

The "Standstill" Agreement in Public Company Mergers A Mock Negotiation

Presented at the Committee on Negotiated Acquisitions "Committee Forum" at the 2000 Annual Meeting of the American Bar Association in New York City.

MODERATOR (Rick Climan): We're going to set things up today as a mock negotiation of a hypothetical acquisition, with David Katz and Diane Frankle playing the role of counsel for the publicly held acquiring company, and with Joel Greenberg and Keith Flaum playing the role of counsel for the publicly held target company. Our transaction structure is a classic one-step, stock-for-stock merger, with our acquiring company considerably larger than our target company.

We begin today at the beginning, before a draft of the definitive merger agreement has even been produced. We're going to assume that the target company's counsel – Joel Greenberg and Keith Flaum – have proffered their standard form of confidentiality agreement to the acquiror. Only this one contains a provision that you normally don't see in a privately-held company's form of confidentiality agreement: a "standstill" provision. Here is what Joel and Keith have offered up on behalf of the target company.

Proposed "Standstill" Provision

"During the three-year period 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 of the Target or any securities of any subsidiary or other affiliate of the Target,
- (ii) any acquisition of any assets of the Target or any assets of any subsidiary 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 or other affiliate of the Target, or involving any securities or assets of the Target or any securities or assets of any subsidiary 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 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 of the Target;
- (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)" of this sentence;
- (e) agree or offer to take, or encourage or propose (publicly or otherwise) the taking of, any action referred to in clause "(a)," "(b)," "(c)" or "(d)" of this sentence;
- (f) assist, induce or encourage any other Person to take any action of the type referred to in clause "(a)," "(b)," "(c)," "(d)" or "(e)" of this sentence;
- (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 expiration of the Standstill Period will not terminate or otherwise affect any of the other provisions of this letter agreement."

MODERATOR (Rick Climan): If you take a look at this "standstill" language, you'll see that it's very broad. The provision is designed to prevent, for a period of three years after the confidentiality

The Players

The Moderator

Rick Climan, partner and firm-wide head of the Mergers & Acquisitions Group at Cooley Godward LLP, based in California's Silicon Valley

Negotiators for the Target

Joel Greenberg, partner and co-chair of the Corporate and Finance Dept. at Kaye Scholer LLP in New York.

Keith Flaum, a partner in the Palo Alto office of Cooley Godward LLP.

Negotiators for the Acquiror

David Katz, partner at Wachtell, Lipton, Rosen & Katz in New York

Diane Frankle, partner and co-chair of the Mergers and Acquisitions Group at Gray, Cary, Ware & Freidenrich in Palo Alto.

agreement is signed, virtually all forms of coercive and quasi-coercive conduct, from outright hostile tender offers and hostile proxy fights to somewhat less aggressive, but still potentially coercive, types of behavior, including "bear hugs" and simple open-market acquisitions of stock in the target company.

Let me begin by posing a question for Joel, one of the authors of this "standstill" provision. What's the rationale for including a provision like this in a confidentiality agreement, and why do you need something so broad?

COUNSEL FOR TARGET (Joel Greenberg): Well, I think the rationale is very simple. As you said, this occurs at the beginning – at a time when the potential acquiror has made no commitments whatsoever to the target company. There's no agreement to do an acquisition, and the potential acquiror has asked for access to the target company's nonpublic information in order to work on a negotiated and consensual proposal to buy the target company. This "standstill" provision is intended to say that, having started down the road of a negotiated and consensual proposal, we – the target company – want it to stay that way. The price of access to this information is participation in a board-managed process without the ability to move to a hostile acquisition. The target company doesn't want to facilitate an unsolicited offer by providing confidential information that can be used against it.

MODERATOR (Rick Climan): Just to get a sense for why the "standstill" provision needs to be so broad, Keith, I see that the last clause – clause "(h)" – provides that the prospective acquiror can't even request, on a friendly basis, a waiver of the "standstill" provision. Why do you need to go so far?

COUNSEL FOR TARGET (Keith Flaum): A couple of reasons. First of all, the target company doesn't want the potential acquiror to take any action that might require the target company to make a public announcement, because then the target company could be put in play before we want it to be. So we want to be careful that the potential acquiror doesn't make a request or take any other action that would require a public disclosure. Also, as Joel said, we want to be able to control the process and we don't want to put the target board in the uncomfortable position of having to analyze the request for a waiver. If we want somebody to come in, then we will certainly invite them to come in and participate in negotiations.

