no shop provision.<sup>323</sup>

Beginning the week of October 25, UBS contacted 25 potential financial buyers and 12 potential strategic buyers, including Movie Gallery and Blockbuster.<sup>324</sup> On October 28, Movie Gallery requested confidential information.<sup>325</sup> To access confidential information, the amended merger agreement required bidders to enter into a confidentiality agreement no less favorable to Hollywood than the one entered into by LGP, which contained a three-year standstill.<sup>326</sup> Movie Gallery initially objected to the standstill provision.<sup>327</sup> On October 29, Blockbuster also requested confidential information..<sup>328</sup>

On November 2, Blockbuster delivered an all-cash proposal at \$11.50 per share. but also indicated that it was unwilling to enter into a standstill with a three-year term.<sup>329</sup> Movie Gallery first unsuccessfully sought to revise the standstill term from three years to one year, but on November 19, inexplicably entered into a confidentiality agreement identical to the agreement between Hollywood and LGP with a three-year standstill.<sup>330</sup> On December 1, Movie Gallery increased its offer to \$13.25 cash.<sup>331</sup> Blockbuster later issued a press release confirming it was interested and able to raise its offer, subject to elimination of the standstill.<sup>332</sup>

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<sup>323</sup> Hollywood Entertainment Corp., Preliminary Revised Proxy Statement (Form PRER14A) (Oct. 27, 2004).

<sup>324</sup> Hollywood Entertainment Corp., Preliminary Proxy Statement (Form PREM14A) (Jan. 26, 2005).

<sup>325</sup> *Id.*

<sup>326</sup> *Id.*

<sup>327</sup> *Id.*

<sup>328</sup> *Id.*

<sup>329</sup> *Id.*

<sup>330</sup> *Id.*

<sup>331</sup> *Id.*

<sup>332</sup> *Id.*

A Special Committee meeting was held a few days later to consider LGP's indication that it would waive the obligation under the merger agreement to include a standstill provision.<sup>333</sup> The Special Committee concluded that including a standstill for all bidders would yield the highest possible price by encouraging bidders to submit their best offers during the market check process, knowing that they would be precluded from making a later bid.<sup>334</sup> It further, concluded that the standstill assured bidders that the process would be fair to all involved and refused to eliminate the standstill provision.<sup>335</sup>

Blockbuster again issued a press release reiterating its unwillingness to enter into a three-year standstill and on December 28, Blockbuster announced it would commence a tender offer for Hollywood at \$11.50 cash per share.<sup>336</sup> On January 10, 2005, Hollywood announced it had terminated the LGP agreement and entered into an agreement with Movie Gallery.<sup>337</sup> On February 2, Blockbuster raised its tender offer to a price of \$14.50 per share, comprised of \$11.50 cash and \$3 stock.<sup>338</sup> However, on March 25 Blockbuster announced it would no longer pursue the tender offer..<sup>339</sup>

Had Blockbuster been brought into the market check process, its presence might have pressured a bidding war between strategic rivals.. After the Blockbuster bid received backing from Carl Icahn, Wattles stated, "A strategic buyer can afford to pay more for this company than a

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<sup>333</sup> *Id.*

<sup>334</sup> *Id.*

<sup>335</sup> *Id.*

<sup>336</sup> *Id.*

<sup>337</sup> *Id.*

<sup>338</sup> Hollywood Entertainment Corp., Solicitation, Recommendation Statements (Form SC 14D9) (Feb. 17, 2005).

<sup>339</sup> Hollywood Entertainment Corp., Current Report (Form 8-K) (Apr. 1, 2005).

financial buyer and I am a financial buyer.”<sup>340</sup>A three year standstill, as Scott Keller, president of Dealanalytics.com stated, is “highly unusual,” and “[o]ne year is the norm.”<sup>341</sup>

The imposition of onerous standstills like the one in Hollywood Video is not unique in the M&A world. Although they are common, as the next section details, the imposition of such standstills is potentially detrimental to shareholders in a sale of corporate control and is contrary to auction theory principles.

#### IV. BALANCING FRIENDS AND FOES IN A SALE OF CORPORATE CONTROL

In most corporate transactions, the parties on both sides of the negotiating table use contracts to manage and balance risks. In the context of M&A transactions, standstills are one of the main contractual tools used to balance risks inherent in the sale process. Namely, target boards

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<sup>340</sup> Jonathan Berr, Blockbuster Says Hollywood Offer Faces ‘Difficulty’, Bloomberg (Dec. 22, 2004, 16:46), *available at* Blockbuster Inc., Current Report (Form 8-K, Exhibit 99.1) (Dec. 23, 2004).

