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Auction Theory and Standstill: 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 and 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 that protect a transaction from topping bids. 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 Delaware Court of Chancery rulings have placed a new spotlight on the use of standstill agreements in M&A 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. It is the first article to apply auction theory in critiquing and evaluating the need for standstills in M&A transactions. Auction theory is an applied branch of economics used 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

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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 postsigning may aid in incentivizing bidders to submit their highest offers during the presigning sale process. But the use of more restrictive standstills—such as those in which a bidder agrees not to request a waiver and a target agrees in advance not to waive a standstill, known as Don't Ask, Don't Waive (DADW) standstills—should turn on the amount of presigning shopping in which the target board has engaged. This Article provides a new framework for deal makers and courts, suggesting that if deal makers are to continue their use of DADW standstills, they should be paired with a minimal fiduciary out and a staggered termination fee.

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INTRODUCTION

A fundamental tension in mergers and acquisitions (M&A) law exists between a selling company's board of directors' *Revlon*¹ 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 that protect the transaction from being overbid.² Standstill agreements are one such way the board of a selling company, the target, restricts the sales process and discourages overbids.³ 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 completed and the target has executed an agreement with a winning bidder.⁴

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.⁵ Moreover, presigning standstills may help a board satisfy its *Revlon* duty to maximize stockholder value, as standstills may provide the target board "leverage to extract

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1. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).
 2. *See id.* at 182 (describing a board of directors as "auctioneers charged with getting the best price for the stockholders at a sale of the company"); *see also* *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) (describing the limitations on a board's authority to grant deal protections to a winning bidder). The term "overbid" is used in this Article to refer to "topping bids" or "jumping bids," situations in which another prior bid or agreement is topped by a higher bid.
 3. The target and its financial advisor generally require that auction participants execute a confidentiality agreement before gaining access to the target's nonpublic information. Alexander S. Gorbenko & Andrey Malenko, *Strategic and Financial Bidders in Takeover Auctions*, J. FIN. (forthcoming) (Apr. 2014 manuscript at 9), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1559481. The standstill can be a separate standalone document or, more typically, it appears as a provision in the confidentiality agreement. *See* *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208, 1218 n.43 (Del. 2012). The terms "standstill," "standstill agreement," and "standstill provision" will be used interchangeably in this Article.
 4. *See* *Martin Marietta*, 68 A.3d at 1219 ("Typically a standstill agreement will prohibit a hostile bid in any form . . .").
 5. William G. Lawlor, *Taming the Tiger: Difficult Standstill Agreement Issues for Targets*, DEAL LAW., July–Aug. 2007, at 7 (noting that standstills "provide[] a stable environment in which the sales process can be managed and controlled by the target").

concessions from the parties who seek to make a bid.”⁶ 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 during the preclosing period, the time between the signing and closing of the contemplated transaction.⁷ In this way, targets and winning bidders use standstills as a type of deal-protection device preclosing. For these reasons, standstills have been called “the M&A equivalent of a schoolyard ‘time-out.’”⁸ In other words, standstills keep friendly bidders friendly and prevent them from becoming foes either to the target or to the winning bidder.⁹ 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 with its *Revlon* duties.¹⁰ More specifically, standstills

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6. *In re* Topps Co. S’holders Litig., 926 A.2d 58, 91 (Del. Ch. 2007). In a 2011 case dealing with a standstill waiver, then-Chancellor Strine reiterated this view:

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.

Status Conference and Motion to Expedite at 22, *In re* Transatlantic Holdings, Inc. S’holders Litig., C.A. Nos. 6574-CS & 6776-CS, (Del. Ch. Aug. 22, 2011).

7. See ROBERT E. SPATT & PETER MARTELLI, 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 (2012); Christina M. Sautter, *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, 37 DEL. J. CORP. L. 929, 932 (2013).
8. *Proxy Battle Time-Out: Standstills Give Boards a Breather*, THOMSON REUTERS (Apr. 2, 2009), http://currents.westlawbusiness.com/Articles/2009/07/20090731_0005.aspx?cid=&src=; see also Lawlor, *supra* note 5, at 7 (describing standstills as “corporate peace treaties”).
9. In this Article, the term “friendly” refers to negotiated acquisitions in which the target company board approves the sale terms and is receptive to a bidder’s overtures. Conversely, the term “foes” refers to hostile transactions in which a bidder does not agree with the target board’s decision regarding the sales process.
10. See STEVEN M. DAVIDOFF, GODS AT WAR: SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLOSION 236 (2009) (explaining that under *Revlon* a target “must keep itself up for sale . . . up to a shareholder vote on the transaction”); *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) (“The directors of a

prevent bidders from making overbids and may prevent boards from considering overbids, even if an overbid provides more value than the deal with the winning bidder.¹¹ Moreover, there is always a risk that a target board may use a standstill to improperly favor one bidder over another or to otherwise entrench itself in office.¹²

Recently, the Delaware courts have issued several decisions commenting on the restrictiveness of some standstills and their potential interference with the satisfaction of a board's *Revlon* duties.¹³ As a result, there has been a surge in the attention being paid to standstills by practitioners.¹⁴ But, to date, scholars have yet to address the dichotomy that standstills raise between aiding and hindering value maximization. In a recently published article, I touched upon this dichotomy by using past Delaware case law to

Delaware corporation have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced.”).

11. *See In re Celera Corp. S'holder Litig.*, C.A. No. 6304-VCP, 2012 WL 1020471, at *6 (Del. Ch. Mar. 23, 2012) (describing how under a DADW standstill, a target company “could not reach out to [already-interested buyer companies], and those [buyer] companies could not reach out to [the target] to take the necessary first step—requesting a waiver of the standstill restrictions—to make a competing offer”); 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.”).
12. *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007).
13. *See, e.g.*, *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208 (Del. 2012); *Koehler v. NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013); *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012); *Celera Corp.*, 2012 WL 1020471; *In re Rehabcare Grp., Inc. S'holders Litig.*, C.A. No. 6197-VCL, 2011 Del Ch. LEXIS 208 (Del. Ch. Sept. 8, 2011); *Topps Co.*, 926 A.2d 58.
14. *See, e.g.*, Steven M. Haas, “*Don't Ask/Don't Waive*” *Standstill Agreements Under Attack*, INSIGHTS, Dec. 2012, at 29; Peter J. Walsh Jr. et. al., *Delaware Insider: “Don't Ask, Don't Waive” Standstill Provisions: Impermissible Limitation on Director Fiduciary Obligations or Legitimate, Value-Maximizing Tool?*, BUS. L. TODAY, Jan. 2013, at 1; *An Ounce of Prevention—Some Guidance for Target Boards*, KIRKLAND M&A UPDATE (Kirkland & Ellis LLP), Jan. 14, 2013, at 2; *The State of M&A Standstills in Delaware*, CLIENT ALERT (Hunton & Williams LLP), Jan. 2013; Trevor S. Norwitz, Igor Kirman & William Savitt, “*Don't Ask, Don't Waive Standstills*” *Revisited (Rapidly)*, CLS BLUE SKY BLOG (Jan. 9, 2013), <http://clsbluesky.law.columbia.edu/2013/01/09/dont-ask-dont-waive-standstills-revisited-rapidly/>; William Savitt, *Don't Ask, Don't Waive Standstills*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 18, 2012, 8:51 AM), <http://blogs.law.harvard.edu/corpgov/2012/12/18/dont-ask-dont-waive-standstills/>.

analyze how the Delaware courts are likely to address some open issues involving standstills.¹⁵ My analysis assumed, however, the continued existence of standstills as they are currently being utilized in most 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.¹⁶

This Article addresses these fundamental issues by applying auction theory to critique and evaluate the role of standstills in M&A transactions. Auction theory is an applied branch of economics used to design optimal bidding procedures and revenue-enhancing sales processes. The application of auction theory to standstills is particularly well suited because targets require the execution of standstills based on the assumption that standstills help to increase value during the sales process. Despite deal makers' assumption that standstills are revenue enhancing, legal 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 describes the use of standstills in the typical M&A sales process. Part III 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 IV details Delaware cases addressing the need for and possible enforcement of various standstills. Part V uses auction theory and recent Delaware cases to develop a new framework for deal makers and courts, taking into consideration the amount of presigning shopping done by the target board. Among other things, this new framework suggests that if deal makers continue using certain more restrictive standstills, then they should pair them with a minimal fiduciary out and a staggered termination fee.

I. AUCTION THEORY AND 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 explicitly addresses the use of standstills in the auction process. This Article addresses this gap and

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15. See generally Sautter, *supra* note 7, at 936 (outlining the article's discussion of a target board's ability to consider a third party's 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).
16. See *id.* at 992-93.

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.¹⁷ Auction theory is “develop[ing] rapidly, and is increasingly being looked to for assistance in practical applications,” but current auction theory is by no means complete.¹⁸ 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. And if auction theory could be used to design optimal auctions in M&A transactions, then theoretically the outcome of an auction should be controllable largely through the structure of the sales process. Yet while it is an admirable goal, controlling the outcome of a sales process by designing an optimal structure is likely not an achievable goal for intricate M&A transactions.¹⁹ This is largely because many factors can impact the results of any given sales process, and it is difficult, if not impossible, to predict or control for these factors.²⁰

Despite these limitations, there is much from auction theory that can be applied to M&A transactions. Part I.A begins by discussing the impact of bidder type on auction results, and Part I.B follows by discussing the role played by information and auction theorists’ suggested strategies to obtain optimal auction results. As discussed in Part V, both of these factors—bidder type and information flow—are relevant to the purpose and proper use of standstills.

A. *Common-Value Versus Private-Value Sales Processes*

Auction theorists have pointed to the type of bidders involved in a sales process as one of the many factors impacting the ultimate results of the process.²¹ Although real-world M&A auctions tend to

17. See generally Paul Klemperer, *Auction Theory: A Guide to the Literature*, 13 J. ECON. SURVS. 227 (1999) (providing a survey of auction theory and discussing optimal auction design).

18. *Id.* at 248.

19. But see Steven J. Brams & Joshua R. Mitts, *Mechanism Design in M&A Auctions*, 38 DEL. J. CORP. L. 873, 884 (2014) (disagreeing with the assertion that an optimal M&A auction cannot be designed).

20. See Klemperer, *supra* note 17, at 234–47 (discussing many factors that impact auctions).

21. *E.g.*, Povel & Singh, *supra* note 11, at 1399–1400 (discussing the reduced competition that can result from unequally informed bidders, particularly because less-informed bidders are more concerned with “the winner’s curse” of beating a better-informed bidder but regrettably overpaying for the target).

include both financial and strategic buyers,²² auction theorists usually address each type of bidder separately.²³ Thus, an article relying on auction theory would be remiss if it did not address the differences between these two bidders and resulting auction types.

