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CONFIDENTIALITY AND STANDSTILL AGREEMENTS: RECENT DELAWARE LAW DEVELOPMENTS

Three Delaware Court of Chancery decisions have involved close scrutiny of "don't ask, don't waive" standstill agreements in connection with claims that the board breached its fiduciary duties in agreeing to such provisions. In another case, the court held that a party breached the use and disclosure provisions in confidentiality agreements in launching a hostile tender offer, even in the absence of an express standstill provision. The authors discuss these and other cases and suggest practice points for corporate counsel.

By Patricia O. Vella and Jessica C. Pearlman *

In public company acquisitions, sellers often enter into confidentiality agreements with potential bidders to ensure that those bidders do not disclose to the public the information the seller discloses to them in the diligence process. These confidentiality agreements may also include standstill provisions under which a prospective bidder of a public target agrees that it will not publicly bid for that target for a given period unless the target consents. Last year, there were three significant developments in Delaware involving confidentiality agreements and standstill agreements. First, the Delaware Court of Chancery indicated it would closely scrutinize standstill agreements where a potential buyer is prohibited from asking a seller for a waiver of the standstill (known as "Don't Ask, Don't Waive" standstills). Second, the Delaware Court of Chancery interpreted use and disclosure restrictions in confidentiality agreements as amounting to a "back-door" standstill, temporarily prohibiting a hostile tender offer; the Delaware Supreme Court affirmed. Third, the Delaware Superior Court dismissed a potential buyer's claim to recover its diligence costs based on intentional misrepresentations made by the seller during diligence, where the confidentiality agreement contained nonreliance and disclaimer of liability provisions; the Delaware Supreme Court affirmed.

"DON'T ASK, DON'T WAIVE" STANDSTILLS

The Delaware Court of Chancery expressed concern in several cases in 2012 over the interplay between a "Don't Ask, Don't Waive" provision in a standstill agreement (whereby the recipient of confidential information agrees not to ask the information provider to waive any provision of the standstill), and a no-solicitation provision in a definitive acquisition agreement (whereby the seller agrees not to contact third parties about potential alternative transactions, typically

∗ *PATRICIA O. VELLA is a partner in Morris, Nichols, Arsht & Tunnell LLP in Wilmington, Delaware, and JESSICA C. PEARLMAN is a partner in K & L Gates LLP in Seattle, Washington. Their e-mail addresses are pvella@mnat.com and jessica.pearlman@klgates.com.*

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subject to a fiduciary out permitting discussions if the seller is approached by a third party). One purpose of "Don't Ask, Don't Waive" provisions is to prohibit bidders involved in the sales process from approaching the target requesting a waiver of the standstill provisions after the target enters into a definitive acquisition agreement with another party. "Don't Ask, Don't Waive" provisions therefore incentivize potential bidders to put in their highest bids during the sales process – otherwise they will be precluded from making any additional offers. Although the court has not identified a bright-line rule, it addressed these "Don't Ask, Don't Waive" provisions in three different cases in 2012. Overall, the court expressed concern over the effect these provisions may have on a target board's fiduciary duty to maximize value for its stockholders in certain circumstances. These three Delaware Court of Chancery rulings highlight the issues at play and the factually dependent nature of the court's analysis.

In re Celera Corp. Shareholder Litigation[1]

In *Celera,* in the context of a court-approved settlement, the court discussed the potentially problematic interaction between a "Don't Ask, Don't Waive" standstill and a no-solicitation clause, suggesting that the provisions may collectively "operate to ensure an informational vacuum" in violation of Delaware law.

The board of directors of Celera Corporation had retained an investment banker to market all or part of the company. Celera entered into confidentiality agreements with five bidders. Each confidentiality agreement contained a provision that prohibited the bidder from requesting a waiver of the standstill. The acquisition agreement contained a no-solicitation provision and an agreement not to waive any existing standstills unless not waiving would be inconsistent with the board's fiduciary duty. In a proposed settlement with the plaintiffs, Celera agreed to reduce the termination fee, modify the no-solicitation provision to invite competing offers from the potential bidders subject to the "Don't Ask, Don't Waive" standstills, and extend the tender offer period.

In its approval of the settlement, the court noted that "Don't Ask, Don't Waive" provisions are not *per se* unenforceable. The court explained that standstill agreements, including those containing "Don't Ask, Don't Waive" provisions, when "viewed in isolation" function to "foster legitimate objectives," such as ensuring that confidential information is not misused, establishing the "rules of the game that promote an orderly auction," and providing a corporation with leverage to "extract concessions from the parties who seek to make a bid."

