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## Standstill Considerations in an M&A Context: Recent Developments and Some Practice Pointers

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In connection with proposed mergers and acquisitions of public companies, the target company often requests that the potential acquiror enter into a standstill agreement providing protection of the public target from unwanted takeover attempts by the potential acquiror. Standstill agreements provide various levels of protection and stability to the target company and its board of directors to conduct an orderly sale process. Such standstill agreements are typically made part of the confidentiality agreement entered into by the parties prior to the exchange of proprietary, non-public information for purposes of the acquiror's due diligence investigations. The rationale for the target company's request for a standstill agreement is simple—the target wants the process to be consensual and the terms mutually agreed upon. So, before providing confidential information about its business and operations and before the potential acquiror has committed to enter into a definitive acquisition agreement, the target company wants to ensure that the potential acquiror does not use the confidential information to launch a hostile bid of the target if the parties cannot reach a mutual agreement on the terms of the sale.

This article (i) describes and analyzes recent case law about standstill agreements, (ii) provides an overview of the legal considerations and duties facing the target company's board of directors in connection with a standstill agreement, (iii) provides an example of a broad and target friendly standstill agreement, and (iv) offers practice pointers regarding some of the key terms of a standstill agreement, typically subject to negotiation and consideration of the parties.

### Recent Delaware Case Law: Breaching a Standstill Agreement Can Result in Substantial Liability

On May 17, 2011, the United States Court of Appeals for the Sixth Circuit upheld a \$101,672,807 judgment rendered by the United States District Court for the Western District of Kentucky, in favor of Ventas, Inc. ("Ventas") and against HCP, Inc. ("HCP"), on Ventas' claim of tortious interference with a prospective advantage.<sup>1</sup> Ventas' claim stemmed from HCP's breach of a standstill agreement entered into with Sunrise Senior Living Real Estate Trust ("Sunrise"), as part of a two-round auction process to purchase Sunrise.<sup>2</sup> This case makes it clear that a prospective buyer may be held liable to another buyer for its breach of a standstill agreement, where such breach denies such other buyer a bargained for prospective advantage. In *Ventas, Inc. v. HCP, Inc.*, the prospective advantage in question was the all but certain approval by Sunrise's unitholders of the definitive acquisition agreement, at Ventas' final offer price of \$15.00 per unit.

In late 2006, Sunrise, a Canadian real estate investment trust, conducted a confidential auction of its units.<sup>3</sup> Ventas and HCP, both large American real estate investment trusts specializing in healthcare-related properties, participated in the auction. During the first round, several potential buyers, including Ventas and HCP, were invited to submit non-binding initial bids to acquire Sunrise. Sunrise used these initial bids to narrow the pool of prospective buyers to those who would be invited to

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submit a final bid. As part of its auction procedures, Sunrise required each participant to sign a confidentiality agreement, which included a standstill provision (the “Sunrise Standstill Agreement”). The Sunrise Standstill Agreement, among other things, prohibited the participant from making or announcing any bid outside of the prescribed auction process for a period of 18 months following the conclusion of the auction. The Sunrise Standstill Agreement also prohibited any actions by the participant that would require Sunrise to publicly announce a bid outside of the auction process. Ventas and Sunrise negotiated and entered into separate Sunrise Standstill Agreements, with neither being party to the other’s agreement. HCP’s Sunrise Standstill Agreement permitted HCP to make one final bid within the time frame allotted for the second round of bids. Ventas’ Sunrise Standstill Agreement, however, permitted Ventas to make a second final bid, if Sunrise accepted a competing offer after Ventas made its final bid.<sup>4</sup>

Ventas and HCP each made competitive preliminary bids for Sunrise. Ventas offered \$13.25 per unit and HCP offered \$16.25. Both bids were expressly conditioned upon the bidding party reaching an agreement with Sunrise Senior Living, Inc. (“SSL”), a third party that managed Sunrise’s properties under long-term management contracts. Upon the completion of the first round of bids, Sunrise selected only Ventas’ and HCP’s bids to proceed to the second round. During the second round, Ventas and HCP were required to submit a final bid by January 14, 2007. Therefore, Sunrise, ultimately, sought to force Ventas and HCP to reach independent agreements with SSL on or before the January 14, 2007 deadline.<sup>5</sup> This proved difficult for HCP, given a pre-existing, separate, and on-going business relationship with SSL in connection with another portfolio of properties.