When financial buyers are the bidders in an auction, academics tend to define those auctions as common-value auctions.²⁴ A common-value auction is an auction in which all of the participants have the same or very similar value for the target.²⁵ This is the case with financial buyers because they can “exploit the same sources of gains (e.g., cost cutting, financial restructuring).”²⁶ 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.²⁷ Strategic, or trade, buyers are often interested in acquiring a target company to optimize possible unique synergies between the buyer and the target.²⁸ Thus, strategic buyers tend to have differing values for a target based on the value each individual strategic buyer places on those particular synergies.²⁹ Therefore, auction processes involving strategic bidders tend to be private-value auctions.³⁰ One exception to this general rule occurs 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.³¹ In such a case, the bidding process resembles the private-value auction.

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22. Gorbenko & Malenko, *supra* note 3 (Apr. 2014 manuscript at 1) (“The set of bidders [for an M&A takeover auction] is comprised of two groups: strategic and financial.”).
 23. *E.g.*, Jeremy Bulow, Ming Huang & Paul Klemperer, *Toeholds and Takeovers*, 107 J. POL. ECON. 427, 428 (1999) (acknowledging the difference between strategic and financial bidders but focusing their analysis on cases involving the latter). *But see* Gorbenko & Malenko, *supra* note 3 (Apr. 2014 manuscript at 1–2) (analyzing the differences between financial and strategic bidders’ valuations of target companies); Povel & Singh, *supra* note 11, at 1340 (“Unlike the existing literature . . . , our model allows for both private value and common value bidding environments.”).
 24. *E.g.*, Bulow, Huang & Klemperer, *supra* note 23, at 428.
 25. J. Russel Denton, Note, *Stacked Deck: Go-Shops and Auction Theory*, 60 STAN. L. REV. 1529, 1534 (2008).
 26. Povel & Singh, *supra* note 11, at 1400.
 27. Paul R. Milgrom & Robert J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 ECONOMETRICA 1089, 1090 (1982).
 28. Povel & Singh, *supra* note 11, at 1400.
 29. Denton, *supra* note 25, at 1535.
 30. *See* Povel & Singh, *supra* note 11, at 1400.
 31. *Id.* at 1399.

The types of bidders involved in an auction impact the auction results because strategic and financial bidders tend to value targets in systematically different ways.³² Generally, strategic bidders are more likely to pay more “for targets with higher investment opportunities, as proxied by [research and development] expenditures and cash balances.”³³ Conversely, financial bidders are more likely to pay more relative to market value for underperforming companies, a characteristic “reflected in substantial negative cash flows.”³⁴

The differing valuations between strategic and financial bidders arise from the differences in information 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.³⁵ In fact, “[a] key feature of auctions is the presence of asymmetric information. (With perfect information most auction models are relatively easy to solve).”³⁶ Of course, strategic bidders and buyers engaged in an MBO have asymmetric information because each bidder uses its own private information to value the object of the auction.³⁷ That is, strategic 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 observable[] [characteristics]” like financial statements or market indicators and demonstrate greater variation on the “unobserved valuation component.”³⁸

Financial bidders can also have asymmetric information.³⁹ While their actual value of the target is the same—at least theoretically after the fact—each bidder has different private information about what the value actually is.⁴⁰ 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

32. Gorbenko & Malenko, *supra* note 3 (Apr. 2014 manuscript at 2) (arguing that “strategic and financial bidders appear to be inherently very different” and, in particular, that “a significant subset of targets is systematically valued more by financial bidders”).

33. *Id.* at 4.

34. *Id.*

35. Povel & Singh, *supra* note 11, at 1399.

36. Klemperer, *supra* note 17, at 229.

37. Denton, *supra* note 25, at 1535.

38. Gorbenko & Malenko, *supra* note 3 (Apr. 2014 manuscript at 6) (“[T]he estimated standard deviation of [strategic bidders’] unobserved valuation component is almost twice as high as that of financial bidders.”).

39. Povel & Singh, *supra* note 11, at 1405.

40. Klemperer, *supra* note 17, at 229–30.

Gorbenko and Malenko explain in their forthcoming article, *Strategic and Financial Bidders in Takeover Auctions*, financial bidders' valuations tend to be based on "observable target and economy-wide characteristics."⁴¹ Thus, the end result is that, unlike strategic bidders, financial bidders' valuations "appear to be more interchangeable than strategic bidders from the target's point of view."⁴² But if a financial bidder already owns a similar company, the financial bidder would resemble a strategic bidder because it would be able to derive certain synergies from the purchase of the target.

Even granting these distinctions in the real world of M&A deal making, the classification of an auction as a pure common-value one or a pure private-value one is not necessarily accurate. As previously mentioned, typical M&A transactions include a mix of both financial and strategic bidders. Moreover, "[a]ctual bidders rarely have identical valuations for an auctioned object nor are their valuations completely uncorrelated."⁴³ As Professor Subramanian recognized in his book, *Negotiauctions*, "[e]ven with a seemingly pure private-value asset, there is a significant common-value element."⁴⁴ Thus, information will not be perfectly symmetric among 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.⁴⁵

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 standstills are inextricably tied to the provision of information. Numerous auction theorists have explored the role of information in the sales process, and some have proposed strategies to manage the flow and asymmetry of information in auctions. While there are several unaccounted-for factors that impact M&A transactions, one auction-theory proposal comes close to meeting the needs of M&A deals.

41. Gorbenko & Malenko, *supra* note 3 (Apr. 2014 manuscript at 5–6).

42. *Id.* at 6.

43. Peter Cramton & Alan Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J.L. ECON. & ORG. 27, 29 (1991).

44. GUHAN SUBRAMANIAN, *NEGOTIAUCTIONS: NEW DEALMAKING STRATEGIES FOR A COMPETITIVE MARKETPLACE* 93 (2010).

45. Povel & Singh, *supra* note 11, at 1417.

Professors Bulow and Klemperer have found that “contrary 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.*”⁴⁶ Once bidders have entered the auction, Professors Boone and Mulherin have found there is a fine line that targets must walk when 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, bid higher.⁴⁷ 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 knowledge that confers competitive advantages.”⁴⁸ As a result, a seller’s management of the sales process, limiting the number and kind of bidders and otherwise managing the process to reduce information costs, can “actually create value.”⁴⁹

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.⁵⁰ This particular theorem states that the auction type does not influence the revenue produced by an auction, regardless of the information each bidder has.⁵¹ Under the theorem, “all the ‘standard’ auctions . . . yield the same expected revenue under the stated conditions, as do many non-standard auctions.”⁵² However, this theory “appl[ies] 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

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46. Jeremy Bulow & Paul Klemperer, *Why Do Sellers (Usually) Prefer Auctions?*, 99 AM. ECON. REV. 1544, 1546 (2009).
47. 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) (“[W]hen bidding companies are confident that their own offers will not be trumped by that of ‘uninformed’ and perhaps overly aggressive bidders, they are likely to offer to pay higher prices . . .”).
48. *Id.* at 34; see also Justin Pettit et al., *Roundtable Discussion: 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 (“The seller in an auction risks opening itself up to tactical investigation by competitors.”).
49. Boone & Mulherin, *supra* note 47, at 28.
50. Klemperer, *supra* note 17, at 232–33.
51. *Id.* at 232.
52. *Id.*

common distribution.⁵³ But more recent developments have suggested that standard auctions cannot be optimal in the presence of bidder asymmetry and that an increase in bidder asymmetry can hurt the seller if it uses a standard auction.⁵⁴

Even if optimal auctions could be created by varying these assumptions,⁵⁵ many other factors can influence the outcome of an auction, and most models have not been extended to completely account for these effects.⁵⁶ Unaccounted-for factors include the entry costs and number of bidders; the ability of bidders to collude; and the divisibility of the unit for sale in the auction, or multiunit auctions.⁵⁷ The idea of a multiunit auction or the divisibility of a business into separate units is generally not examined in auction-theory literature.⁵⁸ However, this singular focus may be misplaced when using auction-theory literature to interpret M&A transactions because of the large number of divisible assets comprising a business. Of the literature that does focus on multiunit auctions, the “main message . . . is that it is very hard to achieve efficient outcomes.”⁵⁹ Furthermore, most existing auction-theory 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.⁶⁰ But the likelihood of such distinct classifications is not realistic.⁶¹

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.⁶² Their model of a sequential-selling procedure “requires commitment to its rules, and deal-protection

53. *Id.* at 232, 236.

54. Povel & Singh, *supra* note 11, at 1403.

55. *See* Klemperer, *supra* note 17, at 234–36 (summarizing auction-theory literature finding that optimal auctions can be created in some cases regardless of assumptions).

56. *See id.* at 234–47 (discussing the implications of various factors on the results of the Revenue Equivalence Theorem, making creation of efficient optimal auctions difficult).

57. *Id.* at 238–243.

58. *Id.* at 240 (“Most auction theory . . . restricts attention to the sale of a single indivisible unit.”).

59. *Id.* at 243.

60. Povel & Singh, *supra* note 11, at 1400.

61. Gorbenko & Malenko, *supra* note 3 (Apr. 2014 manuscript at 21–22).

62. Povel & Singh, *supra* note 11, at 1400.

devices [to] help the target cement this commitment.”⁶³ But 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.⁶⁴

In the present state of auction theory, even if Professors Povel and Singh’s model allowed for an optimal selling procedure in real-world M&A deals, the model likely could not do so alone. Some other structural-protection device would be needed to ensure the best bidding process and optimal outcomes.

II. STANDSTILLS IN THE SALES PROCESS

One structural-protection device used in the vast majority of public-company sales is the standstill. Standstills generally prevent potential buyers from engaging in activity that may be considered hostile to the target. 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.”⁶⁵ 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. 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.⁶⁶ 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.”⁶⁷ At the same time, the main purpose of including a standstill in a confidentiality agreement is to prevent the buyer from having an “informational advantage over other prospective bidders resulting from its review of confidential

63. *Id.* at 1425.

64. SUBRAMANIAN, *supra* note 44, at 119.

65. *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208, 1219 (Del. 2012).

66. *Id.* at 1219.

67. *Id.*

information.”⁶⁸ Hence, standstills give “teeth” to confidentiality agreements that alone may not be enough to establish insider-trading liability under current federal securities laws.⁶⁹

Standstills have been described as the “cost of entry” into discussions with a target.⁷⁰ In fact, some, if not most, targets will refuse to proceed with negotiations if the bidder refuses to execute the standstill.⁷¹ The standstill “serves as a kind of litmus test, an indication of the bidder’s true intentions.”⁷² A bidder can “try to modify the standstill as much as [it] can,” but by executing the standstill the bidder is forsaking its “ability to launch an unsolicited offer.”⁷³

Because standstills work to restrict bidders, the duration 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.”⁷⁴ Standstills can be longer than a year and 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.”⁷⁵ For example, one commonly negotiated aspect of a standstill

68. WILLIAM J. CARNEY, *MERGERS AND ACQUISITIONS: CASES AND MATERIALS* 157 (3d ed. 2011).

69. See 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.”).

70. Interview with Steve Wolitzer, Global Head of Mergers & Acquisitions, Lehman Brothers, in N.Y.C., N.Y. (June 4, 2003), quoted in Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 *YALE L.J.* 621, 660 (2003).