The court also noted that a no-solicitation provision, when viewed in isolation, appears legitimate: although the agreement prevented Celera from contacting potentially interested parties, it contained a fiduciary out permitting the board to waive the standstills if the failure to waive would be inconsistent with the board's fiduciary obligations to stockholders.

The court viewed the pairing of a "Don't Ask, Don't Waive" standstill with a no-solicitation provision, as in this case, as "more problematic." "Don't Ask, Don't Waive" standstills prevent previously interested parties from informing the board of their continued interest, and the no-solicitation clause prevents the board from inquiring further as to those parties' interest. The court explained this "measure of willful blindness" arguably "emasculates whatever protections" the fiduciary exception to the no-solicitation provision and the agreement not to waive existing standstills otherwise could have provided. However, although the *Celera* court noted this potentially problematic interaction, it stopped short of creating a *per se* rule invalidating "Don't Ask, Don't Waive" provisions.

In re Complete Genomics, Inc. Shareholder Litigation[2]

A few months after its decision in *Celera,* in a two-part bench ruling in *Complete Genomics,* the Court of

[1] 2012 WL 1020471 (Del. Ch. Mar 23, 2012).

[2] Telephonic Ruling of the Court, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012) [hereinafter "First Hearing"]; Telephonic Oral Argument and the Court's Ruling, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012) [hereinafter "Second Hearing"].

Chancery once again weighed in on the validity of "Don't Ask, Don't Waive" standstills. Complete Genomics, Inc. had signed four confidentiality/standstill agreements with a version of a "Don't Ask, Don't Waive" provision, and ultimately entered into a two-step merger agreement, including a provision prohibiting the target from waiving or modifying the standstills (with no fiduciary exception). In the First Hearing, a stockholder plaintiff sought to enjoin enforcement of the no-waiver provision in the merger agreement. The court, under the impression that the confidentiality agreements prohibited only public requests to waive the standstill provisions, refused to grant a preliminary injunction on the condition that the target promptly notify the plaintiff if a party made a nonpublic request to be released from the standstill agreement.

Later that same month in its Second Hearing, after learning that one bidder's standstill provision prohibited both private and public waiver requests, the court did enjoin enforcement of a "Don't Ask, Don't Waive" provision in that bidder's confidentiality standstill agreement. The court noted that "a Don't Ask, Don't Waive Standstill resembles a bidder-specific no-talk clause, in violation of a board's ongoing obligation to 'remain informed' and to 'provide a current, candid and accurate merger recommendation.'" The court found that the use of this provision, under the facts at issue, limited the board's ability to satisfy its fiduciary duties to its stockholders.

In re Ancestry.com Inc. Shareholder Litigation[3]

The final installment to date in the string of Delaware "Don't Ask, Don't Waive" rulings is the Delaware Court of Chancery's December 2012 bench ruling in *Ancestry.com*.

Ancestry's banker solicited 17 bidders and Ancestry signed 12 confidentiality agreements containing "Don't Ask, Don't Waive" provisions. The winning bidder signed a merger agreement containing a no-solicitation provision that expressly permitted Ancestry to waive any standstill or similar provision. Ancestry did not waive the losing bidders' standstills or "Don't Ask, Don't Waive" provisions before signing the merger agreement. The stockholder plaintiffs sought to enjoin the merger on the basis that the combination of the no-solicitation and the "Don't Ask, Don't Waive" provisions created an "informational vacuum" by preventing the losing bidders from making a topping bid, or even indicating a willingness to make such a bid, without breaching its standstill agreement with Ancestry, thus preventing the target board from maximizing short-term value for its stockholders. The plaintiffs also sought information as to the specific terms of the standstills. After the plaintiffs filed the litigation, Ancestry waived the "Don't Ask, Don't Waive" provisions in the standstill agreements with all prior bidders. The plaintiffs subsequently sought disclosure relating to Ancestry's decision to waive.

Ultimately, the court found that the target board did not understand the effect of the "Don't Ask, Don't Waive" provision, thereby preventing the board from using the provision for "value-maximizing purposes." The court stated:

> I'm not prepared to rule out that they can't be used for value-maximizing purposes. But the value-maximizing purpose has to be to allow the seller as a well-motivated seller to use it as a gavel to impress upon the people 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. And therefore, you should bid your fullest because if you win, you have the confidence of knowing you actually won that auction at least against the other people in the process.