<sup>341</sup> Jonathan Berr, Blockbuster Says Hollywood Offer Faces ‘Difficulty’, Bloomberg (Dec. 22, 2004, 16:46), *available at* Blockbuster Inc., Current Report (Form 8-K, Exhibit 99.1) (Dec. 23, 2004). The three-year standstill requirement imposed on subsequent bidders stemmed from the original agreement with LGP, when LGP and Wattles were going to buy Hollywood together. Hollywood Entertainment Corp., Preliminary Proxy Statement (Form PREM14A) (Apr. 23, 2004). Wattles was to continue serving as CEO and remain a substantial equity investor in the surviving company. *Id.* The contemplated employment agreement between Wattles and LGP was to terminate on the *third* anniversary of the merger. Hollywood Entertainment Corp., Schedule 13E-3 (Form SC 13E3, Exhibit 99.D4) (Apr. 23, 2004).

use standstills legitimately to control the sale process to ensure friendly bidders remain friendly and do not become foes that preempt the process. However, in the context of a change of control transaction, standstills also potentially carry a risk they will inhibit and not enhance shareholder value. This section uses auction theory principles and examples of dealmakers' real world uses of standstills to detail how standstills help to enhance the sales process. But this does not mean that all standstills will universally aid the value maximization process in every deal. When standstills contain certain provisions or are used in certain ways, standstills can inhibit value maximization. Specifically, standstills with unusually restrictive terms can contractually prevent fair and open competition and hurt the sales process. Moreover, even though initially a standstill may seem relatively unrestrictive, it can become overly restrictive when a definitive merger agreement is signed. Contractual provisions in the agreement can enhance the restrictiveness of existing standstills, resulting in a combination that, not only affects the rights of parties not privy to the merger agreement, but becomes prohibitive to final value maximization. Standstills that are, or become, overly restrictive should not be used unless careful consideration is given and the particular circumstances of the deal warrant their application. While a board's actions need not be perfect, courts should be particularly wary of standstills that do more to restrict the sales process than to promote the best deal.

A. *Standstills in General – Using Standstills to Make Friends, Prevent Foes, and Maximize Stockholder Value*

With so many moving pieces in a real world M&A auction, it is difficult, if not impossible, to rely on one factor to extract higher bids during the pre-signing sales pro-

cess. At the same time, standstills play an important role in the negotiation and sale of public companies. Dealmakers certainly believe standstills enhance the bidding process for public targets. But the ultimate question is whether this is truly the case.

In the case of a pure auction, Professors Bulow and Klemperer argue that because participants are “relatively ill-informed” when entering an auction the auction is “more profitable” than other sale processes, namely a sequential process.<sup>342</sup> Because bidders enter into most standstills as part of a confidentiality agreement and in consideration for the receipt of confidential information, many bidders would not have access to information if they were not willing to execute a standstill.<sup>343</sup>

Thus, by being willing to play by the “rules of the game,” a bidder is able to engage in due diligence and is on a more level playing field with respect to information asymmetries. Therefore, a bidder is better able to make an informed decision regarding its valuation of the target. Auction theorists have found that by being provided with proprietary information a bidder is put at ease and is more likely to submit a higher bid.<sup>344</sup> It follows that standstills likely enhance the pre-signing bidding process to the extent standstills are inextricably tied to the provision of information. Moreover, standstills may provide bidders with an economic incentive to submit their highest bid because of the opportunity cost of losing the auction, perhaps to a competitor, by not submitting the best bid.

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<sup>342</sup> Bulow & Klemperer, *supra* note 59, at 1546.

<sup>343</sup> Boone & Mulherin, *supra* note 42, at 34 (“In exchange for signing [standstill] agreements, prospective bidders are given access to non-public information about the seller . . .”).

<sup>344</sup> *Id.* at 34 (“Revealing proprietary information can reduce uncertainty for some buyers, which increases the price they are willing to pay.”)

