Executive COUNSEL

THE MAGAZINE FOR THE GENERAL COUNSEL, CEO & CFO JUNE/JULY 2012

Shut Up and Stand Still

Understanding the Role of Standstill Provisions in M&A Disputes

By Terri L. Mascherin, Kyle A. Palazzolo and Gaurav Jetley

When HCP, a health care real estate investment trust, announced a topping bid for Sunrise Senior Living REIT (SZR) in February 2007, it probably did not expect to lose the bidding and ultimately shell out more than $225 million to the successful bidder. One of the reasons for the unhappy outcome for HCP: Under the terms of a confidentiality agreement, HCP was prohibited from bidding outside of the sale process and from making any public disclosures regarding its interest in acquiring SZR – let alone disclosures that, it turned out, were inaccurate.

As corporate attorneys know, in the M&A context parties contemplating a negotiated transaction typically enter into a confidentiality or non-disclosure agreement (CA) to facilitate the exchange of non-public information.

Those CAs may include a standstill clause, which aims to protect the target from a hostile takeover attempt by an acquirer armed with access to the target's confidential information. A standstill may prohibit a suitor from making an unsolicited offer, whether public or private, and may limit the suitor's ability to sponsor a proxy contest or take other steps to attempt to pressure the target into a deal, enabling the target to exercise some control over public disclosures. On May 4, 2012, the Delaware Chancery Court found that hostile bidder Martin Marietta had breached confidentiality agreements with target Vulcan Materials, and blocked the transaction. *The Wall Street Journal* called it a "strong message for the deals community: Confidentiality agreements count."

Courts have recognized that a corporation may properly impose restrictions on bidders in order to run an effective process. In the *Topps Co. Shareholder Litigation*, the Delaware Chancery Court recognized "[w]hen a corporation is running a sale process, it is responsible, if not mandated, for the board ... to establish rules of the game that promote an orderly auction ... [A] board striving in good faith to extract the last dollar they could for their stockholders might promise ... [that the top bidder] will get very strong deal protections including a promise from the target not to waive the Standstill as to the losers."

Recently, the Chancery Court reiterated the enforceability of standstills in *Celera Corporation Shareholder Litigation*.

From the target's perspective, standstills help maintain control over the sale process, ideally ensuring that the target's board will be the decision maker in determining when and how to disclose a potential transaction to the market. As a rule, companies do not want to be put in play by another firm, as this creates uncertainty among the targets' employees and customers, which can lead to a decline in revenues and profitability and weaken the target's negotiating ability.

Moreover, public disclosure of a bid attracts arbitrageurs to the target's stock. They seek to profit by realizing the difference between the target's stock price and the ultimate deal price. To get the deal done, arbitrageurs will pressure the target to negotiate with a hostile bidder, even if the target's board is against the deal. The impact of their presence on deal-related disputes can be significant as well. In *Air Products v. Airgas*, a highly publicized case in the Delaware Chancery Court, Chancellor Chandler pointed to the extent to which the common stock of Airgas was held by arbitrageurs as one of the factors in his ruling upholding the Airgas poison pill defense. Given that acquirers try to buy a target for the lowest possible price, having a company in play increases the risk that the target will be sold for a relatively low price.

Courts have recognized that a corporation may properly impose restrictions on bidders in order to run an effective process.

KEEP QUIET

As noted above, CAs, with or without a standstill, restrict the ability of potential acquirers to make public disclosures. The risk of non-compliance with these terms can be severe, as *Ventas v. HCP* illustrates.

By way of background, SZR, a Canadian REIT listed on the Toronto stock exchange, conducted a structured sales process to identify a buyer. Ventas, HCP, and several other potential acquirers negotiated and executed CAs with SZR. HCP's included both a standstill and a confidentiality undertaking. By early 2007, Ventas and HCP were the only two buyers still in the process. Ultimately, only Ventas put forth an unconditional binding final offer. On January 15, 2007, SZR and Ventas announced that Ventas had entered into an agreement to acquire SZR for C$15 in cash per unit, and to assume SZR's debt.

On February 14, after the market closed, HCP publicly disclosed a purported offer to acquire SZR at $C18 per unit. Overnight, SZR's stock price shot from under $C15 to over $C18. Over the next few weeks, litigation in Canada resulted in HCP withdrawing its "offer." However, as to Ventas' deal, the die was cast. Ventas was forced to increase its offer from C$15 to C$16.50 to secure the votes necessary to complete the transaction from SZR's unit holders. Ventas then commenced litigation against HCP in the U.S. It sought to recover $101 million – the amount by which it had to enhance its offer in order to complete the deal – plus punitive damages.

