



Court of Chancery Preliminarily Enjoins Complete Genomics Acquisition

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In *In re Complete Genomics Shareholder Litigation*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012), a recent decision by Vice Chancellor J. Travis Laster, the Court of Chancery preliminarily enjoined BGI-Shenzhen's acquisition of Complete Genomics Inc. pending supplemental disclosures concerning (1) discussions between the company's CEO and BGI's CEO regarding post-transaction employment and (2) clarification of inaccurately described and ambiguous provisions of the merger agreement. The Court of Chancery, however, denied the plaintiffs' request to issue an injunction based on challenges to the deal protection provisions, the change of recommendation provision and the no-waiver-of-standstill provisions despite the "significant issues of Delaware law" they raised. Instead, Laster ordered that the Complete Genomics board of directors must provide prompt notice to plaintiffs if the board considers whether it should change its recommendation or if any party to a standstill agreement makes a nonpublic request to be released from the agreement.

Complete Genomics is a life sciences company that developed and commercialized a unique DNA sequencing platform. The company, founded in 2005, has generated revenue but has not reached profitability, and it received a going concern qualification on its most recent year-end audited financial statements. In May, the Complete Genomics board determined that it should explore strategic alternatives and engaged Jefferies & Co. as its financial adviser. On June 5, the company announced publicly that it was exploring strategic alternatives, and Jefferies reached out to 42 potentially interested parties. Nine parties expressed interest and executed confidentiality agreements; four of the confidentiality agreements contained a standstill provision that prohibited an unsolicited offer to acquire the company but allowed the party subject to the standstill to make a nonpublic request to be released from the agreement. Ultimately, the board received six indications of interest. While the board was soliciting offers to acquire the company, BGI's CEO informed Complete Genomics CEO Clifford Reid that BGI wanted Reid to continue working for Complete Genomics after a potential acquisition by BGI and that the company would remain an independent entity operating under BGI's ownership umbrella.

On September 15, Complete Genomics' board approved an agreement and plan of merger by which BGI would acquire the company in a two-step transaction for \$3.15 per share in cash. The transaction valued the company at approximately \$108 million — a 54 percent premium over the company's closing price the day before the board announced it was exploring strategic alternatives and an 18 percent premium over the company's closing price the day before the board announced the transaction. BGI also extended a bridge loan to Complete Genomics for up to \$30 million. On September 21, a Complete Genomics stockholder filed the first of four putative class action lawsuits in the Court of Chancery alleging, among other things, that the board breached its fiduciary duties by entering into the proposed transaction. Specifically with respect to their motion for preliminary injunction, the plaintiffs asserted that the deal protection measures contained in the merger agreement were impermissible under Delaware law and that the Complete Genomics' board issued materially incomplete and misleading disclosures.

The court first addressed the plaintiffs' challenges to certain provisions of the merger agreement. Pursuant to the terms of the merger agreement, BGI's obligation to close the transaction was subject to a minimum tender condition requiring the tender of at least a majority of the outstanding Complete Genomics shares by December 14. If the minimum tender condition is not satisfied, a 90-day extension automatically extends the period to March 14, 2013. This time period is significant because the board agreed to a no-solicitation provision while the tender offer is pending, and the limited fiduciary out under the merger agreement does not permit the company to terminate the transaction to accept a superior proposal. The board, however, could change its recommendation should an unsolicited superior proposal materialize. Thus, as the court observed, without a breach by BGI or the issuance of a permanent injunction by a court, the company can only terminate the merger agreement if BGI does not meet the minimum tender condition by March 14, 2013. The merger agreement also requires Complete Genomics to pay a termination fee of 4.8 percent of the transaction's equity value if the minimum tender condition is not satisfied after either the board changed its recommendation or the company received a superior proposal. Alternatively, under the terms of the bridge loan, BGI possessed the right to convert the bridge loan into shares of Complete Genomics to permit BGI to receive the topping bid in lieu of receiving the termination fee.

The court determined that the plaintiffs failed to demonstrate a reasonable probability of success on the merits of their claims that the merger agreement was coercive or preclusive. Referencing *WaveDivision Holdings v. Millennium Digital Media Systems, C.A. No. 2993-VCS* (Del. Ch. Sept. 17, 2010), the court observed that "Delaware entities are free to enter into binding contracts without a fiduciary out so long as there is no breach of fiduciary duty involved when entering into the contract in the first place." The court concluded that "the board worked diligently to give [Complete] Genomics stockholders an option," noting that the board explored financing options and all strategic alternatives "in an effort to provide stockholders with an opportunity to receive value for their shares." The transaction was not coercive given that the stockholders could reject BGI's tender offer and opt for the status quo, even if the status quo could result in bankruptcy. Nor did the court determine that the terms of the merger agreement were preclusive to potential topping bids. That is, the court concluded that "there is a realistic path for stockholders to receive an alternative bid" because a competing bidder could launch a public tender offer to be followed by a second-step merger despite the "heavy tolls" imposed by the termination fee and the bridge loan.