Auction theorists have also found the implementation of rules and commitment to those rules play a significant role in whether a given sales process maximizes stockholder value.<sup>345</sup> By implementing rules like standstills targets are able to control the sales process. In turn, potential bidders receive some assurance that another bidder engaged in the process will not preempt the sales process by submitting a bid prematurely.<sup>346</sup> Due to these assurances bidders may be more likely to submit a higher bid. Moreover, and perhaps more importantly, most confidentiality agreements and standstills prevent bidders from revealing that negotiations are taking place. That combined with the fact that standstills prevent bids before the target is ready to receive them, allows the target to control the flow of information regarding valuation. As previously discussed because most auctions are “sealed-bid” auctions, the bidders are kept uninformed of each others’ bids so the target is able to ensure that a “high” bidder will not reduce its bid or refuse to raise its bid after learning that the next closest bid is somewhat lower.<sup>347</sup>

Another significant factor in whether a bidder is willing to submit a higher bid may turn on whether strategic or financial bidders are involved in the process. As a result, this Article advocates that courts and dealmakers should consider standstills on a continuum from least restrictive to most restrictive. A significant factor in how restrictive a standstill may be and still be deemed legitimate would be the types of bidders involved in the sale process.

### *1. Strategic Bidders & the Private Value Sale Process*

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<sup>345</sup> Povel & Singh, *supra* note 19, at 1425.

<sup>346</sup> *See supra* Part I.C.

<sup>347</sup> *See* text accompanying *supra* note 103.

Generally, strategic bidders are interested in the actual business of the target or the target's distinct characteristics that the strategic bidder may exploit for synergistic purposes.<sup>348</sup> As Professors Gorbenko and Malenko point out, strategic bidders "are less tied to publicly observable characteristics" like financial statements or market indicators so that the end result is that each strategic bidder's valuation of the target is "unique."<sup>349</sup> Because strategic bidders tend to operate in related businesses, releasing confidential information to these bidders is more likely to result in a loss of competitive advantages for the target.<sup>350</sup> As such, targets have a keen interest in controlling the sale process and particularly the release of nonpublic information to strategic bidders. Accordingly, stronger, more restrictive standstills may help to protect the target while at the same time encourage strategic bidders to submit higher bidders.

Because of the unique synergies at stake in any given transaction, a strategic bidder may be willing to pay more for a target, but at the same time, a strategic bidder also has more to lose. If a strategic bidder does not "win" a particular auction, there may not be similar companies in existence that have the same characteristics as the target. Moreover, if multiple strategic bidders who are competitors are involved in a particular auction process, the strategic bidder may be further motivated to submit a higher bid as the bidder's loss will be its competitor's gain. So, losing the bidding war to a competitor could result in an even greater loss to the strategic bidder. Therefore, if a strategic bidder is bound by a stronger standstill it has even greater reasons to put forth its best bid during the

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<sup>348</sup> See *supra* Part I.A.

<sup>349</sup> Gorbenko & Malenko, *supra* note 2, manuscript at 4.

<sup>350</sup> Povel & Singh, *supra* note 19, at 1405 (noting that strategic buyers can be competitors, suppliers, or customers).

bidding process. Hence, in a sales process where only strategic bidders are bidding more biased procedures such as more restrictive standstills may help to deal with information asymmetries and encourage bids.

## *2. Financial Bidders & the Common Value Sale Process*

Unlike strategic bidders, most financial bidders are not viewing targets with an eye toward synergistic results.<sup>351</sup> Instead, these bidders tend to base their valuations “on observable factors, captured by the information about the targets available from the market and financial statements.”<sup>352</sup> As financial buyers differ from strategic buyers because they do not similarly operate in the same business as the target and tend to base their bids on public information, the same concerns regarding confidential information releases are not present, and thus the need for a more protective standstill is also lessened. Although financial bidders may have some variation in their bid prices stemming from their own individual estimates or projections, it is more likely that a certain price or range of prices will likely serve as the price that gets the target.<sup>353</sup> Unlike strategic bidders, most financial bidders will not have as much to lose in “losing” an auction because potential synergies are not at stake. Because targets do not provide a source of unique value to a financial bidder, they are more likely to view targets as interchangeable and not have an incentive to pursue any one target.

Financial bidders are also more likely to be able to force a deal because they are sophisticated in deal making and because they have leverage, like little to no anti-trust

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<sup>351</sup> *See supra* Part I.A.

<sup>352</sup> Gorbenko & Malenko, *supra* note 5, manuscript at 4.

<sup>353</sup> *See supra* Part I.A.



uncertainty and substantial financing resources, with which to work. It follows that a more restrictive standstill will likely do little to encourage higher bids. In fact, the more restrictive standstill could serve the opposite purpose and prevent financial bidders from making a bid.