71. See Nicole E. Clark, *Preliminary Agreements*, in *DOING DEALS 2009: UNDERSTANDING THE NUTS & BOLTS OF TRANSACTIONAL PRACTICE* 73, 80–81 (2009) (stating that a target generally asks a bidder to execute a 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 95, 117 (2002) (noting that a target may require a standstill to ensure that the buyer remains committed to the transaction and to prevent the buyer from pursuing a hostile alternative).

72. BRUCE WASSERSTEIN, *BIG DEAL: MERGERS AND ACQUISITIONS IN THE DIGITAL AGE* 689 (2000).

73. Subramanian, *supra* note 70, at 662.

74. Lawlor, *supra* note 5, at 12.

75. Sautter, *supra* note 7, at 948 (citing Subramanian, *supra* note 70, at 660).

is whether the standstill will include a fall-away provision. One practitioner described a fall-away provision as an “escape hatch” for a buyer.⁷⁶ A fall-away provision provides that 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.⁷⁷ A target may resist this provision fearing it may prevent the bidder from submitting its best offer during the presigning sales process.⁷⁸ But targets often end up agreeing to the fall-away provision as a way of moving along the sales process.⁷⁹ Moreover, targets recognize the possibility that a fall-away provision ultimately may result in the target realizing a greater sales price.⁸⁰ Nevertheless, some practitioners argue that whether a target should agree to a fall-away standstill is context specific. For example, if the target has decided that it “is going to run a process that’s going to end in a sale,” a target may be more willing to agree to a fall-away provision.⁸¹ As is evident from the foregoing, whether a standstill falls away is often a matter of some debate and can directly impact the ultimate price received.

Another debatable matter among practitioners and judges is the viability and enforceability of Don’t Ask, Don’t Waive (DADW) standstills. DADW standstills are actually a form of standstill restriction that emanate from two different contracts.⁸² First, the “Don’t Ask” portion of the restriction comes from a provision in the standstill itself that prevents a potential bidder who executed the standstill from requesting a waiver of the standstill.⁸³ Second, the “Don’t Waive” portion of the restriction comes from a provision in the merger agreement that prevents a target board from granting a

76. Richard E. Climan et al., *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 PENN ST. L. REV. 615, 645 (2012) (transcribed panel discussion).

77. *Id.*

78. Savitt, *supra* note 14 (“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.”).

79. See Climan, *supra* note 76, at 647 (describing a “fall-away trigger that [targets] often just agree to, because people start to get ossified in their positions”).

80. *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.”).

81. *Id.*

82. “Don’t Ask, Don’t Waive” Restrictions in Standstill Agreements, PRAC. L. (July 11, 2013), <http://us.practicallaw.com/2-534-1026?source=rss>.

83. *Id.*

waiver of a preexisting standstill.⁸⁴ Because these restrictions may hinder a board's ability to fully exercise its fiduciary duties, DADW standstills have become the subject of much current-day debate.

III. FIDUCIARY DUTIES AND M&A SALE PROCESSES

In analyzing standstills and their related subprovisions, 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 *actually* go about selling themselves. Part III.A first details the fiduciary duties applicable to a target board's actions in a sale of corporate control. Then Part III.B describes 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 Inc. v. MacAndrews & Forbes Holdings, Inc.*⁸⁵ 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.”⁸⁶ Since this holding, the Delaware Supreme Court has recognized that “no single blueprint” exists for a board to satisfy its *Revlon* duties.⁸⁷ 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.”⁸⁸ Moreover, in selecting an acquirer and 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's terms and feasibility, financing, the likelihood of consummation of the proposed transaction, and “the bidder's identity,

84. *Id.*

85. 506 A.2d 173 (Del. 1986).

86. *Id.* at 184.

87. *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989).

88. Transcript of Plaintiffs' Motion for a Preliminary Injunction at 88, *Steinhardt v. Howard-Anderson, C.A.*, No. 5878-VCL (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.”).

prior background and other business venture experiences.”⁸⁹ Along these lines, deal certainty is of primary importance, and it is not uncommon for targets to choose a lower-priced bid over a higher-priced one based on closing certainty. Furthermore, 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.”⁹⁰

A board’s decision to offer deal protections to bidders is subject to the *Unocal*/*Unitrin*⁹¹ enhanced-scrutiny analysis as described in the Delaware Supreme Court’s decision in *Omnicare, Inc. v. NCS Healthcare, Inc.*⁹³ The *Unocal/Unitrin* enhanced-scrutiny standard involves a two-step analysis, the first step of which involves the board showing that it “had reasonable grounds for believing that a danger to corporate policy and effectiveness existed.”⁹⁴ Under the second step, the court first determines whether the deal-protection devices are “preclusive” or “coercive.”⁹⁵ Once the court determines that the deal protections are neither coercive nor preclusive, the court examines the “range of reasonableness” of the board’s decision.⁹⁶

In explicitly extending the *Unocal/Unitrin* enhanced-scrutiny analysis to deal-protection devices, the majority in *Omnicare* stated:

Defensive devices taken to protect a merger agreement executed by a board of directors are intended to give that agreement an advantage over any subsequent transactions that materialize

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89. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1282 n.29 (Del. 1988).
 90. *In re Toys “R” Us, Inc. S’holder Litig.*, 877 A.2d 975, 1000–01 (Del. Ch. 2005) (citing *Barkan*, 567 A.2d at 1286).
 91. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).
 92. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995).
 93. 818 A.2d 914 (Del. 2003). In *Omnicare*, the Delaware Supreme Court applied the *Unocal/Unitrin* enhanced scrutiny to deal protections in a non-change-of-control transaction. *Id.* at 931–32. Similarly, in *Toys “R” Us, Inc.*, the Delaware Court of Chancery applied the *Unocal/Unitrin* enhanced scrutiny to termination fees in a change-of-control transaction. 877 A.2d at 1016.
 94. *Omnicare*, 818 A.2d at 935 (quoting *Unocal*, 493 A.2d at 955) (internal quotation marks omitted).
 95. *Id.* (quoting *Unitrin*, 651 A.2d at 1387) (internal quotation marks omitted).
 96. *Id.* at 931–32 (quoting *Unitrin*, 651 A.2d at 1387–88) (internal quotation marks omitted).

before the merger is approved by the stockholders and consummated. This is analogous to the favored treatment that a board of directors may *properly* give to encourage an initial bidder when it discharges its fiduciary duties under *Revlon*.⁹⁷

Thus, in a change-of-control transaction, the board's decision to enter into a merger agreement with a particular bidder and the process leading up to the merger agreement are subject to the *Revlon* standard, while the deal protections are subject to the *Unocal/Unitrin* enhanced-scrutiny standard as described in *Omnicare*.⁹⁸

B. M&A Sales Processes

The Delaware courts have upheld a variety of sale methods as meeting the *Revlon* 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, presigning market canvass, negotiated acquisition, and postsigning 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 simplest way for a board to ensure satisfaction of its fiduciary duties presigning.⁹⁹ Not only is a classic auction thought to be the easiest way to prove compliance with fiduciary duties but, as Professors

97. *Id.* at 932 (emphasis added).

98. See Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 J. CORP. L. 681, 685 n.24, 703 n.98 (2013) (describing the Delaware Court of Chancery's use of the *Unocal* standard of review for deal-protection devices in *Revlon* transactions).

99. See WASSERSTEIN, *supra* note 72, 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, *MERGERS, ACQUISITIONS AND TENDER OFFERS* 5-205 (PLI electronic ed. rel. 4 Sept. 2012) (2010) (recognizing the best way to sell publicly held companies may be through “active and fair auction[s]” and stating that “[a]ctual market testing through an auction may be more beneficial than relying solely on investment bankers to assess valuation”); Pettit et al., *supra* note 48 (“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, 576 (2008) (noting Delaware courts consider public auctions or presigning targeted market canvasses to be value-maximization procedures).

Bulow and 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.”¹⁰⁰ However, in another study of 400 takeovers of U.S. corporations during the 1990s, Professors Boone and Mulherin found that there were not substantial differences between the wealth effects resulting from auctions versus those resulting from negotiations.¹⁰¹ Despite finding that auctions were not necessarily better at maximizing stockholder value than negotiations, Professors Boone and Mulherin found that half of the 400 takeovers studied resulted from an auction process.¹⁰² 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.¹⁰³ At the same time the offering memorandum is being prepared, the target’s financial advisor creates a list of potential purchasers.¹⁰⁴ The financial advisor then contacts the potential purchasers, and those potential buyers who express an interest in the target are required to execute a confidentiality agreement before being given the offering memorandum and, in some cases, other information.¹⁰⁵ In most deals, the confidentiality agreement will contain a standstill.¹⁰⁶ Thus, auction participants enter the auction process without first determining the value of the company and without knowing what other bidders will

100. Bulow & Klemperer, *supra* note 46, at 1545.

101. Audra L. Boone & J. Harold Mulherin, *How are Firms Sold?*, 62 J. FINANCE. 847, 871 (2007).

102. *Id.* at 869.

103. WASSERSTEIN, *supra* note 72, at 746.

104. *Id.* at 746; *see also* Robert G. Hansen, *Auctions of Companies*, 39 ECON. INQUIRY 30, 30 (2001) (stating that a potential-bidder list likely includes “competitors, suppliers, customers, and acquisition-oriented conglomerates or leveraged buyout houses”).

105. WASSERSTEIN, *supra* note 72, at 746.

106. Climan, *supra* note 76, at 637.

bid.¹⁰⁷ It is this lack of knowledge that Professors Bulow and Klemperer contend enhance value maximization in an auction.¹⁰⁸

At a predetermined date pursuant to the target's bidding procedures, the interested bidders are required to submit a preliminary, nonbinding indication of interest.¹⁰⁹ These indications of interest "will be either a number or a range of numbers that are supposed to represent 'bidders' first approximations of their estimates of value of the target."¹¹⁰ The target and its financial advisor usually then narrow the field of bidders based on the prices contained in the indications of interest and other factors.¹¹¹ At this point, the narrowed field of bidders is asked to participate in a second round of bidding.¹¹² 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.¹¹³ In some cases, bidders will be expected to complete their due diligence reviews before final bids are submitted.¹¹⁴ Thus, the final bids will not be subject to satisfactory completion of due diligence.¹¹⁵ In addition, the target will send the final bidders a

107. Bulow & Klemperer, *supra* note 46, at 1545. A prominent investment banker, Bruce Wasserstein, explained, "The 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 auctioneer 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 72, at 748 (emphasis added).

108. Bulow & Klemperer, *supra* note 46, 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.*"); 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 [managers are] 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.") (citations omitted).

109. WASSERSTEIN, *supra* note 72, at 746.

110. Hansen, *supra* note 104, at 31.

111. WASSERSTEIN, *supra* note 72, at 747.

112. *Id.*

113. *Id.*; Hansen, *supra* note 104, at 31.

