

## **Go-Shops: Market Check Magic or Mirage?**

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A “go-shop” is a provision in a merger agreement that permits a target company, after executing a merger agreement, to continue to actively solicit bids and negotiate with other potential bidders for a defined period of time. Where a target has engaged in a fulsome pre-signing market canvass, a go-shop has little or no utility. However, when a target has not undertaken any form of pre-signing market canvass before signing up a deal (typically either because the buyer professed an unwillingness to bid if the target commences a market canvass or because the target was concerned that an auction process would result in employee and/or customer defections<sup>2</sup>), a go-shop theoretically should produce the best possible transaction for the target company and its stockholders. While the authors are not aware of any empirical analysis of go-shops, our practical experience suggests that while go-shops may be beneficial in some circumstances, they may serve as mere window dressing in other cases. If so, then judicial skepticism of the benefit of a go-shop is warranted in the latter cases.

### **Running the Sales Process**

In considering a transaction involving a change of control, directors of Delaware corporations are charged with obtaining the best transaction reasonably available for the

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<sup>2</sup> The authors have surveyed each of the reported transactions in the past four years that included a no-shop provision (the results of which are attached hereto). Nearly all of the thirty (30) transactions analyzed in the survey involved targets that did not engage in a market canvass before entering into a merger agreement with a private equity buyer.

corporation and its stockholders.<sup>3</sup> The phrase “*Revlon* duties” refers to (i) the standard of review that a Delaware court will utilize in reviewing transactions involving a sale, break-up or change of control of a corporation and (ii) the contextually-specific obligations that are imposed on a board of directors in such transactions. While there is no “blueprint” for running a sales process, the board of directors of a target company generally may satisfy its fiduciary duties to obtain the best transaction reasonably available under the circumstances for the corporation and its stockholders by engaging in one of the following types of transactions: (i) a transaction with the highest bidder after a full public auction of the target company, i.e. a pre-agreement market check, (ii) a transaction with the highest bidder after a more limited pre-agreement market check in which multiple potential bidders are contacted and participate in the bidding, (iii) a transaction with a single bidder where the target board has reliable evidence demonstrating that the board has obtained the best transaction reasonably available, or (iv) a transaction with a single bidder where the target board, due to the absence of reliable evidence that the board has obtained the best transaction reasonably available, bargains for a post-signing market check.<sup>4</sup>

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<sup>3</sup> *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (finding that once directors have decided to sell control of the company “[t]he directors’ role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company”).

<sup>4</sup> A transaction that follows a full auction or involves multiple bidders may warrant more restrictive deal protections, such as a higher termination fee, a matching right and a more limited no shop provision, because the market has been canvassed for potential bidders. By contrast, when a target board lacks sufficiently reliable evidence to permit it to conclude that a transaction with a single bidder is the best transaction reasonably available, the use of a post-signing market check (coupled with modest deal protection provisions) will permit interested competing bidders to emerge, thus ensuring that the target company obtains the best transaction reasonably available under the circumstances. *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286-87 (Del. 1989).

## The Post-Signing Market Check

During the late 1980s, Delaware courts considered whether target company directors who had forsaken an open auction process in favor of negotiating with a single bidder had satisfied their heightened duties in a sale of control when they agreed to a transaction with a post-signing market check. A post-signing market check, it was argued, was effective because it established a “floor” for the transaction and, by providing for a limited period of time after the announcement of the transaction for a competing bidder to emerge, allowed a transaction’s reasonableness to be tested.<sup>5</sup>

The Delaware courts first considered the post-signing market check in the case of *In re Fort Howard Corp. S’holders Litig.*<sup>6</sup> In *Fort Howard*, plaintiffs, shareholders of Fort Howard Corporation, the target company, sought a preliminary injunction against the closing of a tender offer for up to all of the outstanding shares of the company. The tender offer was the first step of a two-step leveraged management buyout transaction. The shareholders alleged, among other things, that the Fort Howard directors favored the management-led buyers and did not seek the best transaction reasonably available under the circumstances.

The transaction at issue in *Fort Howard* included a number of features that came to define the post-signing market check. In particular, the Fort Howard board approved a transaction with a single bidder, but provided a mechanism by which competing bidders could later emerge. The transaction contained (i) a “window-shop” provision allowing the company to receive and consider alternative proposals but not actively to solicit such proposals; (ii) a press

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<sup>5</sup> Evelyn Sroufe, *A Bird in the Hand or Pie in the Sky: The Market Checks in the ‘90’s*, 5 No. 10 Insights 12, 12 (Oct. 1991).

<sup>6</sup> 1988 WL 83147 (Del. Ch. Aug. 8, 1988).

release stating that Fort Howard had the right to consider alternative proposals and would consider alternative proposals; (iii) a window of forty (40) calendar days between the announcement of the transaction and the anticipated closing of the tender offer; and (iv) a modest termination fee (in this case, amounting to 1.9% of the equity value of the transaction).<sup>7</sup>

The Court of Chancery concluded that the rationale for adopting this approach – “for permitting the negotiations with the management affiliated buyout group to be completed before turning to the market in any respect – ma[de] sense.”<sup>8</sup> The Court of Chancery noted that “[t]o start a bidding contest before it was known that an all cash bid for all shares, could and would be made, would increase the risk of a possible takeover attempt at less than a ‘fair’ price or for less than all shares.”<sup>9</sup> The Court also determined that the “alternative ‘market check’ that was achieved was not so hobbled by lock-ups, termination fees or topping fees; so constrained in time or so administered (with respect to access to pertinent information or manner of announcing ‘window shopping’ rights) as to permit the inference that this alternative was a sham designed from the outset to be ineffective or minimally effective.”<sup>10</sup> Rather, it found the device “reasonably calculated to (and did) effectively probe the market for alternative possible transactions.”<sup>11</sup> Having reached the conclusion that the Fort Howard board acted in a good faith pursuit of company and shareholder interests by structuring the transaction in this manner, the Court concluded that the board had not violated its *Revlon* duties.