Yet another factor to consider with financial bidders is their tendency not to overbid another financial bidder's signed transaction.<sup>354</sup> Chancellor Strine even acknowledged these gentlemen's agreements saying that it is "a reality that there is not a culture of rampant topping among the larger private equity players, who have relationships with each other that might inhibit such behavior."<sup>355</sup> A recent lawsuit against eleven private equity firms suggest that these gentlemen's agreements may have extended into pre-signing auctions and that private equity firms colluded during the 2003-2007 merger wave to drive down the price of target companies.<sup>356</sup> More specifically, the lawsuit alleges there was a "secret pact" among the firms in which there was a "you don't bid on my deal, I won't bid on yours" understanding.<sup>357</sup> Against this backdrop, it is hard to imagine how a more restrictive standstill would work to extract more value. Indeed, if the

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<sup>354</sup> Sautter, *supra* note 83, at 560. After private equity giant, Blackstone, outbid Kohlberg Kravis Roberts (K.K.R.) for Freescale Semiconductor, Hamilton Jones, Blackstone's President, wrote to his colleagues, "Henry Kravis [co-founder of K.K.R.] just called to say congratulations and that they were standing down because he had told me before they would not jump a signed deal of ours . . . ." Peter Lattman & Eric Lichtblau, *E-Mails Cited to Back Lawsuit's Claims That Equity Firms Colluded On Big Deals*, N.Y. TIMES DEALBOOK (Oct. 10, 2012 7:42 p.m.).

<sup>355</sup> *In re Lear*, 926 A.2d at 121.

<sup>356</sup> Peter Lattman & Eric Lichtblau, *E-Mails Cited to Back Lawsuit's Claims That Equity Firms Colluded On Big Deals*, N.Y. TIMES DEALBOOK (Oct. 10, 2012 7:42 p.m.).

<sup>357</sup> *Id.*

allegations of collusion are correct, standstills would likely be rendered valueless.

B. *Using Restrictive Standstills to Extract More Value and Make “Friends”*

Although standstills generally aid in value maximization, overly restrictive standstills may cause adverse effects to a sales process involving corporate control. Standstills are overly restrictive when the provisions of the agreement are far too strict or onerous than necessary to accomplish the intended functions required of standstills in the sales process. In particular, this section focuses on potentially restrictive standstills such as DADW standstills and longer-term standstills. In a previous article, *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, I argued the Delaware courts are likely to resolve issues relating to the reasonableness of standstill restrictions and the grant of a waiver (or the promise not to waive a standstill) based on the reasonableness of the target board's sale process.<sup>358</sup> More specifically, the courts are likely to examine the pre-signing sales process in resolving these issues.<sup>359</sup> But that article did not address the more fundamental issue of whether the use of such restrictive standstills results in shareholder value maximization. I argue that this question should be answered by recognizing the need to maintain the standstill's teeth but not sharpen them when other deal protection mechanisms alleviate the workload borne by standstills post-signing. Moreover, consistent with the auction theory principles set forth previously, the restrictiveness and use of standstills should be evaluated based on the types of bidders involved in the sale process.

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<sup>358</sup> Sautter, *supra* note 6, at manuscript at 60 n.433.

<sup>359</sup> *Id.*

### 1. DADW Standstills

In *Celera*, Vice Chancellor Parsons warned that DADW standstills may have the effect of placing the target board in an informational vacuum and that once the board is in such a vacuum it would not be able to obtain information pursuant to which it could evaluate whether continuing to comply with the merger agreement terms would violate the board's fiduciary duties.<sup>360</sup> As a result, Parsons suggested that the board of directors would be breaching its fiduciary duties.<sup>361</sup> Laster then commented in *RehabCare* that DADW standstills "optically look bad" and that they are likely inconsistent with Strine's ruling in *Topps*.<sup>362</sup> Laster also seemed to suggest that even in the context of a fully shopped deal, a DADW standstill may not be valid.<sup>363</sup> Chancellor Strine, also the author of the *Topps* opinion, issued the most recent commentary and ruling on DADW standstills in *Ancestry.com*. In that case, Strine focused on whether the standstill was being used as a "gavel" with a specific a value maximizing purpose and whether the bidders were made aware there may not be any more bites at the apple.<sup>364</sup> Although seemingly irreconcilable at first glance, these opinions can be combined with auction theory principles and folded into a workable system in which targets can utilize these

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<sup>360</sup> *In re Celera*, C.A. No. 6304-VCP, at 53-54.