114. WASSERSTEIN, *supra* note 72, at 747.

115. See *id.* (noting that in certain instances the bid winner is announced on the final bid date).

sample purchase agreement that the final bidders will mark up and return with their offers on the final bid date.¹¹⁶

The auction winner is chosen based in large part on the offer price, but other factors, including the purchase-agreement mark ups, can play a significant role.¹¹⁷ 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 winner.¹¹⁸ 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.¹¹⁹ However, some auctions are “dripping wax” auctions in which the purportedly “final bids” are not actually final.¹²⁰ 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.”¹²¹

As Wasserstein has noted, an auction’s success depends in large part on how the auction is run, with an emphasis on the selective release of information during the auction process.¹²² Although the information provided to bidders in the offering memorandum and through due diligence “is extensive, it is not complete.”¹²³ Thus, bidders will likely have asymmetric information largely based on how

116. *Id.*

117. *See id.* (stating that “[p]rice often is the determining factor in an auction” and that differentiating between bidders who have submitted “unfavorable contract[s]” versus bidders who have submitted “clean” contracts can also play a crucial role); *see also* Jack & Suzy Welch, Op-Ed, *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 [private equity] 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.”).

118. *See In re Topps Co. S’holders Litig.*, 926 A.2d 58, 72 (Del. Ch. 2007) (listing such factors as reasons to deny the bidder continued friendly negotiations); *see also* WASSERSTEIN, *supra* note 72, at 747 (“[O]ne bidder might 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.”).

119. WASSERSTEIN, *supra* note 72, at 747.

120. *Id.*

121. *Id.*

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

123. Hansen, *supra* note 104, 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.*

the bidders interpret the information provided to them in the due diligence period as well as based on the preexisting information already in their possession.

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.¹²⁴ For example, if a company conducts a public auction, the company risks losing employees, customers, and suppliers.¹²⁵ 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.¹²⁶ Thus, in the event of a failed auction, it may take some time for a company to successfully sell itself.¹²⁷ 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.¹²⁸ 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.¹²⁹ Another common situation in which targets

124. 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); *cf. In re MONY Grp., Inc. S’holders Litig.*, 852 A.2d 9, 21 (Del. Ch. 2004) (recognizing benefits of single-bidder approaches).

125. *See In re Dollar Thrifty*, 14 A.3d at 597 (recognizing possible employee strife resulting from a leaked auction); *Yanow v. Scientific Leasing, Inc.*, C.A. Nos. 9536, 9561, 1991 WL 165304, at *668–69 (Del. Ch. July 31, 1991) (stating the board resisted an auction or market canvass fearing adverse effects on the 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 DEALBOOK (Aug. 23, 2012, 12:41 PM), <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.”).

126. Pettit et al., *supra* note 48.

127. *See* COMM. ON NEGOTIATED ACQUISITIONS, AM. BAR ASS’N, THE M&A PROCESS: A PRACTICAL GUIDE FOR THE BUSINESS LAWYER 94 (2005) (detailing the disadvantages of auctions, including the length of time to sell a company after a failed auction).

128. *See In re Topps Co. S’holders Litig.*, 926 A.2d 58, 62 (Del. Ch. 2007) (noting a target’s “legitimate proprietary concerns” about sharing information with a competitor).

129. *See, e.g., id.* at 70 (stating that the buyer’s bid was contingent on the target not conducting a public auction); *In re Dollar Thrifty*, 14 A.3d at 604

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 its financial situation.¹³⁰ For example, a multibillion-dollar corporation may have a limited number of suitors due to the corporation's size or the industry in which it operates.¹³¹ Hence a selling corporation may choose instead to engage in an informal auction process or to negotiate exclusively with one bidder.

2. The Presigning Market Canvass and the Negotiated Acquisition

Another alternative available to target companies is the presigning market canvass, or the informal auction. This is really a variation on the full-blown auction process. 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.¹³² The bidding process, if one does exist, is in "a less structured setting than that of a formal auction."¹³³

The presigning 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 presigning

(stating that a target weighed the risk of losing a potential buyer if the target conducted a public auction); *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 119 (Del. Ch. 2007) (discussing the risk of losing an initial bidder if the target engaged in a public auction and the risk an initial bidder would pay less if the response to the auction was "underwhelming").

130. See Boone & Mulherin, *supra* note 47, at 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 corporate M&A, particularly in cases involving one or a few large corporate bidders with significant expected synergies with the seller."); Pettit et al., *supra* note 48 ("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.").

131. In their research, Professors 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. Boone & Mulherin, *supra* note 47, at 30-32; see also Boone & Mulherin, *supra* note 101, at 870 ("[T]he choice of an auction or a negotiation in a particular takeover is related to characteristics such as target size and industry").

132. Boone & Mulherin, *supra* note 101, at 851.

133. *Id.*

market canvass may take place after a previously not-for-sale target company has been approached by a bidder or in situations 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.¹³⁴ 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.¹³⁵ 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 presigning.

3. Relevant Merger-Agreement Deal Terms and Postsigning Sales Activities

Regardless of the sales method initially chosen, “[b]ecause of [a] board's fiduciary duty to consider higher bids,” an auction-like setting will likely result from the sales process, thus implicating auction-theory considerations.¹³⁶ 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.¹³⁷ 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.¹³⁸ 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.¹³⁹ In addition, the fiduciary out allows the target company to terminate the existing agreement in favor of a third-party

134. Povel & Singh, *supra* note 11, at 1400.

135. *Id.*

136. Denton, *supra* note 25, at 1533.

137. Audra L. Boone & J. Harold Mulherin, *Do Termination Provisions Truncate the Takeover Bidding Process?*, 20 REV. FIN. STUD. 461, 475 (2007).

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

139. *Id.* at 73.

offer if the board determines it would be a violation of its fiduciary duties not to do so.¹⁴⁰ 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 the initial acquirer's confidentiality agreement.¹⁴¹ Thus, because the initial acquirer's confidentiality agreement generally contains a standstill, the overbidder's confidentiality agreement will likely contain a standstill.¹⁴² As will be detailed in Part V, the possibility exists that a target board could use the standstill as a means of favoring the initial acquirer over the overbidder.

Recently, parties have also begun to use go-shop provisions in some transactions.¹⁴³ Unlike a no-shop provision, a go-shop provision allows a target company to actively solicit third-party offers postsigning for a limited period of time.¹⁴⁴ Like the no-shop provision, a typical go-shop provision requires bidders to execute a confidentiality agreement with no-less-restrictive terms than the

140. *Id.*

141. *See* Denton, *supra* note 25, at 1539–40 (noting that go-shop provisions 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” and defining “Acceptable Confidentiality Agreement” as “any confidentiality agreement between the Company and any such Person existing as of the date of this Agreement” and “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 et al., *No-Shops & Fiduciary Outs: A Survey of 2012 Public Merger Agreements*, DALLAS BAR ASS'N 2, 6 (Dec. 11, 2012), http://www.dallasbar.org/system/files/dba_presentat ion--_no-shops_and_fiduciary_outs.pdf (finding, based on data from fifty-three public-company merger agreements signed in 2012 with transaction values over \$1 billion, that in almost half of the merger agreements an acceptable confidentiality agreement with an alternative bidder was one that was “no less favorable” or “not less restrictive”); *see also* Transcript of 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 merger-agreement provision that required third-party bidders to sign a confidentiality agreement with a standstill no less favorable than the one between the merger parties 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”).

142. *See* David Marcus, *Confis, Standstills and the Courts*, DEAL PIPELINE (Oct. 13, 2011, 2:11 PM), <http://www.thedeal.com/content/regulatory/confis-standstills-and-the-courts.php>.

143. Sautter, *supra* note 99, at 555.

144. *Id.* at 557.

initial acquirer's confidentiality agreement, meaning the bidder will be subject to a standstill.¹⁴⁵

IV. 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 through dicta. This Part summarizes those recent cases in which the Delaware Court of Chancery has commented on standstills. In addition, this Part also includes a description of two nonlitigated transactions in which standstills played a significant role in the sales process.

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

The Delaware Chancery Court's 2007 *In re Topps Co. Shareholders Litigation*¹⁴⁶ decision provides some helpful insight on the role and impact of standstills in a sale of corporate control. *Topps* involved a leveraged buyout of Topps Co. by a Michael Eisner-led group that ensured the retention of the majority of the company's key employees and senior management.¹⁴⁷

Although a presigning auction or market canvass was unacceptable under Eisner's proposal, Eisner agreed to a go-shop provision.¹⁴⁸ Thus, the merger agreement included a forty-day go-shop provision and "the right to accept a 'Superior Proposal' after that, subject only to Eisner's receipt of a termination fee and his match right."¹⁴⁹ At the outset of the go-shop period, Topps's financial advisor "contacted 107 potential strategic and financial bidders."¹⁵⁰ The only serious bidder who emerged during the go-shop period was Upper Deck, a competitor of Topps. Upper Deck's bid was for one dollar more per share than the Eisner proposal.¹⁵¹

The Topps board met after the go-shop period expired to determine whether Upper Deck could continue talks past the

145. See, e.g., *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 66 (Del. Ch. 2007) (recognizing a bidder required to execute a confidentiality agreement containing a standstill during a go-shop period).

146. 926 A.2d 58 (Del. Ch. 2007).

147. *Id.* at 61, 73–74.

148. *Id.* at 61.

149. *Id.*

150. *Id.* at 71.

151. *Id.*

expiration of the go-shop period as an “Excluded Party.”¹⁵² In deciding that Upper Deck could not continue talks with Topps, the Topps board raised potential antitrust concerns and questioned Upper Deck’s ability to finance the deal.¹⁵³ Upper Deck then made an unsolicited proposal and offered “to divest key licenses if required by antitrust regulators.”¹⁵⁴ The Topps board again determined the unsolicited proposal was not a “Superior Proposal.”¹⁵⁵ Perhaps more importantly for purposes of this Article, the Topps board also rejected Upper Deck’s request to be released from the standstill agreement, which prevented Upper Deck from publicly disclosing the information regarding its discussions with Topps and from launching a tender offer unconsented to by Topps’ board.¹⁵⁶

A group of Topps stockholders and Upper Deck moved for a preliminary injunction, maintaining that by refusing 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.”¹⁵⁷ Then-Vice Chancellor Strine, who has since become Chief Justice of the Supreme Court of Delaware, began his analysis of the case by acknowledging the “legitimate purposes” standstills can serve, including establishing rules that promote an orderly auction and providing a target with leverage in its negotiations with potential bidders.¹⁵⁸ Then-Vice Chancellor Strine acknowledged, however, that 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.”¹⁵⁹ Then-Vice Chancellor Strine further recognized that 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

152. *Id.* at 72. The Upper Deck offer was submitted only two days before the expiration of the go-shop period. The terms of the Topps-Eisner merger agreement defined an Excluded Party as “a potential bidder that the board considered reasonably likely to make a Superior Proposal.” *Id.* at 65, 71.

153. *Id.* at 72. These antitrust considerations included the possibility that authorities might delay or prevent the transaction and Upper Deck’s failure to sufficiently assume the antitrust risk. *Id.*

154. *Id.* at 90.