MODERATOR (Rick Climan): So, Diane and David, your client, the prospective acquiror, is talking on a very congenial and friendly basis about the possibility of acquiring the target company. I see that

you have prepared an outline of your response to the "standstill" provision proffered by the target company's lawyers. Let's take a look at it.

Response by Prospective Acquiror to Proposed "Standstill" Provisions

- Shorten duration of "Standstill Period" to 180 days
- Delete references to "affiliate" of Target
- Replace "Representatives" with "subsidiaries"
- Add the following sentence:

"Notwithstanding anything to the contrary contained in this letter agreement, if, at any time during the Standstill Period,

(i) a third party (A) "commences a tender offer" (within the meaning of Rule 14d-2 under the Securities Exchange Act of 1934) for at least 50% of the outstanding capital stock of the Target or (B) commences a proxy contest with respect to the election of any directors of the Target, or

(ii) a third party enters into an agreement with the Target contemplating the acquisition (by way of merger, tender offer, or otherwise) of at least 50% of the outstanding capital stock of the Target or all or substantially all of the Target's assets,

then (in either of such cases) the restrictions set forth in this section shall immediately terminate and cease to be of any further force or effect."

MODERATOR (Rick Climan): Why don't you walk us through your response and tell us what you find objectionable about the "standstill" language that's been proffered by Joel and Keith.

COUNSEL FOR ACQUIROR (Diane Frankle): Sure, Rick. First of all, it seems to us that a three-year term for this kind of a "standstill" provision is really beyond what you would normally expect to see, especially given how tightly it's drafted. At this point, the target company has not been willing to sign a "no-shop" agreement – an exclusivity agreement – and our client, the prospective acquiror, is coming in and spending a considerable amount of time and money on this without the assurances that a "no-shop" would provide. We don't know whether there is a deal here for our client, and we just don't think that this "standstill" provision is an appropriate restriction for that length of time. A more reasonable period of time for this type of agreement would be six months.

COUNSEL FOR TARGET (Joel Greenberg): We can certainly talk about the duration, although six months is kind of short. It seems to me that one guidepost for how long the "standstill" period should run is how long the information the target

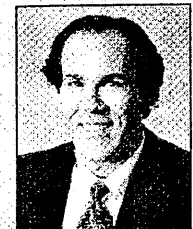
Standstill →



Rick Climan
Cooley Godward



Joel Greenberg
Kaye Scholer



Keith Flaum
Cooley Godward



Diane Frankle
Gray, Cary



David Katz
Wachtell

Standstill

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company is giving your client will have significance. At some point I think that we would agree that the confidential information we provided is no longer terribly helpful to making a bid. Six months is too short, though. As another benchmark, we need enough time to let a board-managed process play out. Again, I think six months is a bit short for that. We might be willing to compromise more in the two-year area.

COUNSEL FOR ACQUIROR (David Katz): Joel, on your first point, the rest of the confidentiality agreement deals with keeping the information confidential, and it's going to protect the target company for more than six months. If the prospective acquiror

misuses or improperly discloses any of your client's sensitive information, nine or twelve months down the road, then your client will have an action against the prospective acquiror under the confidentiality provisions of the agreement. Therefore, these arguments do not support your position on the duration of the "standstill."

COUNSEL FOR TARGET (Joel Greenberg): I'm glad to hear that you're comfortable with the confidentiality provisions in the agreement we served up, but we don't really expect a potential acquiror like your client to be able to compartmentalize its decision-making process that easily. You're

going to make some valuation and synergy judgments based on our confidential information and I don't think it's reasonable to assume that you can be a little schizophrenic and put those out of your mind should you decide to go hostile.

MODERATOR (Rick Climan): Joel and Keith, let me ask another question that ties into that. In the confidentiality provisions that you proffered, in addition to nondisclosure restrictions, there are use restrictions. Your confidentiality language states very specifically that the information being turned over to the prospective acquiror can only be used for purposes of evaluating a "Transaction." You define a "Transaction" as a *negotiated* acquisition. So, don't you indirectly get the comfort you need from the use restriction? If the prospective acquiror tries to do something hostile, it would necessarily be using the target's sensitive, confidential information for a purpose

other than a negotiated transaction.

COUNSEL FOR TARGET (Keith Flaum): We think the use restriction and the fact that it's tied to a negotiated transaction is very helpful, Rick. But we want to be absolutely sure that there can't be any hostile or quasi-hostile action. And we don't want to fight over whether or not the prospective acquiror is misusing the information. We want "standstill" restrictions that are straightforward and unambiguous.