<sup>361</sup> *Id.* at 54.

<sup>362</sup> *In re Rehabcare*, C.A. No. 6197-VCL, at 46.

<sup>363</sup> See Telephonic Oral Argument and the Court's Ruling, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012) and Telephonic Oral Argument and the Court's Ruling, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

<sup>364</sup> *Id.* at 23.

more restrictive standstills to enhance value maximization.

This system begins by dividing the sales processes into those with mainly strategic bidders and those with mainly financial bidders. As previously described, because strategic bidders tend to private values for a target stemming from the valuation strategic bidders give the particular synergies which may be realized if the bidder were to acquire the target, more restrictive standstills, like DADW standstills, may help a target extract greater value from strategic bidders. However, some limitations must be placed on the use of the standstills to obtain the most value enhancing incentives. First, consistent with Strine's indication in *Topps* and my argument in *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, the target board must engage in significant pre-signing shopping of the target. Such a pre-signing shopping may help the board to eliminate the potential for placing itself in the informational vacuum of which Vice Chancellor Parsons warns. Second, consistent with Chancellor Strine's comments in *Ancestry.com*, all bidders entering into the bidding process and entering into standstill agreements with the target must be fully informed of the rules in advance, including the fact that the standstills will not be waived once the sales process has come to an end. Third, to maintain the integrity of the sales process, the target must continue to abide by the rules it sets forth and not make concessions to one bidder over another or otherwise favor one bidder.

Fourth, unlike the DADW standstills we have seen to date, I contend the standstill should be paired with a *minimal* fiduciary out. That is, a bidder bound by such a standstill should be able to privately request a waiver if it can set forth compelling and clearly delineated reasons that it would like to make or increase its bid. These reasons should be based on external and intervening factors such as the release of new information, which would cause

the bidder to increase its valuation of the target. This minimal fiduciary out is analogous to the merger recommendation fiduciary out for intervening events that have become popular in recent years.<sup>365</sup>

In my previous article, *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, I made clear that although the Delaware courts may likely take a different path based on their dicta to date, I was of the opinion that boards of directors should not be able to completely limit their ability to review superior offers in the context of sale of corporate control.<sup>366</sup> Allowing “losing” bidders to request a waiver and make an overbid pursuant to a minimal fiduciary out strikes a balance between the concern that boards should not foreclose themselves from considering higher bids and the legitimate goal as supported by auction theory principles of using standstills to extract more value pre-signing.

If such a fiduciary out were to be implemented, it should be paired with a slightly higher termination fee applicable in these limited circumstances to these bidders. For example, if the merger agreement contains a 3% termination, a 4 or 4.5% termination fee may be appropriate. The goal behind the minimal fiduciary out is to limit or eliminate the informational vacuum these standstills potentially cause. By pairing the minimal fiduciary out with a slightly increased termination fee, the goal is maintain the “teeth” of the standstill.

Moreover, a similar staggered termination fee has been used in some recent deals in the context of a change of merger recommendation based on an intervening event rather than a superior proposal.<sup>367</sup> In those deals, if the

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<sup>365</sup> For a description of these merger recommendation fiduciary outs for intervening events, see Sautter, *supra* note 122.

<sup>366</sup> Sautter, *supra* note 6, at manuscript at 60 n.433.

<sup>367</sup> David Fox & Daniel E. Wolf, *Something Old, Something New . . . A Quick Survey of Recent Developments in*

board were terminate the agreement for an intervening event, a higher termination fee becomes payable.<sup>368</sup> Thus, dealmakers have experience in negotiating and interpreting these intervening events as well as the staggered termination fees that may be applicable.

As previously established, unlike with strategic bidders, more restrictive standstill provisions may not lead to the same value maximizing results with financial bidders. The same “system” may be implemented in sale processes involving mainly financial bidders but because financial bidders tend to have a common value for a target, the DADW standstill is not likely to extract much additional value. With financial bidders, the already in place gentlemen’s agreements and possible collusion appear to render such restrictive standstill provisions useless.