As a result of its failure to reach an agreement with SSL, HCP did not meet its January 14, 2007 final bid deadline, and withdrew from the auction process. On that date, Ventas, having reached an agreement with SSL, submitted its unconditional final bid to acquire Sunrise at \$15.00 per unit, for a total purchase price of \$1,137,712,410. Sunrise’s Board of Trustees approved the offer the same day, and Sunrise and Ventas entered into a definitive acquisition agreement, in which Ventas agreed to purchase Sunrise for \$15.00 per unit, subject to approval of the transaction by two-thirds of Sunrise’s voting unitholders. Additionally, the definitive acquisition agreement required Sunrise to use best efforts to secure unitholder approval, and, although Sunrise remained free to respond to unsolicited offers, the definitive acquisition agreement prohibited Sunrise from any activities in furtherance of alternative bids and required Sunrise to enforce all existing Sunrise Standstill Agreements with third parties.<sup>6</sup>

On January 15, 2007, Sunrise and Ventas issued a press release, announcing the signing of the definitive acquisition agreement, and Canadian markets reacted positively to the news. Initially, Sunrise unitholder approval was viewed as a foregone conclusion—the \$15.00 per unit purchase price was record-breaking, as it represented a 50% premium over Sunrise’s market price before the deal.<sup>7</sup> In fact, Ventas’ investment bankers opined that the Ventas offer had an initial 95% expectation of approval, as no similar deal had ever been rejected by Canadian shareholders. In the weeks following the public announcement of the definitive acquisition agreement, Sunrise’s CEO suggested, via e-mail, that HCP’s CEO should make a follow-up offer for Sunrise. HCP, heeding this suggestion, revived its discussions with SSL in hopes of removing the past obstacles to reaching an agreement. On February 14, 2007, HCP advised Sunrise’s investment bankers that HCP would make an offer of \$18.00 per unit for Sunrise. Despite a request from Sunrise that HCP refrain from announcing its offer publicly, HCP issued a press release announcing its offer and stating the “clear superiority” of its offer to Ventas’. This press release also indicated that HCP’s offer had already received the necessary approval of HCP’s board of directors, but omitted the fact that offer was conditioned upon reaching an agreement with SSL. Later that evening, HCP disclosed to Sunrise that its offer was conditioned on reaching an agreement with SSL. As a result, before the markets opened on February 15, 2007,

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Sunrise issued a press release stating that it would not consider HCP's offer until it received confirmation that the offer is not conditioned on reaching an agreement with SSL. On February 19, 2007, Sunrise issued a second press release stating that the HCP offer was expressly conditional on HCP entering into an agreement with SSL. On February 21, 2007, in response to positive indications from HCP, Sunrise issued a third press release, stating that HCP had amended its offer to include an express condition, and that HCP had indicated that it was prepared to enter into an agreement with SSL on terms substantially similar to the agreement entered into between Ventas and SSL. This prompted a press release from Ventas which stated that the Sunrise Standstill Agreement barred HCP's offer and that HCP's conditional offer was, in fact, less favorable than Ventas' offer.<sup>8</sup>

By April 9, 2007, all indications were that Sunrise would not receive the votes needed to reach the two-thirds approval requirement for Ventas' definitive acquisition agreement.<sup>9</sup> Therefore, on April 11, 2007, Ventas increased its offer from \$15.00 per unit to \$16.50 per unit. Sunrise unitholders approved Ventas' increased offer on April 19, 2007, and the deal closed on April 26, 2007. On May 3, 2007, Ventas filed suit in the Western District of Kentucky asserting Kentucky state law claims of tortious interference with contract and tortious interference with a prospective advantage, based on the theory that HCP improperly interfered with Ventas' valid expectancy that Sunrise unitholders would approve Ventas' \$15.00 per unit offer to purchase Sunrise, cause Ventas to raise its offer to \$16.50 per unit. The District Court granted summary judgment to HCP on the tortious interference with contract claim, but allowed Ventas' claim of tortious interference with a prospective advantage to proceed to trial. At trial, the jury returned a verdict for Ventas in the amount of \$101,672,807 (USD), equal to the USD value of the \$1.50 (Can.) per unit difference purchase price. The Sixth Circuit upheld the judgment, reversed the District Court's denial of punitive damages, and remanded the case so that the matter might proceed to trial on the single issue of punitive damages.<sup>10</sup>

