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Don't Ask, Don't Waive Standstills

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A recent transcript ruling in the Delaware Court of Chancery could have a significant impact on the market for control of public companies, particularly in an auction context, if broadly adopted.

Vice Chancellor Laster's bench decision in In Re Complete Genomics, Inc. Shareholder Litigation questions the enforceability of a standstill agreement that prohibits the bidder from privately requesting a waiver to make a topping bid, which he labeled a "Don't Ask, Don't Waive" standstill. The Vice Chancellor did not object to the bidder being prohibited from publicly requesting a waiver (which he understood would clearly circumvent the standstill), but held that directors have a continuing duty to be informed of all material facts, including whether the rejected bidder is willing to offer a higher price. By analogy to cases holding that a board that has agreed to sell the company may not close its ears to the possibility of higher bids, he suggested that "a Don't Ask, Don't Waive Standstill is impermissible because it has the same disabling effect as the no-talk clause, although on a bidder-specific basis." While this may seem favorable for bidders, it raises questions about the protections afforded by typical standstill arrangements and the willingness of targets to engage in transaction discussions if they have doubts about those protections. The ruling also raises questions about its potential extension to standstill agreements in joint ventures and other commercial contexts, which could undermine the value of contractually bargained-for protections.

Notably this oral ruling provides a new data point on the permissible use of standstill agreements in the context of public company auctions. Facing this question a few years ago (in Ventas vs. Sunrise REIT), the Ontario courts held that a selling board has discretion to bind bidders to firm standstill agreements if the directors believe that is the best way to maximize shareholder value. The ruling in *Complete Genomics* goes the other way, suggesting that a standstill agreement entered into in anticipation of an auction may not require that bidders stand down if they lose the

auction, thus calling into question whether a board embarking on a sale process may adopt auction rules designed to incentivize bidders to make their best bid in the auction.

If broadly adopted, such a rule may affect the way sophisticated parties engage in auctions, and even their willingness to do so. Bidders often argue for fall-away provisions permitting them to rebid if someone else wins (or to low-ball or stand back and “test the auction” rather than bid against themselves, which may allow them, if the auction is flat, to win for less than they would have paid). Sellers usually resist fall-aways both to prevent bidders from holding back and to induce them, by promising certainty, to put their best offer on the table. If “winning the auction” means merely becoming a public stalking horse and being entitled to a modest breakup fee, a bidder has little incentive to put its best foot forward. Also, if this decision is applied broadly, sellers may prefer to engage in one-on-one negotiations with selected bidders rather than risking a failed auction.

Although its intention is to enhance value maximization in sale situations, this decision could thus prove value-destructive. In keeping with the longstanding principle that there is no single blueprint for selling a company, fully-informed and well-advised boards need the discretion to design auction rules proper to the circumstances at hand so long as the directors act reasonably and in good faith to secure the highest value reasonably attainable.