The foregoing framework rests on the assumption that the sales process used is that of a classic auction as described in Part II.B.1. The likelihood of a classic auction being used as the chosen sales process is significant as Professors Boone and Mulherin’s study of 400 corporate takeovers found that half resulted from an auction process.<sup>369</sup> The framework would also work in the context of an extensive market canvass as described in Part II.B.2. Although dealmakers should opt for less restrictive standstill terms in such situations as there is a greater risk that they have not shopped the market and that the value

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*Public M&A Deal Terms*, Kirkland M&A Update, 1 (May 2, 2011), available at [http://www.kirkland.com/siteFiles/Publications/MAUpdate\\_050211.pdf](http://www.kirkland.com/siteFiles/Publications/MAUpdate_050211.pdf) (mentioning deals with a higher termination fee payable for a change of recommendation for an intervening event); see also Sautter, *supra* note 122, at 103-04 (suggesting a higher termination fee be applicable to intervening event change of recommendations).

<sup>368</sup> Fox & Wolf, *supra* note 367.

<sup>369</sup> See Part II.B.I.

being received is not as high as that which could be received pursuant to an auction.

## 2. *Longer-Term Standstills*

Standstills with unusually long durations, like that in the Hollywood Entertainment deal, can be overly restrictive. Hollywood Entertainment's three-year term standstill lasted for a period three times as long as that of an average standstill. Because of this burdensome provision, at least one major player, Blockbuster, was not even willing to enter into the standstill agreement and participate in a friendly process. Considering that the brick and mortar movie rental industry market—which as we now know and leaders of all companies involved in the process feared—was rapidly declining, a three-year standstill would have imposed severe limitations on Blockbuster's ability to pursue a strategic transaction with Hollywood Entertainment.<sup>370</sup> The same would hold true for many businesses in today's rapidly changing global marketplace, when over a period of three years entire industries and business can rise or fall. Implementing such a long standstill could actually have the reverse effect of value maximization. Using a standstill with such a long duration can deter viable and wealthy bidders from participating in a friendly process which could result in a higher bid after confirmatory due diligence. Moreover, such a long-term standstill could cause hostile action, further risking to disrupt a certain, but less favorable, deal already in place.

Further, the Hollywood deal shows the potential harm to future bidders who are not part of the original sales process or even privy to a standstill, but enter the picture after a definitive agreement is announced. A typical provision in a merger agreement requires that for any new bidder to gain access to confidential information, it must

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<sup>370</sup> See source cited *supra* note 342.

enter into a confidentiality agreement no less favorable to the bidder than the one entered into between the parties to the merger agreement. Thus, the winning bidder will be able to use this provision as leverage or to impose an abnormally long standstill on future offers to inhibit their ability to make higher proposals and protect the deal at the expense of shareholders.

While every sales process is different and often the target may need substantial protections, in most instances the decision to use an abnormally long standstill will not be value additive to the sales process. These standstills are not responsive to changing market conditions or new circumstances that arise over a relatively lengthy sales process. Instead the term of the standstill should bear a direct relationship to the industry in which the target operates taking into consideration possible market changes as well as the type of sales process being used. For example, dealmakers should consider the time needed to conduct the sales process whether it is an auction, market canvass, or a limited negotiation and the time it will take to get to closing. To be reasonable, standstills should be tailored to take into account these factors and should not far exceed the estimated time to closing.

Opting for a timeframe beyond that estimate makes it appear that the board is using the standstill for potentially nefarious means. While standstills should be strong enough to discourage bids outside of the sales process, they should not be used to completely prevent a bidder from making any offer at any time. If greater protections or incentives are needed, a myriad of other readily available deal protection devices can be used to encourage bidders to put their best bids on the table.

### *3. An Alternative to Highly Restrictive Standstill Terms*

In lieu of using restrictive standstills, including the



revised DADW “system” described previously, the target and the “winning” bidder have other alternatives in the form of deal protection devices. A definitive acquisition agreement for a publicly traded target generally contains a number of deal protection devices aimed at preventing third party overbids during the pre-closing period. In negotiating these deal protection devices, the target and initial acquirer can tailor their deal protection devices so that they specifically hinder bids being submitted by bidders who have previously executed a standstill. More specifically, the parties could adopt a staggered termination fee such that if the target were to enter into a transaction with an over-bidder who had previously executed a standstill, that transaction would result in a higher termination fee than would typically be paid under the agreement.

The possibility of a higher termination fee may incentivize bidders to submit their best offers during the pre-signing sales process. For example, the typical termination fee in a M&A transaction is 3-4% of the deal value.<sup>371</sup> The merger agreement between a target and a winning bidder could contain a 3% termination fee applicable to most termination events, including the target’s termination of the agreement to enter into an agreement with a third party over-bidder who was not bound by a standstill. If, however, the third party over-bidder is a party bound by a standstill, a higher termination fee, like 5%, could be applicable.