The *Ventas* case makes it clear that the breach of a standstill agreement by one bidder in an auction context, may create a valid cause of action for tortious interference with the prospective advantage that another bidder expected to obtain by entering into its own standstill agreement with the target company. Therefore, a bidder may seek essentially to enforce the provisions of another bidder's standstill agreement with the target company, even though the first bidder was neither a party to, nor an expressly identified third party beneficiary of, the second bidder's standstill agreement. This concept has potentially far-reaching implications, as potential acquirors need not only concern themselves with the temperature of the target company for actions which may amount to breach of a standstill agreement, but also with whether another bidder may take issue with such actions. In the *Ventas* case, HCP's failure to consider its potential liability to Ventas amounted to a \$100 million judgment—the delta between Ventas' winning bid and the purchase price paid as a result of HCP's tortious interference.

### Legal Considerations and Duties Facing the Target's Board of Directors

The Delaware courts recognize several virtues of standstill agreements in an M&A context: (1) facilitating an orderly bidding process, (2) guarding against the misuse of non-public information, and (3) providing the target company with leverage to extract concessions from potential bidders.<sup>11</sup> These virtues, the courts understand, frequently promote the maximization of shareholder value. For this reason, the judicial blessing extends to the highly scrutinized realm of takeover contests, even when a standstill agreement acts in part to entrench a target's management.<sup>12</sup> A target's board of directors may even go so far as creating an unequal bidding process, if such inequity is incidental to an action intended to maximize shareholder value.<sup>13</sup>

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Despite the Delaware courts' apparent reluctance to invalidate standstills, *Revlon* duties still apply—where a corporate sale is inevitable, a target board's duty is to act solely to obtain “the best price for the stockholders at a sale of the company.”<sup>14</sup> Where a target's board of directors uses a standstill agreement for an inappropriate purpose, Delaware courts will likely find a breach of that duty. In a 2007 case (involving Topps, the chewing gum and baseball trading-card company),<sup>15</sup> the Chancery Court granted a motion for preliminary injunction and held it likely that the target's board violated its *Revlon* duties.<sup>16</sup> The Court found that, by abusing a standstill agreement, the Topps board inappropriately preferred a management-friendly bid<sup>17</sup> to the detriment of company rival Upper Deck's bid. Key to the Court's finding was the fact that, in addition to failing to negotiate in good faith and making misleading public disclosures regarding financing and regulatory roadblocks to a possible Upper Deck deal, the Topps' board refused to release Upper Deck from a standstill agreement so that it could either correct the public misstatements or bring a tender offer directly to shareholders.<sup>18</sup>

In sum, Delaware courts support and enforce the use of standstill agreements as a tool for maximizing shareholder value. However, once a target's board crosses the line from hardball negotiation to management entrenchment, Delaware courts will likely find a breach of fiduciary duty. In order to protect itself from such result, a target's board of directors is encouraged to carefully document (1) its deliberations and determination that a standstill agreement is made in good faith efforts to maximize stockholder value, and (2) all legal and financial advice received supporting the use of a standstill agreement.

### Proposed Standstill Provision

The level of protection afforded by a standstill agreement will vary from transaction to transaction based on the relative positions and bargaining power of the parties. Below is a proposed broad and target-friendly standstill provision. The provision is designed to prevent, for a period after the confidentiality agreement is signed, virtually all forms of coercive conduct from outright hostile tender offers and proxy fights to “bear hugs” and simple open-market purchases of the target's stock.

