The Harvard Law School Forum on Corporate Governance and Financial Regulation
SUPPORTED BY: CSC CORPORATION SERVICE COMPANY

Don't Ask/Don't Waive Standstills & Attorneys' Fees in Delaware

Posted by Noam Noked, co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Monday November 18, 2013

Editor's Note: This post is based on a Morris, Nichols, Arsht & Tunnell LLP client memorandum by Morris Nichols' Delaware Corporate Counseling Group partners Andrew M. Johnston, Eric Klinger-Wilensky, and associate Jason S. Tyler, and Morris Nichols' Delaware Corporate & Business Litigation Group partners William M. Lafferty and John P. DiTomo. This post is part of the Delaware law series, which is cosponsored by the Forum and Corporation Service Company; links to other posts in the series are available here.

Court of Chancery Revisits Covenants Against Waiving "Don't Ask/Don't Waive" Provisions

In a recent bench ruling, *In re Complete Genomics, Inc. Shareholder Litigation*, the Court of Chancery offered new insight into the ability of a target board to promise an acquiror that the target will not waive a "don't ask/don't waive" standstill provision.

A "don't ask/don't waive" standstill provision is typically found in a confidentiality agreement that a target requires potential bidders to enter into before being entitled to receive sensitive target information. The "don't ask/don't waive" provision precludes a potential bidder from making a private approach to the target board *and* from requesting any waiver of the standstill itself. If the target later signs a merger agreement with another party containing a negative covenant prohibiting the waiver of standstill agreements, the "don't ask/don't waive" and the negative covenant (the "Coupled Provisions") preclude the previous bidder from ever providing a topping bid to the target.

In an earlier ruling in *Complete Genomics*, Vice Chancellor Laster enjoined the enforcement of a "don't ask/don't waive" provision. Focusing on a board's ongoing duty to make a fully informed recommendation to stockholders, the Court held that the combined effect of the Coupled Provisions impeded the "flow of incoming information" to directors and, in turn, impermissibly limited the board's obligation to "make a meaningful merger recommendation to its stockholders."

Many read this decision as signaling the Court would find the use of the Coupled Provisions invalid *per se*.

Later rulings from the Court of Chancery eschewed a view that use of the Coupled Provisions is invalid *per se*. Most notably, in *Ancestry.com*, Chancellor Strine observed that use of the Coupled Provisions *might* be permissible if (i) done to extract additional value in an auction process (ii) the target board satisfied its duty of care in deciding to do so and (iii) sufficient disclosure was made to stockholders (i.e., that the stockholders understand the informational limitations created by the use of the Coupled Provisions).

In a recent hearing to approve a request for attorneys' fees, Vice Chancellor Laster appeared to adopt the *Ancestry* approach. Although re-emphasizing that the use of the Coupled Provisions "creates informational gaps for the stockholders and the board," and suggesting a preferred approach of enjoining the "don't ask/don't waive," the Vice Chancellor stated that an alternative would be to "cure the informational vacuum by telling the stockholders the type of information that they're never going to get."

The law governing a fiduciary's use of the Coupled Provisions is still developing, and the Court's ruling was made in the context of a fee application; it was not a decision on the merits. Nonetheless, the Vice Chancellor's statements suggest that the Coupled Provisions may be properly deployed if done so in a manner consistent with the directors' fiduciary duties of loyalty and care, and if the existence and effect of the Coupled Provisions are fully disclosed to stockholders. Practitioners should be wary of a formulaic approach, however. The propriety of using the Coupled Provisions, and the amount of disclosure to stockholders required, must be assessed against the facts of each transaction.

Court of Chancery Further Refines How It Assesses Attorneys' Fees for Therapeutic-Only Benefits

The amount of fees awarded for "Therapeutic-Only" benefits has attracted considerable commentary in recent years. In a noteworthy bench ruling, Vice Chancellor Laster signaled a conscious effort to keep attorneys' fees for achieving nonmonetary benefits from exceeding attorneys' fees awarded in cases that result in actual monetary payments to stockholders.

On October 2, 2013, the Court heard argument on a stockholder plaintiff's request for an award of attorneys' fees for obtaining supplemental disclosure about the negotiation process leading up to a merger and the injunction of a "don't ask/don't waive" provision. Plaintiffs were seeking a fee award of $1,400,000.

For the supplemental disclosure, Vice Chancellor Laster departed from the $400,000 to $500,000 baseline he had set a few years earlier in *In re Sauer-Danfoss Inc. Shareholders Litigation*, 65 A.3d 1116 (Del. Ch. 2011). Vice Chancellor Laster observed that, in another recent case, a plaintiff had obtained a $2.5 million post-trial judgment, which resulted in a fee of only about $500,000. The Court noted that "[i]t is completely implausible … [to] equate the injunctive relief that was made here about the CEO disclosure with $2.5 million in hard cash money recovery." The Court then awarded $300,000 for the disclosure, largely because that was the amount defendants argued was appropriate. The Vice Chancellor "probably independently would have come in below [that] amount."

Regarding the injunction of the "don't ask/don't waive" standstill, Vice Chancellor Laster observed that the benefit of modifying deal protection measures is "an increased opportunity for stockholders to receive a greater value." The Court then employed a quasi-mathematical formula to derive a reasonable attorneys' fee for obtaining such a benefit.

Under the Court's formula, it multiplied the likely incremental increase of a topping bid by the increased probability of the topping bid attributable to the modification, and then awarded counsel a portion of that amount (typically 25%). Here, the Court's formula suggested $84,000 was a reasonable fee for enjoining the "don't ask/don't waive" provision. Importantly, the Court reduced the amount to $15,000 because the standstill prevented only 1 bidder out of 9 from making a competing offer. The total fee awarded was $315,000.

Implications

The Complete Genomics ruling reflects the Court's continuing efforts to ensure that awards of attorneys' fees remain commensurate to the results plaintiffs' counsel achieve in deal litigation cases. Vice Chancellor Laster confirmed that he will continue to employ the mathematical formula used in Complete Genomics, and to rely on statistical studies for determining the probability of topping bids. The Court did note, however, that the value that formula yields "doesn't make that the answer [i.e., the fee award]. That makes that the upper bound."