The court ordered the target to disclose the effect, and eventual waiver, of the "Don't Ask, Don't Waive" provisions because the stockholders should know what comfort they can take as to the ability of a topping bidder to make a superior proposal under the terms of the acquisition agreement. Specifically, the court found that before Ancestry waived the "Don't Ask, Don't Waive" provisions, there was a segment of the market that could not take advantage of the opportunity to make a superior proposal, at least not without risking that such act would constitute a breach of such bidder's standstill agreement with Ancestry.

The court's ruling in *Ancestry.com* is particularly important for its clarification of the rulings in *Celera* and *Complete Genomics*: the court clarified that although "Don't Ask, Don't Waive" standstills could be found to be inequitable under certain facts, they are not *per se* illegal.

[3] Court's Ruling on Plaintiffs' Motion for Preliminary Injunction, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

In re Intermec, Inc. Shareholder Litigation[4]

An even more recent decision from the State of Washington addressed the validity of "Don't Ask, Don't Waive" standstills. In *Intermec*, plaintiffs sought a preliminary injunction of the stockholder vote on the acquisition of Intermec, a Delaware corporation, by Honeywell under a merger agreement governed by Delaware law, in part because the merger agreement contained a no-solicitation provision and three of the 12 standstill agreements negotiated in a pre-signing market check included "Don't Ask, Don't Waive" standstill provisions. (The other standstills included either a "fall-away" trigger under which the standstill agreements would expire upon a public announcement of a transaction with, or proposal by, another party, or a "confidential proposal carve-out" under which the party could make a private request to waive the standstill agreement.) The Washington Superior Court denied the motion for a preliminary injunction, noting that the three parties subject to "Don't Ask, Don't Waive" provisions were not "serious contenders" – one was only interested in buying a portion of the business, one bowed out of the bidding, and one was never really a player. The court also pointed out that while "[t]he language in *Complete Genomics* goes the farthest in plaintiffs' favor . . . that case does conflict with comments in the *Celera* and *Ancestry* opinions which do essentially indicate that such provisions are not per se unenforceable."

"Don't Ask, Don't Waive" Practice Points

The cases indicate that a "Don't Ask, Don't Waive" standstill is a powerful value-maximizing tool in the sales process; therefore, a board needs to be informed of the interplay between a no-solicitation provision in a definitive acquisition agreement, a "Don't Ask, Don't Waive" provision in a standstill agreement, and a provision in a definitive acquisition agreement under which the seller agrees not to waive any prior standstills. The board should consider the advice of its financial advisor as to whether it would be value-maximizing under the circumstances for the prior bidders in the process to continue to be bound by the standstill agreement, including the "Don't Ask, Don't Waive" provision, or whether the standstill should fall away once the target enters into a definitive acquisition agreement. Moreover, if the circumstances warrant, before signing a definitive acquisition agreement, the board should consider whether it should waive any standstill agreements, including the "Don't Ask, Don't Waive" provisions. The board should also consider the existence of standstills entered into outside of the current sale process and the possibility that the provision in the definitive acquisition agreement to not waive any existing standstills would limit those parties, even though not involved in the current sale process, from making a topping bid. Finally, the board should consider the extent of the disclosure required of the details of standstills entered into by various bidders.

"BACK-DOOR" STANDSTILLS

The second important development involving confidentiality agreements (also commonly referred to as nondisclosure agreements) is the Delaware Court of Chancery's interpretation of use and disclosure provisions in confidentiality agreements so as to prevent the recipient of confidential information under such agreements from launching a hostile takeover, even in the absence of an express standstill provision, if the hostile tender offer resulted in a violation of the use or disclosure provisions of the confidentiality agreements.

Martin Marietta Materials, Inc. v. Vulcan Materials Co.[5]

Martin Marietta involved a hostile takeover attempt by Martin Marietta for Vulcan. Martin Marietta and Vulcan had agreed to provide one another with nonpublic information under the terms of a nondisclosure agreement ("NDA") in connection with their exploration of a negotiated merger of equals. Under the NDA, each party agreed it (i) would use the other party's confidential information "solely for the purpose of evaluating a Transaction," with "Transaction" defined as "a possible business combination transaction . . . between" Martin Marietta and Vulcan or one of their subsidiaries, and (ii) would not disclose such information for purposes other than the evaluation of a Transaction. Also under the NDA, the parties agreed not to disclose the fact that confidential information was made available or that discussions or negotiations had taken place, unless disclosure was "legally required." The NDA also included a process requiring the party compelled to disclose information in response to an external demand to give prior notice to the other party to give that other party an opportunity to seek a protective order preventing such disclosure. Similar restrictions on use and disclosure were contained in a joint defense and confidentiality agreement (the "JDA") between the parties, which provided that confidential materials could be used "solely for purposes

[4] No. 12-2-01841-1 (Wash. Super. Ct. Mar. 15, 2013).