For a period of [NUMBER] of year[s] commencing on the date of this letter agreement (the “Standstill Period”), neither the Prospective Acquiror nor any of the Prospective Acquiror's Representatives will, in any manner, directly or indirectly:

(a) make, effect, initiate, cause or participate in: (i) any acquisition of beneficial ownership of any securities (including derivatives thereof) of the Target or any securities (including derivatives thereof) of any subsidiary, division or other affiliate of the Target; (ii) any acquisition of any assets of the Target, any assets of any subsidiary, division or other affiliate of the Target; (iii) any tender offer, exchange offer, merger, business combination, recapitalization, restructuring, liquidation, dissolution or extraordinary transaction involving the Target or any subsidiary, division or other affiliate of the Target, or involving any securities (including derivatives thereof) or assets of any subsidiary, division or other affiliate of the Target; or (iv) any “solicitation” of “proxies” (as those terms are used in the proxy rules of the Securities and Exchange Commission) or consents with respect to any securities (including derivatives thereof) of the Target;

(b) form, join or participate in a “group” (as defined in the Securities Exchange Act of 1934 and the rules promulgated thereunder) with respect to the beneficial ownership of any securities (including derivatives thereof) of the Target;

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- (c) act, alone or in concert with others, to seek to control or influence the management, board of directors or policies of the Target;
- (d) take any action that might require the Target to make a public announcement regarding any of the types of matters set forth in clause (a);
- (e) agree or offer to take, or encourage or propose (publicly or otherwise) the taking of, any action referred to in clauses (a), (b), (c), or (d);
- (f) assist, advise, induce or encourage any other Person to take any action of the type referred to in clauses (a), (b), (c), (d) or (e);
- (g) enter into any discussions, negotiations, arrangement or agreement with any other Person relating to any of the foregoing; or
- (h) request or propose that the Target or any of the Target's Representatives amend, waive or consider the amendment or waiver of any provision set forth in this section.

The provisions of this Standstill shall terminate upon the public announcement by Target that it has entered into a definitive agreement providing for the Transaction. The expiration of the Standstill Period shall not terminate or otherwise affect any of the other provisions of this letter agreement.

### Some Standstill Practice Pointers

#### *What's the right duration of a standstill?*

A customary and reasonable term is somewhere between 12 and 24 months. The duration of the standstill period should principally be based on (a) how long the proprietary information provided by the target company remains of significance and (b) how much time the target's board believes it needs to complete the sale process. Typically, confidential information (including financial projections, business plans and price information) is still of relevance after six months. On the other hand, most confidential financial information of public companies is stale after two years and would be of no or limited use in connection with a hostile bid. The standstill period should also be based on the context. If the target company is seeking a sale through an auction process with many potential bidders, a longer standstill period is generally recommended. In this context, the longer standstill period helps to ensure that none of the parties steps outside the process and the target obtains adequate time to complete the process in an orderly manner within its control. Conversely, if in the context of a one-off transaction where the parties are just trying to find out if a deal can happen, then the acquiror usually will resist being tied down by a lengthy standstill.

If the parties operate in an industry with substantial consolidation, the acquiror may be more hesitant to enter into a standstill for a longer period. It is difficult to predict what will happen in the future with its business and to its competitors, and the acquiror may want to retain freedom to act to in its best interest down the road to secure its position in the industry.

When negotiating a standstill, the acquiror may argue that the target company does not need a lengthy standstill because it is already indirectly protected by the confidentiality agreement providing that the proprietary information to be provided to the acquiror may only be used in connection with the currently negotiated transaction and not for any other purpose. Targets should resist such argument—the target's board wants certainty that the acquiror cannot launch a hostile bid and does not want to get into an argument about whether the acquiror is misusing the proprietary information.

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### *Should the standstill be waivable by target at acquiror's request?*

From the target company's perspective, preferably not. First, the target does not want the acquiror to take any action that may trigger a requirement for the target to make a public announcement about the request for the waiver, which could put the target in play. Second, the target wants to control the sale process and does not want to have to ask its board of directors to make a determination with respect to a waiver request by one of potentially many bidders—either the acquiror is part of the negotiated process as the rest of bidders or it is out and restricted by the standstill.

### *What "representatives" and "affiliates" of the acquiror should be covered by the standstill?*

It is important for the acquiror to carefully consider who should be covered by the definitions of "representatives" and "affiliates" of the acquiror so as not to inadvertently breach the standstill. For example, it may not be appropriate to have the term "representative" cover all employees of the acquiror, but rather be limited to certain officers and directors of acquiror and allow for insignificant open-market purchases of the target's stock. Similarly, if an investment banking firm of the target company is considered a "representative," then it may be appropriate to carve-out normal market-making activities of the bank's trading floor (subject to "Chinese Wall" procedures). The acquiror should also consider which entities may be considered an "affiliate" of the target, *e.g.*, should it be permissible for an acquiror to make open-market purchases of securities of an upstream entity "affiliated" with the target company solely as a result of it owning 15% of the target's stock?