MODERATOR (Rick Climan): Let me ask each of you to step out of character for a moment. Joel, David, Diane, Keith – when you finish negotiating the duration of the "standstill" provision, where do you typically end up?

COUNSEL FOR TARGET (Joel Greenberg): Most typically I think you would see it somewhere between one and two years. It's likely to come out at the shorter end when you're trying to get a deal done quickly and the target has significant leverage. But six months is very short, and three years is unusually long. I think we all agree on that.

COUNSEL FOR ACQUIROR (David Katz): I think Joel is correct. I think the more normal term is in the eighteen-month to two-year range, but I certainly do see "standstills" outside that timeframe. It also depends on what the context is. If it's an auction-type process where the target company is trying to hold everybody to the same limitations and really wants a controlled process, you don't want anybody stepping outside the process. In this type of controlled auction, the target company probably has a much better argument for whatever period it sets and whatever "standstill" provision it's going to impose because it can say it's making all the bidders toe the same line. Bidders who want access to this process often will agree to a longer "standstill," as long as it's clearly required for all of the players. Contrast this with the situation where it's a one-off transaction and the parties are just trying to see if they can put together a deal. Then, absent some type of exclusivity or "no-shop" agreement between the parties (and often there isn't such an agreement), the potential acquiror is not usually willing to agree to a "standstill" like this if it has any real length of time to it. If somebody comes in on an unsolicited basis or the target company is otherwise put into play, our client is going to have to compete with other bidders. It wants to be sure it won't be foreclosed or have to rely on the target's board of directors to decide unilaterally to waive the "standstill," especially where, as here, the "standstill" would prevent our client from even asking for a waiver.

MODERATOR (Rick Climan): David, you mentioned something that I'd like to explore a little further.

A potential acquiror is more willing to entertain a request for a "standstill" if it knows it's being given a leg-up via exclusivity.

**David Katz
Wachtell**

In your experience, is the trade-off between a "standstill" provision and a "no-shop" provision a typical one? In other words, do you often see the "standstill" provisions considered in tandem with a request by the prospective acquiror for an exclusivity provision that precludes the target company from talking to anyone else about an acquisition for some period of time?

COUNSEL FOR ACQUIROR (David Katz): I think you often see the two tied together. A potential acquiror is more willing to entertain a request for a "standstill" if it knows it's being given a leg-up via exclusivity. However, exclusive "no-shop" agreements are not very common at all for public companies and, if they are given, are usually for a very limited duration (like two weeks).

Let me mention a few other points on the topic of "standstills." In some situations — for example, where the target company is in a consolidating industry — nobody really knows what's ultimately going to happen. Companies in today's world often are very unwilling to limit themselves to a "standstill" or a "no-shop" for any real length of time because they just don't know what is going to happen among their competitors and they really have to be free to deal with a variety of situations.

Another thing a prospective acquiror presented with a request for a "standstill" ought to be concerned with is what happens if the target company is acquired by someone else down the road. Are you now going to have a "standstill" that is going to apply perhaps twelve months down the road and is even broader in that it now applies to the merged company?

Something else that comes up in this context is how to advise the client whose attitude is "Let's not fight it. Let's go ahead and sign the 'standstill' since we can always just breach it." And frankly there have been some cases where people breach "standstills" and, at the end of the day, the target company doesn't sue. If the target company is "in play" it is very difficult to actually litigate one of these "standstill" provisions. The forum is very public, and the target company fears it would be seen as keeping its shareholders away from what may be a better offer. But even though the target company may decide not to litigate, as the lawyer for the potential acquiror you should counsel your client that if it proceeds to breach a "standstill," then the next time around when your client is negotiating one of these provisions with another target, that target may not be willing to give your client any confidential information at all because your client may be seen as untrustworthy based on its past behavior. So it's too easy an answer for a prospective

acquiror to say "we can decide later on the 'standstill' issue because we can always just breach the 'standstill,'" That approach can have a detrimental business impact on the prospective acquiror.

MODERATOR (Rick Climan): Still, the target company's counsel should let his or her client know that these "standstill" agreements don't always stand up in court — that a bidder's lawyer may successfully defend a suit brought to enforce an executed "standstill" agreement simply by raising the question of what damages are being caused by the bidder's breach of the agreement.

COUNSEL FOR ACQUIROR (David Katz): I agree that putting the target in the position of having to argue that a court should enjoin an offer that's clearly superior to the one on the table is difficult; it's not a case I would find very attractive to bring on behalf of a target company, even though it may be legally correct.

