Judgment Call: Don't Ask, Don't Waive

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Two recent bench rulings by respected Delaware Chancery Court judges — In re: *Complete Genomics Inc. Shareholder Litigation* (Vice-Chancellor Laster) and *In re: Ancestry.com Inc. Shareholder Litigation* (Chancellor Strine) — questioned, and in one case enjoined the enforcement of, so-called "don't ask, don't waive" standstill provisions in deal process confidentiality agreements. Although we do not believe that these provisions are now per se unenforceable in Delaware, target companies will need to employ these provisions with care to ensure that they survive judicial scrutiny.

In Delaware and some other states, in certain circumstances company sales processes are characterized as auctions — processes designed to produce the highest short-term value reasonably available to stockholders. Auctioneers of rare art or other items say "going, going …" and pause before saying "gone" for a reason — to induce the best bid, but they never let bidders hold back and rebid after the gavel comes down for good reason. Before *Genomics*, most deal practitioners believed that the same thinking applied to company sale processes.

The rationale behind "don't ask, don't waive" provisions is the same — once a bidder has been invited into the process to make an offer and has been given access to confidential information, the target board wants to incentivize bidders to make their best and final proposals as to price and terms. The Chancery Court's rulings in *Genomics* and *Ancestry.com* were bench rulings, and thus lack binding precedential effect. Nonetheless, such decisions indicate how the Chancery Court views certain issues put before it.

In Genomics, Vice Chancellor Laster enjoined Complete Genomics Inc. from enforcing a "don't ask, don't waive" provision in a confidentiality agreement with a bidder in connection with its merger with BGI-Shenzhen. He stated that "[b]y agreeing to this provision, the Genomics board impermissibly limited its ongoing statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information, and make a meaningful merger recommendation to its stockholders."

Ancestry.com Inc. was involved in a going-private transaction in which the company entered into a confidentiality agreement that also included a "don't ask, don't waive" provision. Chancellor Strine's bench ruling, published about three weeks after the *Genomics* bench ruling, stated that these provisions were not per se invalid, although Chancellor Strine concluded that Ancestry.com's public disclosures regarding the nature of the restriction were not sufficient.

In discussing the issue, Chancellor Strine observed that the Delaware courts have been reluctant to create bright-line rules invalidating, in all cases, contract provisions in mergers. "Per se rulings where judges invalidate contractual provisions across the board are exceedingly rare in Delaware, and they should be. . . . This Court is a court of equity, and usually we're dealing with the [question of whether something is equitable under the circumstances]. And it's usually for the [l]egislature to determine when something is per se unlawful."

Chancellor Strine recognized the analysis in Genomics, as well as the *In re: Celera Corporation Shareholder Litigation* case from earlier in 2012 in which Vice-Chancellor Parsons also expressed concern about the effect of a "don't ask, don't waive" standstill provision particularly when taken together with a no-shop provision. Chancellor Strine pointed out, however, that Celera expressly stated that the court was not adopting a per se rule against "don't ask, don't waive" provisions, and that there was no prior ruling of the Delaware courts to that effect. "I think what *Genomics* and *Celera* both say, though, is [w]hoa, this is a pretty potent provision … [and] directors need to use [these provisions] consistently with their fiduciary duties, and they better be darn careful about them."

We do not conclude from these cases that "don't ask, don't waive" standstill provisions are unenforceable per se and continue to believe that they should be included in standstills signed up at the outset of a strategic assessment process in appropriate circumstances. These provisions can effectively incentivize acquirers to make their best bids at a time in the auction process, thereby increasing the likelihood that stockholder value will be maximized. As such, we think that these provisions can and should be enforceable. Chancellor Strine's admonition that there is no per se rule against "don't ask, don't waive" standstill provisions, made after *Genomics*, should be observed in other cases, and the specific facts in *Genomics* will afford the courts the ability to do what they think is right. As with other merger process issues, we think that courts will consider the extent to which the deal was shopped originally, the number of potential buyers and the extent to which the stockholders have committed to supporting the transaction.

An important lesson of *Ancestry.com* is that a target's board should be informed of the key elements of the bidding process in general, and that the process advisers need to create the record that appropriately reflects this. Although we do not believe that these cases require extensive oversight on these matters by the board, we do think that more involvement than has historically been the case may now be needed. At the very least, the board should be apprised of the approach taken with the confidentiality and standstill agreements, and should consider and approve the approach utilized in the process.

Cases like *Genomics* and other decisions since the financial crisis in which the board's oversight powers have been nitpicked seem to proceed from the assumption that the board is not really on the job. Real life experience, however, indicates that this is not at all the case. The *Genomics* court was concerned by the prospect of directors willfully blinding themselves to potential higher bids in the future, but what incentive do they have to do that? In our experience, target boards in fact do their best to maximize stockholder value, including in circumstances in which management may have conflicting interests like leveraged buy-outs.

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