Notably, the court stated that even if the plaintiffs had demonstrated a reasonable probability of success on the merits of their *Unocal* and *Revlon* claims, the court would nevertheless have denied the requested injunction because of the absence of a topping bid. Laster observed that the company is in a "highly fragile state" and "it would be imprudent on the facts to issue an injunction that would create even an incremental risk of deal loss in the absence of a topping bid."

Next, the court considered the plaintiffs' challenge to the limitation on the board's ability to change its recommendation. The merger agreement placed "extensive limitations on the board's ability to provide [Complete] Genomics' stockholders with a current merger recommendation." The court observed that limitations on a board of directors' ability to change its recommendation are "fraught with peril" because the provisions implicate "duties to target stockholders to communicate truthfully" that cannot be overridden by contract. Because the plaintiffs were not contending that the board needed to change its recommendation, the court denied the plaintiffs' injunction application, but ordered that the Complete Genomics board provide them with prompt notice if it considers whether to change its recommendation. The court reached the same conclusion with respect to the no-waiver provisions in the standstill agreements. The court denied the plaintiffs' application, but conditioned denial on the plaintiffs receiving prompt notice if any party subject to a standstill agreement makes a nonpublic request to be released from the agreement.

Finally, the court addressed the alleged disclosure deficiencies and determined that two of the plaintiffs' claims alleged material omissions sufficient to warrant an injunction. First, the court ordered Complete Genomics to disclose information about Reid's discussions with BGI's CEO concerning post-transaction employment. Second, the court ordered curative disclosures to correct inaccuracies and ambiguities in the description of how the merger agreement operates. Specifically, the court required supplemental disclosures to correct a typographical error in the merger agreement, to define accurately the definition of "outside date" with respect to the tender offer's closing, and to make clear whether the 90-day extension for regulatory approval operates successively or concurrently with the automatic 90-day extension of the tender period to satisfy the minimum tender condition.

Accordingly, the court enjoined BGI from closing the tender offer until the earlier of (1) a post-trial decision on the merits or (2) 10 business days after Complete Genomics disseminated the supplemental disclosures. On November 16, Complete Genomics amended its Schedule 14D-9, filed with the Securities and Exchange Commission, to reflect the supplemental disclosures ordered by the court. Also, on November 16, Illumina Inc., which was not subject to a standstill agreement, confirmed in a filing with the SEC that it previously made an offer to acquire the company for \$3.30 per share. The Complete Genomics board rejected Illumina's offer as inadequate because, among other reasons, the board concluded that there was a substantial likelihood that any transaction between the company and Illumina would not receive antitrust clearance. Based on additional discovery related to Illumina's offer, the plaintiffs moved for reargument on their motion for preliminary injunction. On November 21, the court denied the plaintiffs' motion because the court "held that the plaintiffs failed to show a reasonable probability of success on the merits in their challenge to the exclusive merger agreement" and that "the emergence of the topping bid [did] not change that holding." The court further stated that "only the eliciting of additional facts regarding the initial decision to enter into the merger agreement would potentially cause [the court] to revisit [its] holding." Also in denying the plaintiffs' motion for reargument, the court observed that the board's decision to reject Illumina's offer did not alter the court's prior ruling with respect to the recommendation provisions of the merger agreement or the standstill agreements.

The court's decision in *Complete Genomics* provides another example of the court's hesitation to enjoin the enforcement of certain terms of a merger agreement in a premium transaction in the absence of a viable topping bid. Even after Illumina surfaced with its competing offer and the parties engaged in limited discovery related to the board's rejection of Illumina's bid, the court reaffirmed its prior holding that the plaintiffs failed to demonstrate a reasonable probability of success on their challenge to the exclusive merger agreement. Thus, the court's focus remained on whether the board breached its fiduciary duties when it initially agreed to the terms of the merger agreement with BGI. Illumina's offer did not alter the court's conclusion that the plaintiffs failed to demonstrate a reasonable probability of success on the merits and therefore did not warrant an injunction over the deal protection terms of the merger agreement. Instead of enjoining certain provisions of the merger agreement, the court fashioned an equitable remedy designed to alleviate its concerns with respect to the provision limiting the board's ability to change its recommendation and the no-waiver provisions in the standstill agreements. By ordering the company's board to inform the plaintiffs promptly of any developments with respect to the board's decision to consider a change in recommendation or a nonpublic request to be released from a standstill by a potential topping bidder, the court preserved its ability to consider the plaintiffs' challenge to these provisions on a more fully developed factual record.

Further, Laster's decision to enjoin the tender offer's closing for 10 business days provides guidance for both transactional and litigation counsel in determining the length of time necessary to allow the market to absorb supplemental disclosures. The 10-day preliminary injunction follows similar rulings by Laster in *Steinhardt v. Howard-Anderson*, C.A. No. 5857-VCL (Del. Ch. Feb. 5, 2011), and *In re Art Technology Group Shareholders Litigation*, C.A. 5955-VCL (Del. Ch. Dec. 21, 2010).

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