COUNSEL FOR TARGET (Keith Flaum): Incidentally, what we often do if a prospective acquiror refuses to sign a "standstill" is to stage the disclosure of information so that we will give some not-so-sensitive information about the target company early on and, as the prospective acquiror looks to be more interested, provide more sensitive information in progressive steps.

COUNSEL FOR ACQUIROR (Diane Frankle): There are some other problems with this "standstill" provision beyond the unreasonable term. Let's discuss the issue of to whom the "standstill" is meant to apply. As drafted, it applies not only to the target company, our client, but also to "Representatives" of our client. The definition in the target company's draft provides:

"For purposes of this letter agreement, a party's 'Representatives' will be deemed to include each Person that is or becomes (i) a subsidiary or other affiliate of such party, or (ii) an officer, director, employee, partner, attorney, advisor, accountant, agent or representative of such party or of any of such party's subsidiaries or other affiliates."

If you look at the definition of "Representatives" it appears to us, for example, that if an employee of our client's subsidiary located in France, knowing nothing about this deal, happens to buy a share of target company stock, then our client will breach the "standstill." I think that's really too broad and we really ought to think about a limitation there. It may be appropriate for certain of our client's officers and directors to be held accountable here, but not too many people beyond that.

COUNSEL FOR TARGET (Joel Greenberg): But Diane, shouldn't the prohibition extend at a minimum to

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the same class of people that the prospective acquiror is authorized to disclose the target company's sensitive information to? And I suspect that in your response to our draft of the confidentiality agreement you're going to ask for permission to disclose the information to your client's "Representatives." I can understand trying to exempt insignificant open-market purchases by people who are totally away from the transaction process, and I don't think that will be a problem to work out. But I do think that anybody who gets into the process has got to be caught up in this.

COUNSEL FOR ACQUIROR (David Katz): Then Joel, are you saying that this "standstill" restriction should apply to our client's investment banker, who is clearly a "Representative" of our client and who trades in securities of the target company every day? That's obviously not going to be acceptable.

COUNSEL FOR TARGET (Joel Greenberg): No. I think there you can come up with an appropriate carve-out. The investment bankers are going to need "Chinese-wall" provisions anyway if they're going to continue to trade in the target company's stock. I don't think my client would be terribly offended by normal market-making activities.

MODERATOR (Rick Climan): David and Diane, isn't there another, related problem with this "standstill" language? The "standstill" provision forbids not only any acquisition of securities of the target company itself, but also any acquisition of securities of the target company's "affiliates." It's one thing if the term "affiliates" is taken to refer only to subsidiaries and other downstream entities controlled by the target company, but we all know that the term "affiliates" can be construed very broadly. It may well be interpreted to cover significant shareholders of the target company, such as venture capital funds and other entities that may hold a 15 or 20% block of the target company's stock and may have representation on the target company's board. So a bidder that signs a "standstill" in this form can be deemed to breach it merely by investing in one of these upstream entities. And David, doesn't this also tie into an issue you raised earlier – the issue of what happens if the target company gets acquired by another public company that thereby becomes an upstream "affiliate"?

COUNSEL FOR ACQUIROR (David Katz): It does, and you are correct in pointing out that you have to look very carefully at what the "standstill" really applies to – which companies' securities and

exactly what actions it covers. The target company's initial draft of these types of provisions tends to be overbroad. As counsel for the prospective acquiror, you've got to really focus on these provisions and think about them in different contexts. As drafted, the "standstill" restriction likely applies to the stock of these current and future upstream entities. It's hard for the target company, I would think, to justify why it should be entitled to this type of protection. The rationales that Joel and Keith gave earlier wouldn't seem to apply to these scenarios.

COUNSEL FOR TARGET (Joel Greenberg): I think it depends a lot on the factual context. You can conceive of situations where the upstream affiliate is so closely tied to the target company that it's not unreasonable to seek a "standstill" that applies to acquisitions of the upstream affiliate's stock.

COUNSEL FOR ACQUIROR (Diane Frankle): Another issue here is that this "standstill" provision ties our client's hands in a case where a third party comes along and puts the target company in play. At that point, we've spent a lot of time thinking about this acquisition, and our client would want to be able to participate freely in a bidding contest and go forward with an offer. So if the target company is in play, I think you would agree with me that this "standstill" provision should just terminate and fall away, as I've provided in the "fall-away" provision I've provided for your consideration.