Dealmakers could also increase the termination fee based on how well shopped the company was pre-signing.

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<sup>371</sup> David Fox & Daniel E. Wolf, *Something Old, Something New . . . A Quick Survey of Recent Developments in Public M&A Deal Terms*, Kirkland M&A Update, 2 (May 2, 2011), available at [http://www.kirkland.com/siteFiles/Publications/MAUpdate\\_050211.pdf](http://www.kirkland.com/siteFiles/Publications/MAUpdate_050211.pdf) (noting most merger agreements provide for a break-up fee between 2% and 4% of deal value).

For example, if the target held a full public auction pre-signing, the termination fee applicable to third party overbidders bound by a standstill could be higher. This may further incentivize bidders to submit their highest bids pre-signing as a higher termination fee would be applicable to them post-signing. Moreover, the “winning” bidder would be further assured that its deal would be protected by virtue of the termination fee.

*C. Standstills that Become Unusually Restrictive When Combined with Other Contractual Rights: A Backdoor Method of Limiting Stockholder Value*

In addition to standstills that may be considered overly restrictive such as DADW standstills and longer term standstills, a seemingly less restrictive standstill could be combined with other contractual rights to result in a scheme detrimental to value maximization. When standstills continue to impose obligations on all parties after one party enters into a definitive merger agreement, the world of contractual rights among bidders and the target substantially change, but the standstill usually does not. This is a foreseeable event and perhaps one of the main reasons that standstills contribute to value maximization. Because the standstill will continue to operate to restrict the manner in which a losing bidder may make an offer, if an offer is allowed at all, bidders are incentivized to make their best offers during the period when offers are freely invited. Further, bidders know that, even if a standstill can somehow be overcome, there is a cost to jumping a winning deal, so most would rather be the first to sign. However foreseeable a change in position regarding the standstill is though, bidders will not know the extent of this change in rights until the merger agreement is announced.

From signing onward to closing, the same level of inefficiency that Professors Bulow and Klemperer argue

makes the auction more profitable does not necessarily exist.<sup>372</sup> Of course, new bidders who have previously not engaged in due diligence and been privy to the target's confidential information will still be "relatively ill-informed." But, at the same time, a potential over-bidder benefits from knowing the price being paid by the winning bidder, from seeing the deal embodied in the merger agreement, and from having access to any other publicly available information regarding the pre-existing deal. In other words, a potential over-bidder can free-ride to a certain extent on the existing deal to make an acquisition proposal. Those bidders who were part of the pre-signing sales process and gained access to the target's publicly available information, are obviously at a greater advantage in this respect.

Of course, if all the bidders knew that the standstill would disappear after the signing of an agreement then all bidders would not necessarily be incentivized to submit their highest bid before signing, at least by virtue of the standstill. There are advantages to being the first to sign however, such as deal protection devices that would discourage bidders from submitting uncompetitive bids. But, for standstills to be effective pre-signing, they must continue after a deal is signed, or else they may be ignored. Granted that a standstill needs to continue after a deal is signed to have any integrity, it should not become even more restrictive and made part of an impenetrable deal protection scheme.

An excellent example of this potentially impenetrable deal protection scheme is the Great Wolf deal.<sup>373</sup> In that deal, the standstills executed by the potential bidders seemed to become DADW standstills but only after the definitive acquisition agreement was executed. The bidders in that transaction entered the process and executed standstills on the belief they were on a level playing field.

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<sup>372</sup> Bulow & Klemperer, *supra* note 59, at 1546.

<sup>373</sup> See *supra* Part III.B.5.

However, without asking for final bids from the bidders, Great Wolf granted Apollo exclusivity, which ultimately led to an executed agreement between the two parties. After the execution of the Great Wolf-Apollo agreement, the previously executed standstills prevented the bidders from making an offer for Great Wolf.<sup>374</sup> Not only did the standstills continue to restrict bidders interested in Great Wolf, in combination with the other deal protections embodied in the Great Wolf-Apollo agreement, a standstill waiver could not be affected.<sup>375</sup> Thus, the standstill became, what I would dub, a Reverse DADW standstill. Luckily for the Great Wolf shareholders however, KSL who was uninhibited by a standstill, created the opportunity for a more fair and open sales process and thereby increased shareholder wealth by 157%.<sup>376</sup>

But, the other bidders were unable to participate when KSL entered the picture because of the transformation of the standstill into a Reverse DADW standstill.