[5] 56 A.3d 1072 (Del. Ch. 2012), *aff'd*, ___ A.3d ___, 2012 WL 2783101 (Del. July 10, 2012).

of pursuing and completing the Transaction," and used a different definition of "Transaction" than that in the NDA (in this case, "a potential transaction being discussed by [the parties] . . . involving the combination or acquisition of all or certain assets of their stock").

After executing the NDA and the JDA, Vulcan lost interest in the merger, and Martin Marietta, taking advantage of a decline in Vulcan's stock price, sought to acquire Vulcan by way of an exchange offer made directly to Vulcan's stockholders. Martin Marietta sought a declaration from the Delaware Court of Chancery that the NDA and JDA did not bar its exchange offer.

Vulcan argued that Martin Marietta breached the NDA and JDA by using the confidential information to formulate a hostile bid, and a hostile bid does not qualify as a "business combination transaction between" Vulcan and Martin Marietta because the exchange offer does not require a contract "between" the companies leading to a combination. Vulcan also argued that even if Martin Marietta could launch a hostile bid, it could not reveal publicly its prior discussions with Vulcan (or any of the confidential information) in federally required filings in connection with the exchange offer, because the "legally required" exception only applied if the requirement to disclose came from an external demand (*e.g.*, requests via legal proceedings, subpoena, civil investigative demand). Since there was no external demand (but instead simply a unilateral decision to launch the exchange offer triggering the federal disclosure requirements), Martin Marietta should not be permitted to disclose. Finally, Vulcan argued that even if Martin Marietta could launch a hostile bid and could make the follow-on disclosures triggered by federal rules, Martin Marietta went further and disclosed information when such information was not legally required to be disclosed – *i.e.*, in investor calls and press releases.

Martin Marietta argued that the lack of an explicit standstill agreement in the NDA and JDA allowed for the exchange offer. Martin Marietta also argued that a tender offer constituted a "Transaction" under the NDA and the JDA because it was a business combination between the parties, and therefore Martin Marietta should be permitted to use the confidential information in its consideration of its exchange offer and back-end merger. Finally, Martin Marietta argued that "legally required" exceptions to the nondisclosure obligation should not be limited to external demands but should include any time a disclosure is legally required – even if the requirement is triggered by a party's own discretionary actions. Once such information was disclosed in a required public filing, Martin Marietta argued it should be free to disclose the same information in other formats, such as in investor conference calls.

The court found that Martin Marietta breached the NDA. The court's factual findings – namely, (i) that Martin Marietta's CEO was concerned about confidentiality and was initially only interested in sharing information in support of a consensual deal and (ii) that Martin Marietta used confidential Vulcan information in launching and formulating the terms of its hostile bid – were important to the court's finding of a breach.

The court found that although "business combination transaction" has no single, clear meaning, and "between" could refer to a negotiated transaction between the parties or the eventual mingling of assets, the extrinsic evidence (negotiating history, course of conduct, objective manifestations of intent) supported Vulcan's interpretation of the ambiguous phrase "business combination transaction between" Vulcan and Marietta as prohibiting use of confidential information in a hostile transaction. The court also found that the exchange offer was not a "Transaction" under the JDA because it was not a transaction "being discussed" at the time the JDA was negotiated. Moreover, the court found "legally required" to be an ambiguous term and looked to the drafting history and the Martin Marietta CEO's initial intent to maintain maximum confidentiality in interpreting its meaning. Based on the extrinsic evidence, the court found that the only disclosures that were "legally required" were those that were in response to an external demand. Therefore, Martin Marietta's Form S-4, with 10 pages of negotiating history included therein, breached the nondisclosure obligations of the NDA because it was not filed in response to an external demand. Beyond that, even if the Form S-4 disclosure was "legally required," disclosure of the same information to the media and on investor calls was a breach. The court enjoined Martin Marietta's bid for four months, thereby preventing Martin Marietta from running an opposing slate of directors at Vulcan's annual meeting – effectively, a "back-door" standstill in the absence of an actual standstill agreement. The Delaware Supreme Court affirmed.