155. *Id.* at 72.

156. *Id.* at 62.

157. *Id.* at 63.

158. *Id.* at 91.

159. *Id.*

shopping process before signing with Eisner.”¹⁶⁰ Additionally, he recognized the board’s obligation to enforce the standstill only for “proper purposes.”¹⁶¹

By refusing to release Upper Deck from the standstill, the Topps board prevented its stockholders from both accepting a potentially higher offer and from receiving information regarding the transaction.¹⁶² Moreover, the board’s refusal also precluded “Upper Deck from obtaining antitrust clearance.”¹⁶³ As a result, then–Vice Chancellor Strine found that the Topps board’s enforcement of the standstill was “likely, after trial, to be found a breach of fiduciary duty.”¹⁶⁴ Until quite recently, then–Vice Chancellor Strine’s decision in *Topps* was the leading case providing guidance on how deal makers may use standstills during a sale of corporate control.

B. Potential Enforceability of DADW Standstills After Topps

Five transactions from 2011 and 2012 provide helpful commentary on the potential enforceability of DADW standstills. The first two cases, *In re Celera Corp. Shareholder Litigation*¹⁶⁵ and *In re RehabCare Group, Inc. Shareholders Litigation*,¹⁶⁶ arose in the context of the Delaware Chancery Court’s approval of settlements. Thus, those cases simply provide dicta regarding the enforceability of DADW standstills. However, two significant rulings issued in the final months of 2012 considered DADW standstills in depth. In *In re Complete Genomics, Inc. Shareholder Litigation*,¹⁶⁷ Vice Chancellor Laster invalidated a confidentiality agreement because it contained a DADW standstill.¹⁶⁸ In another case, *In re Ancestry.com Inc. Shareholder Litigation*,¹⁶⁹ then-Chancellor Strine found that the target board had likely breached its duty of care because of the way it employed a DADW standstill.¹⁷⁰ The Court of Chancery did not weigh

160. *Id.*

161. *Id.*

162. *Id.* at 92.

163. *Id.*

164. *Id.* Then–Vice Chancellor Strine stated that “Upper Deck ha[d] shown a reasonable probability of success on its claim that the Topps board [wa]s misusing the Standstill.” *Id.* at 91.

165. C.A. No. 6304-VCP, 2012 WL 1020471 (Del. Ch. Mar. 23, 2012).

166. C.A. No. 6197-VCL, 2011 Del. Ch. LEXIS 208 (Del. Ch. Sept. 8, 2011).

167. C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

168. Telephonic Oral Argument & the Court’s Ruling at 13, *Complete Genomics, Inc.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

169. C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

170. *In re Ancestry.com Inc. S’holder Litig.*, C.A. No. 7988-CS, slip op. at 22–29 (Del. Ch. Dec. 17, 2012).

in on the fifth transaction, Apollo Management VII, LP and KSL Capital Partners, LLC's fight for Great Wolf Resorts, Inc.¹⁷¹ But that deal provides an excellent example of the potentially erosive effects on shareholder value maximization that some standstills may have during the preclosing period.

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

From late 2007 through early 2008, RehabCare Group, Inc. and Kindred Healthcare, Inc. held preliminary discussions regarding Kindred's possible acquisition of RehabCare.¹⁷² At that time, Kindred submitted a preliminary indication of interest to acquire RehabCare, but the discussions ended after the parties were unable to reach an appropriate valuation for RehabCare.¹⁷³

After RehabCare's stock "dropped significantly," the board reevaluated its position and met in August 2010 to review strategic alternatives, including "standalone alternatives, potential acquisition targets, and potential financial and strategic partners."¹⁷⁴ The RehabCare board determined the only viable strategic acquirer was Kindred after considering "four other logical potential strategic acquirers of RehabCare and the various reasons that each such third party would not be a likely acquirer."¹⁷⁵ Uncertain of Kindred's willingness to proceed with a transaction due to the previous failed negotiations, the board directed its financial advisor to contact certain financial buyers to assess their interest in a potential transaction.¹⁷⁶

Starting on October 1, 2010, RehabCare's financial advisor contacted nine financial buyers, including parties referred to as Party A and Party B in the SEC disclosures.¹⁷⁷ Eight of the nine, including Party A and Party B, executed confidentiality and DADW standstill agreements preventing those parties from making unsolicited offers for RehabCare. Following the execution of these agreements, Party A and Party B submitted preliminary offers, both

171. *See supra* Part IV.B.5.

172. RehabCare Grp., Inc., Current Report (Form 8-K) (May 12, 2011).

173. *Id.*

174. *Id.*

175. *Id.* 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." *Id.*

176. *Id.*

177. *Id.* The financial buyers "were selected based on their experience in the healthcare industry and their ability to finance a transaction of this size." *Id.*

of which the RehabCare board found to be insufficient.¹⁷⁸ The other financial buyers did not submit offers and withdrew from the sales process.

On November 4, 2010, Kindred expressed to RehabCare an interest in making an all-cash acquisition of RehabCare at a price range above that of Party A's and Party B's offers.¹⁷⁹ A couple of weeks later, Kindred and RehabCare entered into a confidentiality agreement, including reciprocal standstill provisions. After conducting its due diligence review, Kindred submitted its first written offer of thirty-two dollars per share. Although more than both Party A's and Party B's preliminary offers, the RehabCare board nonetheless rejected Kindred's offer as inadequate.

Kindred increased its offer price to thirty-five dollars per share, of which twenty-six dollars was payable in cash and nine dollars was payable in Kindred common stock. The parties executed a merger agreement on February 7, 2011. Following the merger announcement, a number of RehabCare stockholders brought class action suits against the RehabCare directors and Kindred. Those suits were consolidated, and, on May 12, 2011, the parties reached a memorandum of understanding regarding a settlement.¹⁸⁰

Under the settlement, RehabCare and Kindred completely eliminated matching rights from the agreement, reduced their termination fee to \$13 million, and issued supplemental disclosures. More importantly for the purposes of this Article, they waived existing standstill provisions.¹⁸¹ The only issue before the court was the legal fees for the plaintiff's counsel.¹⁸² With respect to the DADW standstills, Vice Chancellor Laster commented:

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, at a minimum, or can ask in a back channel way. Why

178. *Id.* Kindred had expressed an interest in engaging in a transaction but did not formally submit a bid. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *See id.* (reporting that the memorandum of understanding reflected the parties' contemplation that “plaintiff's counsel [would] file petitions for the award of attorneys' fees and expenses”); *In re Rehabcare Grp., Inc. S'holders Litig.*, C.A. No. 6197-VCL, 2011 Del. Ch. LEXIS 208, at *12–13 (Del. Ch. Sept. 8, 2011) (granting attorneys' fees).

would you hurt yourself in terms of the optics by asking for that? One of those strange things in life.¹⁸³

Hence, at least in Vice Chancellor Laster’s opinion, even in the context of a more thorough sales process compared to the sales process conducted in *Topps*, DADW standstills may not be upheld during the preclosing period.

2. *Celera* and the Preclosing Period “Informational Vacuum”

Several months after Vice Chancellor Laster’s statement in *RehabCare*, Vice Chancellor Donald F. Parsons Jr., again in the context of a settlement, addressed a similar DADW standstill in *In re Celera Corp. Shareholder Litigation*.¹⁸⁴ The roots of that case began in November 2009 when the board of directors of Celera Corporation, a healthcare company, started to consider potential strategic transactions for the company.¹⁸⁵ In early February, the Celera board instructed its financial advisor and Celera senior management to engage in discussions with potential strategic buyers regarding a sale of the whole company, its individual assets, or business units.¹⁸⁶

Celera’s financial advisor and CEO “contacted nine potential bidders, five of which performed at least some measure of due diligence on the Company by April 2010”¹⁸⁷ Each of these five companies executed a confidentiality agreement containing a standstill preventing them from “making offers for Celera shares without an express invitation from the Board.”¹⁸⁸ The agreements also included “a broadly worded provision” that prevented the signing parties from requesting a waiver of this restriction.¹⁸⁹

In mid-April, Quest, one of the five parties, made a nonbinding preliminary offer to acquire the company as a whole for ten dollars, cash, per share.¹⁹⁰ Quest “conditioned its offer upon the execution of employment agreements with [Celera’s] key personnel including the [CEO].”¹⁹¹ In addition to the Quest offer, other parties made “lesser offers” and there was an “indication of interest from ‘Bidder C’” to

183. Transcript of Settlement Hearing at 46, *In re Rehabcare Grp., Inc. S’holders Litig.*, C.A. No. 6197-VCL (Del. Ch. Sept. 8, 2011).

184. *In re Celera Corp. S’holder Litig.*, C.A. No. 6304-VCP (Del. Ch. Mar. 23, 2012).

185. *Id.* at 5.

186. *Id.* at 5–6.

187. *Id.* at 6.

188. *Id.*

189. *Id.* (deeming the agreements “Don’t-Ask-Don’t-Waive Standstills”).

190. *Id.* at 7.

191. *Id.*

acquire only the company's products division.¹⁹² Following negotiations with Celera's special committee formed to oversee the sales process, on June 25, Quest increased its offer to \$10.25 per share, which the special committee deemed acceptable.¹⁹³ However, after meeting with the CEO to negotiate her employment agreement, Quest withdrew its offer, citing the potential effects of a negative study of one of Celera's drugs, KIF6, and "concerns regarding retention of the Company's management" following the merger.¹⁹⁴ Throughout the remaining six months of 2010, Celera continued to pursue strategic transactions but "no serious suitors emerged."¹⁹⁵ During that time "Celera's business was deteriorating, due in part to the publication of the negative KIF6 study in October."¹⁹⁶

On January 27, 2011, Quest submitted an offer of \$7.75 per share to acquire Celera. A few days later, Celera rejected an offer from Bidder *C* to acquire the company's products division, instead choosing to proceed in negotiations with Quest.¹⁹⁷ By mid-February, Quest and Celera entered into a merger agreement.¹⁹⁸ Under the agreement, Quest would commence a twenty-one-day tender offer for Celera common stock at eight dollars per share.¹⁹⁹ The agreement contained a no-shop provision, requiring Celera "to terminate any existing discussions with, and not to solicit competing offers from, potential bidders other than Quest."²⁰⁰ 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."²⁰¹

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.²⁰² Celera and Quest negotiated a settlement with the lead plaintiff, pursuant to which the termination fee would be reduced and the no-shop provision would be

192. *Id.*

193. *Id.*

194. *Id.* at 7–8 (indicating that Quest learned of the study during negotiations with the CEO).

195. *Id.* at 8.

196. *Id.*

197. *Id.*

198. *Id.* at 9.

199. *Id.* at 12 (indicating that the offer was made through Quest's acquisition subsidiary, Spark Acquisition Corporation).

200. *Id.* at 13.