A Delaware court is not likely to find such a Reverse DADW Standstill to be valid using either Vice Chancellor Laster's or Chancellor Strine's reasoning. Applying Chancellor Strine's reasoning from *Ancestry.com*, the provision was not used as a "gavel" with the goal of value maximization.<sup>377</sup>

Based on the facts as extracted from SEC filings, Great Wolf does not appear to have run an auction during which bidders were asked to make final bids and were told in advance of the auction ending.<sup>378</sup> Because of this, the bidders may have been operating under the assumption they could request a waiver if need be. Instead of using the standstill as a means of extracting greater value by

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<sup>374</sup> See *supra* note 304 and accompanying text.

<sup>375</sup> See *supra* notes 304-06 and accompanying text.

<sup>376</sup> See *supra* notes 308-12 and accompanying text.

<sup>377</sup> *In re Ancestry.com*, C.A. No. 7988-CS, at 23.

<sup>378</sup> See *supra* notes 292-99 and accompanying text.

instructing bidders to submit their best and final offers for possible deal protection in the resulting agreement, Great Wolf appears to have used the standstills as a form of deal protection device which favored Apollo. Under *Ancestry.com*, this is potentially even more problematic than using a DADW standstill whereby bidders would be made aware of the consequences.

Not only would these Reverse DADW standstills not carry weight under Strine's reasoning but also a court applying Vice Chancellor Laster's reasoning would likely find that a target's use of such a combination would result in an informational vacuum.<sup>379</sup> The bidders previously bound by the standstills would not be able to make a bid and the target board, like the Great Wolf board, would not be able to waive the standstill provision to consider potentially higher bids. The end result then places the board in an informational vacuum when making its recommendation regarding the contemplated transaction. Thus, the Reverse DADW standstill combination like the DADW standstill would likely be invalid in Laster's view.

In cases like Great Wolf, what starts out as a necessary prelude for the protection of the target and the facilitation of an exchange of confidential information can turn into a value-maximization deterrent for the target, and a powerful deal protection device for the first party that obtains a signed agreement. Standstills customarily are used to deter hostile bids or control the auction process and *prevent* a bidder from buying the target at a bargain price. When standstills are combined with other contractual provisions to preempt the auction process and prevent interested buyers from any further participation in the sales process, standstills can become an impediment to value maximization. Reminiscent of the methods used by the mafia to "eliminate the competition," basic supply and demand dictates that the result will *allow* a bidder to buy the target at a bargain price.

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<sup>379</sup> See *In re Complete Genomics*, C.A. No. 7888-VCL.

## CONCLUSION

Standstills, the M&A equivalents of a “school-yard time-out,” have become standard features of the public company sales process. Despite the prevalence of standstills, the courts and academics alike, have not fully addressed the role of standstills in the sales process or whether they aid in maximizing stockholder value. Auction theorists agree that a significant factor in any M&A sale process is the presence of asymmetric information. In most auctions, standstills allow the target to control the process by keeping bidders uninformed of each other’s bids and ensuring that no bidder can preempt the process while giving bidders access to its proprietary information, assuring bidders of their valuation. Thus, standstills help to enhance the sales process by selectively controlling information releases to encourage higher bids. As such, standstills at least aid in providing a floor for the valuation of the target. In doing so, standstills help to keep bidders friendly.

At the same, however, when standstills are enhanced to provide greater restrictions on the sales process or perform functions after the execution of a definitive agreement with a “winning” bidder, there is a risk these restrictions could have detrimental effects on value maximization. This Article uses auction theory to provide a framework pursuant to which more restrictive standstill provisions, like DADW standstills, may be used legitimately under certain circumstances to extract value from bidders. This framework takes into account several factors including that such restrictive standstills only be used pursuant to a thorough shopping process in which all bidders are informed that they may never have another bite at the apple. Moreover, this framework provides that such standstills be paired with a minimal fiduciary out based on intervening events that carried a slightly increased termination fee. Other forms of restrictive standstills, such as standstills with long durations or reverse

DADW standstills, should be declared invalid. As an alternative to restrictive standstills, this Article also suggests using a staggered termination fee that can better achieve value maximization with less risk. In adopting the framework set forth in this Article, dealmakers would strike a balance between keeping bidders from becoming foes to the “winning” bidder while at the same time encouraging the maximization of stockholder value.