In the trial that followed, a jury found HCP liable for tortious interference with Ventas' C$15 deal and awarded $101 million in damages. The jury found that HCP engaged in "significantly wrongful conduct" because HCP's press release misrepresented that HCP had made a binding offer to acquire SZR, and HCP did not disclose that it was unable to reach an agreement with the firm that managed SZR's properties and that its board was unwilling to make an unconditional bid without that agreement in hand.

The Sixth Circuit affirmed, finding that HCP made several statements to SZR and to the market that were "contaminated by fraud, misrepresentations, and concealment." The court held that "HCP's alleged fraud in this case was the direct cause of Ventas's injury." Following that appeal, HCP agreed to pay an additional $125 million to settle Ventas' punitive damages claim.

The Ventas case shows how markets react to disclosures relating to a transaction, and the critical importance of controlling the flow of information. The market's reaction to HCP's February 14, 2007 release was swift. Not only did the price jump to over C$18, but an unusually large number (over 25 times the normal volume) of shares were traded. The fact that new unit holders had paid significantly more than C$15 doomed Ventas' ability to generate enough votes to close the transaction at C$15. HCP's subsequent withdrawal of its offer did not change that dynamic, as HCP's conduct gave unit holders enough leverage to make Ventas increase its offer to C$16.50.

HCP ran afoul of the law because Ventas and SZR had negotiated careful deal protections, and because HCP sought to take its case to the public markets with inaccurate information. The standstill in HCP's CA factored heavily in that outcome. Ventas' Purchase Agreement with SZR gave Ventas the legal means to protect its deal in the Canadian courts and require SZR to enforce the standstills entered into by other potential acquirers. After HCP issued its press release, SZR and Ventas both went to the Canadian courts seeking adjudication of the parties' rights and obligations. SZR's ability to consider HCP's purported offer was litigated under Canadian law, which governed the deal documents.

Litigation in Canada resulted in HCP withdrawing its "offer," but the die was cast.

The Ontario Superior Court, and later the Court of Appeal, found for Ventas. The courts held: (1) HCP's standstill precluded HCP from submitting a subsequent bid, and the Purchase Agreement required SZR to enforce that standstill; (2) the requirement that SZR enforce the standstill was balanced and objectively reasonable; and (3) SZR acted reasonably in designing and conducting the auction process to maximize value. The Canadian courts' rulings led HCP to announce that it was withdrawing its purported offer to acquire SZR.

The damages awarded Ventas in the U.S. courts resulted from HCP's unusual strategy of taking its case to the public markets and doing so with less than completely accurate and truthful information. Those damages might have been avoided had HCP complied with its CA. But the courts did not have to rely upon the CA, because the jury found that HCP's statements to the market were fraudulent. As the Sixth Circuit recognized in upholding the jury's verdict, "[t]he public interest in full and fair competition is furthered by imposing liability on a market player, such as HCP, for fraudulently leveraging a public market to sabotage a competitor, as liability for such conduct will deter similar future conduct and promote economic certainty in the marketplace."

Inaccurate disclosures can distort market prices and, hence, are not sanctioned by the courts. In the context of M&A, inaccurate information can be and usually is harmful. Consider that HCP's disclosures increased the risk that SZR's deal with Ventas would not close. Had that risk materialized, the loss to Ventas and to SZR would potentially have been even greater than the damages awarded to Ventas. Enforcing CAs and standstills, and preventing inaccurate disclosures, will facilitate transactions, as both targets and bidders will have reason to be confident that deals will not be derailed by unauthorized or inaccurate information.

Corporate counsel for the target and bidders in a sales process are well advised to understand how standstills can benefit parties on both sides of the transaction, and to assess the risks inherent in the loss of control over the deal process. ■

Terri L. Mascherin is a partner in Jenner & Block's Litigation Department, based in Chicago. She has extensive experience in disputes over corporate transactions, partnerships, joint ventures, licenses, and contracts.
tmascherin@jenner.com

Kyle A. Palazzolo is an associate based in Jenner's Chicago office. He concentrates on complex civil litigation.
kpalazzolo@jenner.com

Gaurav Jetley is a vice president in the New York office of Analysis Group, an economic consulting firm. He has worked on numerous merger-related litigations and authored research on M&A issues.
gjetley@analysisgroup.com

Reprinted with permission from Executive Counsel, June/July 2012. On the Web at www.executivecounsel.info.
© EXECUTIVE COUNSEL. All Rights Reserved. Foster Printing Service: 866-879-9144, www.marketingreprints.com.