201. *Id.*

202. *Id.* at 3, 15.

amended to invite bidders subject to the DADW provision of the standstill to submit bids.²⁰³

Vice Chancellor Parsons issued an opinion upholding the settlement agreement.²⁰⁴ In the decision, Vice Chancellor Parsons stated he was not proclaiming DADW standstills unenforceable.²⁰⁵ Moreover, Vice Chancellor Parsons recognized that 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."²⁰⁶ At the same time, Vice Chancellor Parsons stated the "[p]laintiffs have at least a colorable argument that these constraints collectively operate to ensure an informational vacuum."²⁰⁷ Once the board is in an "informational vacuum," it would not have any information enabling it to evaluate whether compliance with the merger-agreement terms would violate the board's fiduciary duties.²⁰⁸ Thus, he explained, "[c]ontracting into such a state conceivably could constitute a breach of fiduciary duty."²⁰⁹ Following Vice Chancellor Parsons's analysis, 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 DADW in *Rehabcare*, Vice Chancellor Laster addressed head-on the validity of DADW standstills in *In re Complete Genomics, Inc. Shareholder Litigation*.²¹⁰ He enjoined the enforcement of the DADW standstill without any suggestion that the sales process was inadequate or that the standstill restrained any party desiring to make a bid.²¹¹ In May 2012, Complete Genomics, Inc. engaged in a sales process, during which forty-two parties were contacted and nine parties signed confidentiality

203. *Id.* at 15 (indicating that the termination fee was reduced from \$23.45 million to \$15.6 million).

204. *Id.* at 3.

205. *Id.* at 54.

206. *Id.*

207. *Id.* at 53.

208. *Id.* at 53–54.

209. *Id.* at 54.

210. *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Dec. 4, 2012).

211. Telephonic Oral Argument & the Court's Ruling, *supra* note 168, at 20–21.

agreements.²¹² After receiving six proposals, the Complete Genomics board narrowed the field to two parties—BGI and Party *H*.²¹³ The board ultimately reached an agreement with BGI in September.²¹⁴

Vice Chancellor Laster enjoined the DADW standstill binding Party *J*, who had only participated briefly in the sales process.²¹⁵ In his ruling, Vice Chancellor Laster started by analogizing illegal bidder-specific, no-talk clauses²¹⁶ to DADW standstills, reasoning that both can similarly disable a board from making a reasonably informed decision.²¹⁷ While not ruling that DADW standstills were invalid per se, Vice Chancellor Laster reasoned that the DADW standstill agreement prevented the flow of information from Party *J* and thus precluded the Complete Genomics board from providing a current and candid recommendation.²¹⁸ Citing 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.”²¹⁹

Vice Chancellor Laster determined that harm existed because incoming information from bidders would be prevented under any circumstance, regardless of whether Party *J* breached the standstill.²²⁰ Thus, his concern focused on the harm caused by the board’s act of preemptively preventing communication altogether, not the harm that could result from another party being unable to bid.²²¹ Vice Chancellor Laster supported his reasoning by adding that a topping

212. Telephonic Ruling of the Court at 7–8, *In re Complete Genomics, Inc. S’holder Litig.*, C.A. No. 7888-VCL, 8 (Del. Ch. Nov. 9, 2012).

213. *Id.* at 8, 22.

214. *Id.* at 9.

215. Telephonic Oral Argument & the Court’s Ruling, *supra* note 168, at 13; Complete Genomics, Inc., Solicitation/Recommendation Statement (Schedule 14D-9) (Sep. 25, 2012) at 16. Party *J* first expressed interest only a few weeks prior to the deadline for final proposals from Party *H* and BGI. But on August 2, Party *J* indicated that it would not pursue a transaction and ended communications with the Complete Genomics board. *Id.*

216. Bidder-specific, no-talk provisions were invalidated in *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, C.A. No. 17398, 1999 Del. Ch. LEXIS 202 (Del. Ch. Sep. 27, 1999).

217. Telephonic Oral Argument & the Court’s Ruling, *supra* note 168, at 14–18.

218. *Id.* at 18.

219. *Id.*

220. *Id.* at 20.

221. *Id.* The situation therefore could not be remedied even in the absence of a bid from Party *J*. *Id.*

bid, presumably by Party *H*, was present, but he also went on to say that the reasoning would apply even in the absence of a topping bid.²²² Reflecting this observation, the order invalidated the provision of the standstill that prevented Party *J* from making private requests for permission to submit bids and had no effect on such public communications.²²³

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

Less than three weeks after Vice Chancellor Laster ruled on DADW standstills in *Complete Genomics*, then-Chancellor Strine weighed in, although expressing a very different view on the issue. In *In re Ancestry.com Shareholder Litigation*,²²⁴ then-Chancellor Strine was critical of the manner in which the board used the DADW standstill, but he otherwise sanctioned the general use of DADW standstills as an auction tool for value-maximization purposes.²²⁵

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 Ancestry.com, in which Spectrum owned a 30.7% stake.²²⁶ 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. 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. Party *A* thereafter indicated an interest in exploring a transaction for a price between thirty and thirty-two dollars per share. The board decided to perform a market check to evaluate the indication of interest from Party *A*.²²⁷

On April 22, a representative of private equity firm Permira Funds contacted Ancestry.com management to discuss a potential transaction. In May, Qatalyst, the board's selected financial advisor, contacted four potential strategic bidders and eight private equity firms including Party *A* and Permira.²²⁸ Later that month, Permira and six other private equity firms (Parties *C*, *E*, *F*, *G*, *H*, and *J*)

222. *Id.* at 23.

223. Complete Genomics, Inc., Amendment No. 12 to Solicitation/Recommendation Statement (Schedule 14D-9) (Dec. 7, 2012), at 2.

224. C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

225. *Id.* slip op. at 23.

226. Ancestry.com Inc., Preliminary Proxy Statement (Form PREM14A) (Oct. 30, 2012), at 16.

227. *Id.*

228. *Id.*

executed confidentiality agreements.²²⁹ Two potential strategic acquirers executed confidentiality agreements—Party *I* on June 4 and Party *L* on July 11—but neither ever submitted a proposal.²³⁰

Between June and October, Ancestry.com received bids from several of these financial investors.²³¹ During that time numerous newspaper articles reported on the sales process, one of which commented on the difficulties involved in the auction as a result of tensions between financial bidders.²³² Initially, some parties bid as high as thirty-eight dollars per share.²³³ However, after executing confidentiality statements and conducting due diligence, the parties each reduced their initial bids.²³⁴ Ultimately, the Ancestry.com board selected four parties—Party *C*, Party *J*, Permira, and later Party *A*—to invite to submit final bids.²³⁵ After Permira submitted the highest bid at thirty-two dollars per share and indicated it would go no higher, Permira and Ancestry.com executed a merger agreement on October 21.²³⁶

Litigation was filed challenging the propriety of the DADW standstills used in the process that were not previously mentioned in the SEC filings.²³⁷ Ancestry.com reacted on December 11 and sent letters waiving the DADW provisions to allow parties to request standstill waivers.²³⁸ On December 17, then-Chancellor Strine issued his ruling.²³⁹ Careful to take a fact-based approach and not make a per se ruling, then-Chancellor Strine noted the limited precedential value of bench rulings generally before discussing *Complete Genomics*

229. *Id.* at 17. Party *B* and Party *D*, potential strategic acquirers, both declined to participate in the sales process. *Id.*

230. *Id.* at 17, 19.

231. *Id.* at 18–23.

232. *Permira Back in Talks to Acquire Ancestry.com*, (Bloomberg TV television broadcast Oct. 2, 2012); see also Ancestry.com Inc., Preliminary Proxy Statement, *supra* note 226, at 18 (discussing different proposals submitted by financial bidders).

233. Ancestry.com Inc., Preliminary Proxy Statement, *supra* note 226, at 18.

234. *Id.*

235. *Id.* at 19, 21 (indicating that Party *A* was not initially selected as one of the final bidders but the board later reinvited Party *A* to engage in the negotiations).

236. *Id.* at 25, 26.

237. Ancestry.com Inc., Current Report: Supplement to Proxy Statement (Form 8-K) (Dec. 19, 2012).

238. *Id.*

239. *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

and *Celera*.²⁴⁰ He contemplated that DADW standstills could be used consistently with a board's fiduciary duties, but only when used for a particular value-maximizing purpose.²⁴¹ 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."²⁴²

Then-Chancellor 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.²⁴³ 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.²⁴⁴ In light of the waiver, then-Chancellor Strine's order merely required disclosure of the circumstances surrounding the use and waiver of the DADW provision.²⁴⁵

5. The Potentially Erosive Effects of Standstills on Value Maximization During the Preclosing Period

In addition to the potential informational vacuum and communication issues caused by standstills preclosing, if used improperly, standstills may have other potentially erosive effects on value maximization. For example, as then-Vice Chancellor Strine recognized in *Topps*, target boards can use standstills to favor a winning bidder over others.²⁴⁶ In addition, winning bidders will generally advocate for strict standstills as a type of deal-protection device to preclude losing bidders from any participation after signing.²⁴⁷ 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

240. *Id.* slip op. 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.”).

241. *Id.* at 23.

242. *Id.*

243. *Id.* at 25.

244. *Id.* at 24–25.

245. *Id.* at 26.

246. *In re Topps Co. S’holders Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007).

247. *Id.*

Wolf and expressed interest in a potential transaction.²⁴⁸ The company entered into five confidentiality agreements with strategic and financial parties, including Apollo.²⁴⁹ Several of the agreements were revised to include standstill provisions “for the protection of” Great Wolf.²⁵⁰

In July, Great Wolf’s financial advisor, Deutsche Bank, began a formal sale process, contacting approximately thirty-eight potential bidders, both strategic and financial.²⁵¹ Deutsche Bank distributed confidentiality agreements to approximately thirty-three parties interested in a strategic transaction.²⁵² By December, Great Wolf had entered into confidentiality agreements with eleven additional parties and continued to amend previously executed confidentiality agreements with more restrictive standstill covenants.²⁵³ Notably, the Apollo–Great Wolf standstill remained far less restrictive than any other agreement entered into by Great Wolf.²⁵⁴

As the sales process progressed, the field was narrowed to Party *N*, Party *J*, and Apollo.²⁵⁵ After evaluating the proposals, Great Wolf agreed to an exclusivity agreement with Apollo on December 20, based largely on financing considerations and the fact that Apollo had conducted greater due diligence.²⁵⁶ Several successive extensions of exclusivity occurred before Great Wolf accepted an offer from Apollo priced at five dollars per share.²⁵⁷ On March 12, 2012, the transaction, structured as a tender offer, was approved and executed by Apollo

248. Great Wolf Resorts, Inc., Solicitation/Recommendation Statement (Schedule 14D-9) (Mar. 13, 2012), at 14.

249. *Id.*

250. *Id.* at 11, 15.

251. *Id.* at 16.

