



Shopping in Different Places – Certain Trends with Go Shop Provisions

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Deal protections, such as no shops, go shops, fiduciary outs, matching rights and termination fees, are some of the most heavily negotiated provisions in merger agreements involving public company targets. Deal protections are designed to make it more difficult (though not impossible) for a third party to swoop in with a better offer after a transaction is publicly announced. After the target's board decides to sell control, it will be focused on satisfying its *Revlon* duties (*i.e.*, its duty to secure the best price reasonably available for shareholders). This necessarily means having the ability to accept an unsolicited superior offer, or, in some cases, to actively solicit one. On the other hand, after spending a great deal of time, effort and money pursuing the transaction, the intended acquirer has little interest in stoking the bidding fire and wants to make it difficult for the target to go with another suitor.

Go Shops and How They Work

"Go shop" provisions permit a target to actively seek a superior bid for a limited period of time (typically 30-60 days, after which time a customary "no shop" provision kicks in) following execution of the merger agreement. They typically incorporate a bifurcated termination fee, allowing the target to pay a reduced termination fee if the agreement is terminated during the go shop period (and an agreement is entered into with a superior bidder) and the full termination fee if it is terminated thereafter. Go

shop provisions are designed to balance a target board's desire for deal certainty with the need to engage in a process that secures the highest price reasonably available for shareholders. These provisions became popular during the private equity boom circa 2003, largely due to PE firms' distaste for long and expensive auction processes. Since this time, go shops have been seen almost exclusively in transactions involving PE buyers. However, as discussed below, some recent transactions call into question whether the go shop provision will play a greater role in strategic deals going forward.

Delaware Case Law

Delaware courts have tended to (i) uphold reasonable deal protections when they are found to enhance bidding and when the court otherwise finds no material flaw in the target's sale process, and (ii) strike them down when found to be overly preclusive of a higher bid. Specific to go shops, Delaware case law generally supports their use to satisfy a board's *Revlon* duties, so long as the deal protection package does not, on the whole, preclude higher bids. For example, in *In re Topps Co. S'holders' Litig.*, the Chancery Court considered the combination of a 40-day go shop period, a bifurcated termination fee and matching rights. Although it issued a limited injunction on other grounds, the court concluded that the deal protection package at issue "left reasonable room for an effective post-signing market check." In *In re Lear Corp.*

S'holders' Litig., the Chancery Court upheld a similar deal protection package, including a 45-day go shop period. In that case, the Chancery Court concluded the deal protections were reasonable, noting that there were sufficient signals to the market to make it obvious that the target was open to bidders and that the limitations would not deter serious bids.

It should be noted that a reviewing court must be convinced that the sale process, taken as a whole, was “real.” *Lear* suggests that a go shop cannot be used simply as a ploy for the target to enter into an agreement with a management-preferred buyer while creating only the appearance of shaking the bushes for a better offer. The recent J.Crew – TPG/Leonard Green transaction came under criticism for this very reason. J.Crew’s CEO, Millard Drexler, told the special committee of the board that he “had significant reservations about the prospect of working for a new boss, but that he had a high comfort level with TPG.” According to news reports, this statement led the special committee to believe that Mr. Drexler, an important part of J.Crew’s past success, would be unwilling to remain with J.Crew if an alternate buyer were selected. This, in turn, created the perception that other bidders were not being treated fairly in the go shop process.

Recent Trends – Go Shops with Strategic Buyers & Modified Go Shops

Go Shops with Strategic Buyers. Go shop provisions, although historically confined almost exclusively to deals involving a PE buyer, have appeared in at least two recent deals involving strategic buyers. For example, the Odyssey HealthCare/Gentiva Health Services transaction included

a 30-day go shop period and a bifurcated termination fee. Similarly, the Peet’s Coffee/Diedrich Coffee deal permitted Diedrich to actively solicit competing bids for 21 days and included a bifurcated termination fee. It is too early to tell whether go shop provisions will become increasingly prevalent in transactions involving strategic buyers; but these examples may stand for the proposition that target boards are increasingly uncomfortable with relying on limited pre-signing market checks to fulfill their fiduciary duties.

Modified “Go Shop” Provisions. Modified go shop provisions also have appeared in recent transactions involving strategic buyers and public company targets. These provisions combine the more traditional “no shop” provisions with a termination fee that is bifurcated to provide a lower termination fee for a limited period of time following execution in the event the target receives a superior, unsolicited bid, and a higher termination fee after the expiration of such period of time. For example, the 2010 Aon/Hewitt transaction included a customary no shop, but permitted Hewitt to pay a reduced termination fee in the event it terminated the agreement during the 50-day period following filing of the merger agreement with the SEC in order to concurrently enter into a superior transaction. A similar provision was included in the recent Pfizer/King Pharmaceuticals transaction. Such modified go shop provisions provide the target board with an argument that (i) any serious bidder would likely surface during the limited window, (ii) such a serious bidder would benefit from the reduced break up fee and, accordingly, would be incentivized to get in the game quickly, and (iii) that as a result, the no shop is less preclusive of competing

bids than it otherwise would be. It should be noted that this type of post-signing market check likely would be subject to greater scrutiny in a small transaction in which the target was less known than either Hewitt or King Pharmaceuticals.

Conclusion

In this era of increased shareholder activism, the terms of deal protection devices, including go shops, are in flux. Although it is too early to tell whether go shops and modified go shops will appear more frequently in transactions involving strategic buyers, dealmakers and their counsel should be mindful that deal terms are constantly evolving. Companies exploring strategic alternatives should work closely with their legal and financial advisors as they seek to maximize value for shareholders.



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