"Back-Door" Standstill Practice Points

Martin Marietta provides several useful takeaways with regard to "back-door" standstills. Practitioners should use care when drafting "use" restrictions in confidentiality agreements. Practitioners will want to craft terms such as "transaction" carefully, and ought to pay particular attention to the use of "between" versus "involving" in such definitions. The negotiating history

– including handwritten notes and internal memoranda – is also important in that a court may use it in its fact-finding process. Further, practitioners should review contemporaneous agreements for consistency in approach and defined terms.

NONRELIANCE PROVISION

In another decision that the Delaware Supreme Court affirmed, the Delaware Superior Court held that potential buyers will not be permitted to recoup diligence costs based on the theory that the seller misrepresented the existence of certain liabilities, when a confidentiality agreement contains a form of nonreliance provision (in this case, a provision expressly stating that the seller is not making, and the buyer is not relying on, any representations or warranties whatsoever until such time as specific representations and warranties are set forth in an executed definitive acquisition agreement), a provision disclaiming seller's liability, and a waiver by the potential buyer of the right to bring any claim against the seller.

RAA Management, LLC v. Savage Sports Holdings, Inc.[6]

The issue in *RAA* arose in the context of RAA's attempt to acquire Savage. The parties executed an NDA, whereby RAA agreed not to disclose nonpublic, confidential information regarding Savage. The NDA contained a form of nonreliance clause providing that no representation as to the information being provided to RAA was being made by Savage until set forth in a definitive acquisition agreement and that Savage would have no liability resulting from RAA's use of the information. The NDA also included a provision whereby RAA expressly waived the right to bring any claim relating to a transaction between the parties except claims based on a completed transaction where the parties had entered into a binding, final sale agreement.

RAA eventually lost interest in acquiring Savage due to its belief that Savage had committed fraud by misrepresenting to and concealing from RAA three material unrecorded liabilities. RAA sought to recover $1.2 million in due diligence costs in the Delaware Superior Court, which costs it claimed it would not have incurred if Savage had been candid about these liabilities from the beginning of the diligence process. The court dismissed RAA's complaint, finding that the NDA unambiguously barred any liability to seller for fraudulent misrepresentations. The Delaware Supreme Court affirmed.

[6] 45 A.3d 107 (Del. 2012).

Although the Delaware Supreme Court applied New York law, it noted that the result would be the same under Delaware law. The court held that the NDA was unambiguous and did not contain an express exception for intentional or fraudulent misrepresentations, or an implicit exception for inaccurate or incomplete information attributable to fraud. Moreover, although New York law allows for a "particular-knowledge exception" – when a nonreliance provision would not successfully bar a fraudulent inducement claim if relevant facts were "peculiarly within the misrepresenting party's knowledge" – this exception is typically unavailable when a sophisticated party fails to contractually protect itself. The court, citing *Abry Partners V, L.P. v. F&W Acquisition LLC*,[7] further noted that Delaware's public policy weighs in favor of enforcing contractually binding written disclaimers of reliance on representations made outside of a final sale agreement. Therefore, since RAA's fraud claim was based on misrepresentations allegedly made by Savage in the due diligence process outside of a final written agreement, its claim was barred by the nonreliance, disclaimer, and waiver provisions in the NDA.

Nonreliance Practice Points

In light of *RAA*, a carefully drafted nonreliance provision will limit the liability of a disclosing party – even for claims of fraud or intentional misrepresentation – for information disclosed during the due diligence process outside of a final written agreement. Thus, to the extent a bidder desires to maintain an ability to recoup diligence costs based on the fraudulent or intentional actions of the seller, it should exclude intentional misrepresentations and fraud from the nonreliance provision and from any broad waivers of seller's liability; otherwise, Delaware courts will follow the parties' agreed-upon language and disallow such claims.

CONCLUSION

These recent cases from the Delaware courts have important ramifications on the enforceability and operation of provisions that companies employ in their confidentiality and standstill agreements. Accordingly, practitioners should keep these cases in mind in the early stages of potential transactions when negotiating confidentiality and standstill agreements, whether on behalf of sellers or potential bidders. ■

[7] 891 A.2d 1032 (Del. Ch. 2006).