252. *Id.*

253. *Id.*

254. *Compare* Great Wolf Resorts, Inc., Amendment No. 13 to Solicitation/Recommendation Statement (Schedule 14D-9) (Apr. 25, 2012), at 2 (containing the confidentiality agreements between Great Wolf and prospective bidders), *with* Great Wolf Resorts, Inc., Solicitation/Recommendation Statement, *supra* note 248, at 20 (containing the standstill and confidentiality agreement between Apollo and Great Wolf).

255. Each of these parties had executed confidentiality agreements. Great Wolf Resorts, Inc., Solicitation/Recommendation Statement, *supra* note 248, at 15–19.

256. *Id.* at 20.

257. *Id.* at 21–22, 25.

and Great Wolf, and Apollo began the publicly announced tender offer the following day.²⁵⁸

The definitive agreement provided a strong deal-protection scheme for Apollo.²⁵⁹ It contained a no-shop provision and provided that 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.²⁶⁰ Under the no-shop provision, Great Wolf was only permitted to entertain unsolicited bona fide written takeover proposals.²⁶¹ Great Wolf also agreed to immediately cease negotiations with any parties that may be ongoing as of the date of the agreement.²⁶² Together, the deal protections and reinforced standstill ensured that losing bidders would not even consider a bid.

After the merger announcement, Great Wolf shares began to trade well above the five-dollar offer price from Apollo, shareholders began to publicly criticize the deal, and several lawsuits were filed.²⁶³ Thereafter on April 4, despite Apollo’s ironclad deal-protection scheme, Great Wolf publicly announced the receipt of an unsolicited bid from KSL Capital Partners at a price of \$6.25 per share.²⁶⁴ On April 5, KSL and Great Wolf entered into a confidentiality agreement that waived the standstill provisions with respect to the April 4 KSL proposal and any future favorable proposals from KSL.²⁶⁵ A bidding

258. *Id.* at 26. The tender offer was scheduled to expire on April 10, 2012. Apollo Mgmt. VII LP, Tender Offer Statement (Schedule TO) (Mar. 13, 2012), at S-3.

259. Great Wolf Resorts, Inc., Current Report (Form 8-K) (Mar. 12, 2012), at 9. The deal provisions included an irrevocable top-up option, giving Apollo the right, if it were to acquire over fifty percent of Great Wolf shares in the tender offer, to purchase enough new Great Wolf shares at five dollars per share to obtain ninety percent 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 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 Statement (Schedule 14D-9) (Mar. 13, 2012), at 20–26.

260. Exhibit 2.1: Agreement and Plan of Merger by and among K-9 Holdings, Inc., K-9 Acquisition, Inc. and Great Wolf Resorts, Inc. (Mar. 12, 2012), at 54 *in* Great Wolf Resorts, Inc., Current Report, *supra* note 259.

261. *Id.*

262. *Id.* at 55.

263. Great Wolf Resorts, Inc., Amendment No. 5 to Solicitation/Recommendation Statement (Schedule 14D-9) (Apr. 9, 2012).

264. *Id.* at 19.

265. *Id.*

war ensued between Apollo and KSL, ending with a \$7.85 offer from Apollo that was agreed to by Great Wolf on April 20.²⁶⁶

On April 25, an agreement in principle was reached in the litigation.²⁶⁷ In connection with the settlement, Great Wolf agreed to make certain disclosures in its SEC filings and waive the standstill provisions with certain parties to permit confidential unsolicited bona fide written takeover proposals.²⁶⁸ In addition to exposing the details of the standstill agreements and the poison pill,²⁶⁹ 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 of it.²⁷⁰ 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 Entertainment and the Potential Detrimental Impact of Standstills During Preclosing Market Checks

The events surrounding the sale of Hollywood Entertainment Corporation—which operated Hollywood Video stores—best illustrate the potential detrimental impact of requiring overbidders to execute the same constrictive standstill to which the initial acquirer is subject during the postsigning market check. On December 10, 2003, the Hollywood board met to discuss strategic options after Mark Wattles—founder, chairman, CEO, and second largest shareholder of Hollywood Entertainment—learned of various private equity firms that could potentially acquire Hollywood, including Leonard Green & Partners (LGP).²⁷¹

After negotiating with Wattles, LGP signed a nondisclosure agreement containing a three-year standstill provision, and thereafter LGP proposed to acquire 100% of Hollywood’s stock for

266. Exhibit 99.1: Press Release, Great Wolf Resorts, Great Wolf Resorts Says KSL Notifies Company It Does Not Intend to Submit Further Acquisition Proposals (Apr. 20, 2012) *in* Great Wolf Resorts, Inc., Current Report, *supra* note 259. “The \$7.85 offer price represents a premium of 171% to the six-month average of Great Wolf’s share price prior to the announcement of Apollo’s original offer (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 closing stock price on the day prior to the announcement of the original offer.” *Id.*

267. Great Wolf Resorts, Inc., Amendment No. 13, *supra* note 254, at 5.

268. *Id.*

269. See *supra* note 259 for discussion of the poison-pill provision.

270. Great Wolf Resorts, Inc., Amendment No. 13, *supra* note 254, at 2.

271. Hollywood Entm’t Corp., Preliminary Proxy Statement (Form PREM14A) (Apr. 23, 2004), at 14.

thirteen dollars per share.²⁷² Hollywood's special committee rejected the thirteen-dollar price as inadequate and decided not to solicit additional bidders, fearing the risks of material-nonpublic-information leaks or a failed transaction.²⁷³ LGP then raised its offer to fourteen dollars per share, and the parties executed a merger agreement on March 28.²⁷⁴ The agreement contained a no-shop provision with a fiduciary out.²⁷⁵

Litigation ensued, provoking a settlement that required additional disclosures in the proxy statements, a reduction of the termination fee, and the preclusion of Wattles voting on the merger.²⁷⁶ After LGP shared its concerns regarding satisfaction of the merger agreement's financing condition, the agreement was amended to reduce the price from to \$10.25 and eliminate the termination fee and no-shop provision.²⁷⁷

Beginning in October, UBS Securities LLC, Hollywood's financial advisor, contacted twenty-five potential financial buyers and twelve potential strategic buyers, including Movie Gallery, Inc. and Blockbuster, Inc.²⁷⁸ Movie Gallery and Blockbuster requested confidential information.²⁷⁹ However, 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.²⁸⁰

On November 2, Blockbuster delivered an all-cash proposal of \$11.50 per share, but on November 4, the company also indicated that it was unwilling to enter into a three-year standstill.²⁸¹ 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, including a three-year standstill.²⁸² Movie

272. *Id.* at 15.

273. *Id.*

274. *Id.* at 19–20.

275. *Id.* at 51–54.

276. Hollywood Entm't Corp., Current Report (Form 8-K) (Jul. 8, 2004).

277. Hollywood Entm't Corp., Amendment No. 3 to Preliminary Proxy Statement (Form PRER14A) (Oct. 27, 2004).

278. Hollywood Entm't Corp., Preliminary Proxy Statement (Form PREM14A) (Jan. 26, 2005), at 15.

279. *Id.* at 15, 18.

280. *Id.* at 15.

281. *Id.* at 16.

282. *Id.* at 17.

Gallery then increased its offer to \$13.25 per share in cash.²⁸³ Blockbuster later issued a press release confirming it was interested and able to raise its offer, subject to elimination of the standstill.²⁸⁴

Hollywood's special committee met to consider LGP's indication that it would waive the obligation under the merger agreement to include a standstill provision.²⁸⁵ The special committee refused to eliminate the standstill provision and concluded that including a standstill for all bidders would not only 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—but also assure bidders that the process would be fair to all involved.²⁸⁶

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.²⁸⁷ On January 10, 2005, Hollywood announced it had terminated the LGP agreement and entered into an agreement with Movie Gallery.²⁸⁸ On February 2, Blockbuster raised its tender offer to a price of \$14.50 per share.²⁸⁹ However, on March 25, Blockbuster announced it would no longer pursue the tender offer.²⁹⁰

Had Blockbuster been brought into the market-check process, its presence might have pressured a bidding war between strategic rivals.²⁹¹ A three-year standstill, as Scott Keller, president of Dealanalytics.com stated, is “highly unusual,” and “[o]ne year is the norm.”²⁹² The imposition of onerous standstills like the one in

283. *Id.* at 18.

284. *Id.*

285. *Id.* at 18–19.

286. *Id.* at 19.

287. *Id.* at 20.

288. *Id.* at 22.

289. Hollywood Entm't Corp., Solicitation/Recommendation Statement (Schedule 14D-9) (Feb. 17, 2005), at 1.

290. Hollywood Entm't Corp., Current Report (Form 8-K) (Mar. 25, 2005).

291. After the Blockbuster bid received backing from Carl Icahn, Wattles stated: “A strategic buyer can afford to pay more for this company than a financial buyer and I am a financial buyer.” Exhibit 99.1: Jonathan Berr, *Blockbuster Says Hollywood Offer Faces ‘Difficulty’*, BLOOMBERG (Dec. 22, 2004, 4:46 PM), in Blockbuster Inc., Current Report (Form 8-K) (Dec. 23, 2004).

292. *Id.* 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 Entm't Corp., Preliminary Proxy Statement, *supra* note 278. Wattles was to

Hollywood Entertainment is not unique in the M&A world. Although they are common, as Part V details, the imposition of such standstills is potentially detrimental to shareholders in a sale of corporate control and is contrary to auction-theory principles.

V. 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 M&A process. Namely, target boards use standstills legitimately to control the process and 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 that they will inhibit and not enhance shareholder value. This Part uses auction-theory principles and examples of deal makers' real-world uses of standstills to detail how standstills can help enhance the sales process. But this does not mean that all standstills will universally aid the value-maximization process in every 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 presigning sales process. At the same time, standstills play an important role in the negotiation and sale of public companies. Deal makers 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.²⁹³ Because bidders enter into most standstills as part of a confidentiality agreement and in consideration for the receipt of confidential information, many bidders

continue serving as CEO and remain a substantial equity investor in the surviving company. *Id.* at 15. The contemplated employment agreement between Wattles and LGP was to terminate on the third anniversary of the merger. Exhibit (D)(4): Employment Agreement *in* Hollywood Entm't Corp., Transaction Statement (Schedule 13E-3) (Apr. 23, 2004).

293. Bulow & Klemperer, *supra* note 46, at 1546.

would not have access to information if they were not willing to execute a standstill.²⁹⁴

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.²⁹⁵ It follows that standstills likely enhance the presigning 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.

Auction theorists have also found that the implementation of rules and subsequent commitment to those rules play a significant role in whether a given sales process maximizes stockholder value.²⁹⁶ 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.²⁹⁷ 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 other’s 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.²⁹⁸

Auction theorists have found that strategic and financial bidders value companies differently and often rely more heavily on different types of information in reaching their valuations. Thus, auction theorists may argue that whether a bidder is willing to submit a higher bid may turn on another significant factor: whether strategic or financial bidders are involved in the process. But, as discussed in

294. Boone & Mulherin, *supra* note 47, at 29 (“In exchange for signing [standstill] agreements, prospective bidders are given access to non-public information about the seller . . .”).