COUNSEL FOR TARGET (Keith Flaum): Well I don't think so, Diane. If the target company is put into play because some third party takes some hostile action, we can easily fend off that hostile third party because that party doesn't have the same access to our sensitive information that your client does. Now it might be that the target company would want to invite your client in at that point in time because we want to negotiate a deal with your client. But as Joel was saying earlier, the critical thing here is for the target company's board to be able to control that process.

MODERATOR (Rick Climan): If I may interject here, this is one issue that seems to come up in virtually every "standstill" negotiation. On one side, you have the prospective acquiror – often in a consolidating industry where there may be only two or three other players – saying to the target company, "Look, I don't want to be the poor fool standing on the sidelines with my hands tied by this overbroad 'standstill' agreement while you negotiate a deal with one of my hated competitors." On the other side, you have the target company making the arguments that Keith and Joel have been making here today.

As I look at Diane's "fall-away" language, I

note that there are really two separate triggers – two separate situations in which the prospective acquiror is seeking to have the “standstill” restrictions terminate. One is the hostile tender offer made by someone else. Here Keith has made the persuasive argument that one of the best defenses a target company has against a hostile tender offer is the fact that the hostile bidder hasn’t had the opportunity to do consensual due diligence on the target company. But letting a third party’s hostile bid give a once-friendly bidder – a bidder that *has* had the opportunity to do thorough due diligence on the target company – the ability to become a hostile bidder can be very dangerous, so this particular prong of the “fall away” can often be successfully resisted by a well-advised target company.

The second trigger in the “fall-away” language proffered by Diane is the target’s execution of a definitive acquisition agreement with another acquiror – a definitive agreement that presumably will be protected through the use of traditional arrangements in the form of a “break-up” fee, a “lockup” option and other customary contractual deal-protection measures. Joel, what’s wrong with having the “standstill” fall away under these circumstances? Why wouldn’t you allow Diane’s client to lob in a competing bid, subject to the payment of the “break-up” fee provided for in the existing definitive agreement?

COUNSEL FOR TARGET (Joel Greenberg): I’d make this observation. If my client – the target company – is conducting an auction, it will want to give Diane’s client every motive to put its best deal on the table during the auction process. As the target’s counsel, I don’t want any prospective acquiror to hold something in reserve thinking it can come back and top its original bid later if it is not the successful bidder. If my client is talking to a bunch of potential acquirors, my client would like to try to squeeze the best price out of each of them during the process.

MODERATOR (Rick Climan): Let me ask just a couple of additional questions before we move off the topic of “standstills.” Suppose the two parties represented here today – the target company and the acquiror – come together and actually negotiate a definitive agreement contemplating the acquisition of the target company by the acquiror in a stock-for-stock merger. There’s traditionally a provision in that definitive acquisition agreement stating that the pre-existing confidentiality agreement between the two parties – which we can assume includes a “standstill” provision – will survive the execution of the definitive acquisition agreement and will remain in effect thereafter. After all, there’s no assurance that the

acquisition is ultimately going to be consummated, and the target company has a strong interest in continuing to maintain the confidentiality of its sensitive information. David, as counsel for the acquiring company, would you seek to include an additional clause in the definitive acquisition agreement clarifying that the “standstill” portion of the confidentiality agreement will not survive, but rather will fall away once the definitive agreement has been signed? Obviously, if a third party later comes in with a competing bid, this would allow your client to continue to “play in the game.”

COUNSEL FOR ACQUIROR (David Katz): It depends. Target companies that insist on having the board control the process often resist this. One other thing I would definitely do as counsel for the acquiring company in this situation – and this is something people often don’t focus on until the last minute – is include, in the “conduct-of-business” covenant in the definitive acquisition agreement, a provision limiting the target’s ability to release anybody else from any of these confidentiality and “standstill” agreements. Of course, one of the things that target companies sometimes do in anticipation of this, right before the definitive agreement is signed, is send a letter to various other prospective acquirors who have previously signed these agreements, stating that they are being released from their “standstill” obligations.

MODERATOR (Rick Climan): Joel and Keith, do you ever object when an acquiring company’s lawyers attempt to include in a definitive acquisition agreement a provision requiring the target company to enforce all of its “standstill” agreements and not waive any rights under them?

COUNSEL FOR TARGET (Joel Greenberg): It’s kind of hard to take the position that our client should have complete freedom to waive those protections when we’ve just had this discussion about how our client wants to manage the process and use those “standstills” to ensure that it can do this. So I think that, properly drafted, this type of provision is not unreasonable.

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**Joel Greenberg
Kaye Scholer**

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