In contrast, the target company may seek to prevent "clubbing" (cooperation and information sharing in submitting bids) by private equity firms who are bidding for an acquisition, by requiring each private equity firm to bid separately, and thus increase competition (and hopefully price), unless the target specifically consents to it because it determines that clubbing may be the best way to have a competitive process. The target may address this issue by excluding "any person that would act as a co-bidder" from the definition of "representatives" in the confidentiality and standstill agreement, thereby forcing each private equity firm to enter into a separate confidentiality and standstill agreement with the target company.

### *Enforcement of standstill can be tricky if the target is in play*

As discussed above, although the courts generally recognize and enforce standstills, enforcement of a standstill can be tricky and, for that reason, some acquirors may choose to accept a standstill under the notion that "we can always just breach it and go hostile on the target." There is some truth to that position. First of all, it may be difficult for the target company to prove damages as a result of breach of the standstill. Perhaps more importantly, it is difficult for a target to litigate a standstill if it has put itself up for sale, as it may very well be perceived as management entrenchment and preventing the shareholders from receiving maximum value. Of course, breaching a standstill agreement could, as shown by *Ventas*, result in significant liability and inflict some reputational damage on an active acquiror.

### *Should the standstill contain a "fall away" provision if another bidder puts the target in play?*

The target company wants the standstill so it can control the sale process. On the other hand, the acquiror does not want to end up standing on the sideline watching if another bidder comes along and puts the target in play. The battle lines are drawn and, consequently, the parties often end up

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negotiating the circumstances, that the standstill should terminate. The above standstill example states that it “shall terminate upon the public announcement by Target that it has entered into a definitive agreement providing for the Transaction.” But what if a third party launches a hostile tender offer? One of the best defenses a target company has against a hostile bidder is that the hostile bidder has not had the opportunity to conduct a due diligence investigation based on confidential information provided by the target. However, allowing a once friendly acquiror—who has the benefit of the confidential information—an opportunity to launch a hostile bid can be a dangerous proposition and should be resisted by the target.

### *Ask target for a covenant not to release and to enforce!*

Let’s say the parties have now reached a deal and are ready to sign the definitive acquisition agreement. The definitive agreement will typically provide that the confidentiality and standstill agreement between the parties will survive the execution of the definitive agreement since consummation of the transaction at that point in time is not yet certain. But what about standstills between the target company and other unsuccessful bidders? The acquirer should request that the “conduct of business until closing” covenant in the definitive agreement provide that the target shall not, without the acquiror’s prior written consent, release or waive any other standstills and shall be obligated to enforce such standstills if breached by a third party.

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<sup>1</sup> See *Ventas, Inc. v. HCP, Inc.*, 2011 WL 1844093 (C.A.6 (Ky.)).

<sup>2</sup> See *Ventas, Inc. v. HCP*, 2011 WL at 1.

<sup>3</sup> See *Id.*

<sup>4</sup> See *Id.*

<sup>5</sup> See *Id.* at 2.

<sup>6</sup> See *Id.* at 3.

<sup>7</sup> See *Ventas, Inc. v. HCP, Inc.*, 2011 WL at 3.

<sup>8</sup> See *Id.* at 4.

<sup>9</sup> See *Id.* at 6.

<sup>10</sup> See *Id.*

<sup>11</sup> *The Upper Deck Co. v. The Topps Co.*, 926 A.2d 58, 91 (Del. Ch. 2007).

<sup>12</sup> *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345-46 (Del. 1987) (holding the target's board breached no fiduciary duty despite the Chancery Court's finding entrenching effects in the standstill agreement).

<sup>13</sup> *J.P. Stevens & Co., Inc.*, 542 A.2d 770, 782 (Del. Ch. 1988) (“[T]he board may tilt the playing field if, but only if, it is in the shareholders’ interest to do so.”).

<sup>14</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

<sup>15</sup> *Topps*, 926 A.2d 58 (Del. Ch. 2007).

<sup>16</sup> *Id.* at 92.

<sup>17</sup> The management-friendly bid originated from investment vehicles led by Michael Eisner.

<sup>18</sup> *Id.* at 91-92.