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

296. Povel & Singh, *supra* note 11, at 1425.

297. *See supra* Part II.

298. *See supra* notes 105–08, 119 and accompanying text.

detail in Part I.A., most real-world M&A sales include *both* financial and strategic bidders. Moreover, even if a particular sales process includes only one type of bidder, it is difficult, if not impossible, to assume that a particular sales process is a purely common-value one or a purely private-value one. Thus, the use and validity of standstills, particularly DADW standstills, cannot turn simply on whether strategic or financial bidders are involved in the sales process, and distinctions cannot be drawn based on such an assumption. This Article assumes that most, if not all, transactions in which standstills are used have both private-value and common-value characteristics.

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

Although standstills generally aid in value maximization, some standstills may cause adverse effects on a sales process involving corporate control. In particular, this Part focuses on potentially restrictive standstills, such as DADW standstills and longer-term standstills. In another recently published 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.²⁹⁹ More specifically, I argued the courts are likely to examine the presigning sales process in resolving these issues.³⁰⁰ I contended that the more thorough the presigning sales process, the more likely the Delaware courts would be to uphold more restrictive standstills like DADW standstills.³⁰¹ Thus, if a target were to engage in an extensive full-blown auction process presigning, the more inclined the Delaware courts would be to enforce a target board’s refusal to waive a standstill.³⁰² Conversely, if the target were to engage in a more limited sales process presigning or only negotiate with one potential bidder, the Delaware courts are more likely to take issue with a board’s refusal to waive a standstill or to otherwise enforce a standstill that prevents the board from considering all possible offers.³⁰³ But that article did not address the more fundamental issue of whether the use of DADW 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 these teeth should not be sharpened when other deal-protection mechanisms alleviate the workload borne by standstills postsigning.

299. Sautter, *supra* note 7, at 988–89.

300. *Id.*

301. *Id.* at 988.

302. *Id.*

303. *Id.*

1. DADW Standstills

In *Celera*, Vice Chancellor Parsons warned both 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 to evaluate whether continuing to comply with the merger agreement's terms would violate the board's fiduciary duties.³⁰⁴ As a result, Vice Chancellor Parsons suggested that the board of directors would be breaching its fiduciary duties.³⁰⁵ Vice Chancellor Laster then commented in *RehabCare* that DADW standstills "optically look bad" and that they are likely inconsistent with then-Vice Chancellor Strine's ruling in *Topps*.³⁰⁶ Vice Chancellor Laster also seemed to suggest that even in the context of a fully shopped deal, a DADW standstill may not be valid.³⁰⁷ Then-Chancellor Strine, the author of the *Topps* opinion, then weighed in on DADW standstills in *Ancestry.com*. In that case, then-Chancellor Strine focused on whether the standstill was being used as a "gavel" with a specific value-maximizing purpose and whether the bidders were made aware that there may not be any more bites at the apple.³⁰⁸ 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 more restrictive standstills to enhance value maximization.

In an ideal world, to analyze whether DADW standstills are legitimate and consistent with auction theory, one would divide the sales processes into those with mainly strategic bidders and those with mainly financial bidders because of the unique valuations arising from each group. However, because in practice most sales processes involve both strategic and financial bidders, one must assume that the sale process will have both private value and common value elements. But the bottom line for all bidders, common value and private value, is that information, both with respect to the target company and other

304. *In re Celera Corp. S'holder Litig.*, C.A. No. 6304-VCP, 2012 WL 1020471, at *21 (Del. Ch. Mar. 23, 2012).

305. *Id.*

306. *In re Rehabcare Grp., Inc. S'holders Litig.*, C.A. No. 6197-VCL, 2011 Del. Ch. LEXIS 208, at *46 (Del. Ch. Sept. 8, 2011).

307. *See* Telephonic Ruling of the Court, *supra* note 212, at 5, 7–8 (declining to enjoin the standstill provision but recognizing that legal issues were present even where forty-two parties were contacted as potential acquirers); *see also* Telephonic Oral Argument & the Court's Ruling, *supra* note 168, at 18 (finding that a DADW standstill "represents a promise by a fiduciary to violate its fiduciary duty, or represents a promise that tends to induce such a violation").

308. *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS, slip op. 23 (Del. Ch. Dec. 17, 2012).

bidders, is of paramount importance. As previously discussed, standstills help to control this flow of information. Moreover, as auction theorists have found, to the extent that is practical, the enactment of rules and structure in the auction process aids in enhancing value and optimizing the auction. Standstills are one of the tools in a target board's toolkit. But some limitations must be placed on the use of the standstills to obtain the most value-enhancing incentives and to ensure the board's sale process is consistent with its fiduciary duties.

First, consistent with then-Vice Chancellor 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 presigning shopping of the target. Such presigning 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 then-Chancellor Strine's comments in *Ancestry.com*, all bidders entering into the bidding process and agreeing to a standstill 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 any 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 has become popular in recent years.³⁰⁹

In my previous work, 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 sale-of-control context.³¹⁰ 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

309. See Sautter, *supra* note 138, at 59, 85–87, for a description of these merger-recommendation fiduciary outs for intervening events.

310. Sautter, *supra* note 7, at 989 n.433.

supported by auction-theory principles of using standstills to extract more value presigning.

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 fee, 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 to 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.³¹¹ In those deals, if the board were to terminate the agreement for an intervening event, a higher termination fee becomes payable.³¹² Thus, deal makers have experience in negotiating and interpreting these intervening events as well as the staggered termination fees that may be applicable.

The foregoing framework rests on the assumption that the sales process used is that of a classic auction as described in Part III.B.1. The likelihood of a classic auction being used as the chosen sales process is significant because Professors Boone and Mulherin’s study of 400 corporate takeovers found that half resulted from an auction process.³¹³ The framework would also work in the context of an extensive market canvass as described in Part III.B.2. Although deal makers should opt for less restrictive standstill terms in such situations because there is a greater risk that they have not shopped the market and that the value 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’s three-year term standstill lasted for a period three times longer than

311. *Something Old, Something New . . . : A Quick Survey of Recent Developments in Public M&A Deal Terms*, KIRKLAND M&A UPDATE (Kirkland & Ellis LLP), May 2, 2011, at 1 [hereinafter *Something Old, Something New*] (mentioning deals that used a higher termination fee “payable to the buyer if it terminates the deal following an intervening event change of recommendation by the target”); see also Sautter, *supra* note 138, at 102–03 (suggesting a higher termination fee be applicable to intervening event change of recommendations).

312. *Something Old, Something New*, *supra* note 311.

313. See *supra* Part III.B.1 for a discussion of this study and the auction process.

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—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. The same would hold true for many businesses in today's rapidly changing global marketplace, where 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 that could result in a higher bid after confirmatory due diligence. Moreover, such a long-term standstill could cause hostile action, further risking disruption of 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 who 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 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 bidders 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 accretive to the sales process. These standstills are not responsive to changing market conditions or to 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, deal makers 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 account for 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, myriad other readily available deal-protection devices can be used to encourage bidders to put their best bids on the table.

3. An Alternative to DADW Standstills

In lieu of using DADW standstills or 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 preclosing period. In negotiating these deal-protection devices, the target and initial acquirer can tailor those devices to 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 overbidder 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 presigning sales process. For example, the typical termination fee in an M&A transaction is three to four percent of the deal value.³¹⁴ The merger agreement between a target and a winning bidder could contain a three percent termination fee applicable to most termination events, including the target's termination of the agreement to enter into an agreement with a third-party overbidder who was not bound by a standstill. If, however, the third-party overbidder is a party bound by a standstill, a higher termination fee, like five, six, or even seven percent, could be applicable.

Deal makers could also increase the termination fee based on how well shopped the company was presigning. For example, if the target held a full public auction presigning, 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 presigning as a higher termination fee would be applicable to them postsigning. Moreover, the winning bidder would be further assured that its deal would be protected by virtue of the termination fee. Of course for this arrangement to properly incentivize bidders, all bidders must be made aware, prior to bidding, that the target is willing to agree to this higher-termination-fee structure in the definitive acquisition agreement with the winning bidder.

314. *Something Old, Something New*, *supra* note 311, at 2 (noting that most merger agreements provide for a break-up fee between two percent and four percent of deal's value).

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; thus, 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 until closing, the same level of inefficiency that Professors Bulow and Klemperer argue makes the auction more profitable,³¹⁵ does not necessarily exist. Of course, new bidders who have previously neither engaged in due diligence nor been privy to the target's confidential information will still be "relatively ill-informed." But at the same time, a potential overbidder 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 preexisting deal. In other words, a potential overbidder can free ride to a certain extent on the existing deal to make an acquisition proposal. Those bidders who were part of the presigning 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 presigning, they must continue after a deal is signed; otherwise, they may be ignored. Granted that a standstill needs to continue after a deal is signed to have any integrity, it

315. Bulow & Klemperer, *supra* note 46, at 1546.

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.³¹⁶ 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 that they were on a level playing field. 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.³¹⁷ 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.³¹⁸ 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 171%.³¹⁹ 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 Parsons’s or now–Chief Justice Strine’s reasoning. Applying then–Chancellor Strine’s reasoning from *Ancestry.com*, the provision was not used as a “gavel” with the goal of value maximization.³²⁰ Based on the facts as extracted from SEC filings, during its sales process, Great Wolf does not appear to have asked bidders to make final bids or to have told bidders in advance of the auction ending.³²¹ 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 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

316. *See supra* Part IV.B.5.

317. *See supra* note 268 and accompanying text.

318. *See supra* notes 259–62 and accompanying text.

319. *See supra* notes 266 and accompanying text.

320. *In re Ancestry.com Inc. S’holder Litig.*, C.A. No. 7988–CS, slip op. 23 (Del. Ch. Dec. 17, 2012).

321. *See supra* notes 248–57 and accompanying text.

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 now-Chief Justice Strine's reasoning but also a court applying Vice Chancellor Parsons's reasoning would likely find that a target's use of such a combination would result in an informational vacuum.³²² 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 be unable 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 Great Wolf DADW standstill, would likely be invalid in Vice Chancellor Parsons's view.

In cases like Great Wolf, what begins as a necessary prelude for the protection of the target and the facilitation of an exchange of confidential information can turn into both 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.

CONCLUSION

Standstills, the M&A equivalents of a "school-yard time-out,"³²³ have become standard features of the public company sales process. Despite the prevalence of standstills, 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 will preempt the process while giving bidders access to its proprietary information, assuring bidders of their valuation. Thus, standstills help to enhance the sales

322. *In re Celera Corp. S'holder Litig.*, C.A. No. 6304-VCP, 2012 WL 1020471, at *21 (Del. Ch. Mar. 23, 2012).

323. *See supra* note 8 and accompanying text.

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 time, however, when standstills are enhanced to provide greater restrictions on the sales process or to 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 under 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 DADW 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 carries 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 DADW standstills, or even the revised DADW framework advocated in this Article, I suggest using a staggered termination fee that can better achieve value maximization with less risk. In adopting the framework set forth in this Article, deal makers 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.