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<sup>7</sup> *Id.* at \*6-8.

<sup>8</sup> *Id.* at \*13.

<sup>9</sup> *Id.*

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

<sup>11</sup> *Id.*

Following *Fort Howard*, a board may satisfy its *Revlon* duties – to pursue shareholder interests upon sale of the company, in good faith and advisedly – even when involved with only a single bidder, provided that the procedure it adopts to structure a transaction and the negotiations surrounding that transaction are “sufficient to inform the exercise of judgment that board [will have] made in entering the merger agreement.”<sup>12</sup>

### **The Post-Signing Market Check Redux**

In recent years, the Delaware courts have revisited – and, some would argue, liberalized – the characteristics of an adequate post-signing market check. In *In re Pennaco Energy Inc.*<sup>13</sup> and *In re MONY Group Inc.*<sup>14</sup>, the Court of Chancery approved post-signing market checks that differ in several important respects from the post-signing market checks previously approved by the Court of Chancery. First, in both *Pennaco* and *MONY*, the target company board of directors agreed to a termination fee that, by the standards generally applied in similar circumstances in the past, was significantly higher (3.0% and 3.3%, respectively) than might have been expected in the context of a sale of control to a single bidder in the absence of a market canvass. In prior decisions, the Court of Chancery approved post-signing market checks with termination fees ranging from 1.9% to 2.2% of the equity value of the deal.<sup>15</sup> The Court of

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<sup>12</sup> *Id.* The Court has consistently reiterated both the rationale and factors relied upon in the *Fort Howard* decision. See, e.g., *Kohls v. Duthie*, 765 A.2d 1274 (Del. Ch. 2000); *Braunschweiger v. American Home Shield Corp.*, 1989 WL 128571 (Del. Ch. Oct. 26, 1989); *Roberts v. General Instrument Corp.*, 1990 WL 118356 (Del. Ch. Aug. 13, 1990).

<sup>13</sup> 787 A.2d 691 (Del. Ch. 2001).

<sup>14</sup> 852 A.2d 9 (Del. Ch. 2004).

<sup>15</sup> Compare *Pennaco*, 787 A.2d at 707 (approving a termination fee amounting to 3% of the equity value in the context of a transaction involving a third party single bidder and a post-agreement market check); and *MONY*, 852 A.2d at 18 (approving a termination fee amounting to 3.3% of the equity value in the context of a transaction involving a third party single bidder and a post-agreement market check); with *Kohls*, 765 A.2d at 1285 (refusing to enjoin a transaction involving a termination fee amounting to 2.2%

Chancery has only approved termination fees in the context of post-agreement market checks exceeding this minimal percentage when the market has been canvassed prior to the deal.<sup>16</sup> Citing precedent decided in the context of stock-for-stock mergers or liquidated damages provisions, the Court of Chancery approved the higher termination fees in *Pennaco* and *MONY*, without any analysis as to whether a higher termination fee of this size was reasonable in comparison to the fees previously approved by the Court of Chancery in earlier decisions involving single bidders and post-agreement market checks.<sup>17</sup> In addition, the fact that the press releases issued by the *Pennaco* and *MONY* boards both failed to explicitly invite competing proposals did not cause the Court any pause.<sup>18</sup>

Before the *Pennaco* and *MONY* decisions, most practitioners were of the view that a target that had not engaged in a prior canvass of the market could nevertheless negotiate with a single bidder and agree to be acquired by that bidder, provided that the transaction included a post-agreement market check, a press release inviting competing bids, and a modest

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of the equity value of the transaction); and *Fort Howard*, 1988 WL 83147, at \*13 (refusing to enjoin a transaction involving a termination fee amounting to 1.9% of the equity value of the transaction); and *Braunschweiger*, 1989 WL 128571, at \*7 (refusing to enjoin a transaction involving a termination fee amounting to 1.9% of the equity value of the transaction); and *Roberts*, 1990 WL 118356, at \*9 (refusing to enjoin a transaction involving a termination fee amounting to 2% of the equity value of the transaction).

<sup>16</sup> See, e.g., *In re KDI Corp. Shareholders Litig*, 1988 WL 116448, \*3 (Del. Ch. Nov. 1, 1988) (refusing to enjoin a transaction involving a three month pre-agreement market check and a post-agreement market check and containing a termination fee amounting to 4.3% of the equity value); *In re Formica Corp. Shareholders Litigation*, 1989 WL 25812 (Del. Ch. Mar 22, 1989) (approving a transaction involving an active pre-agreement market check and a post-agreement market check and containing a termination fee amounting to 4.5% of the equity value).

<sup>17</sup> *Pennaco*, 787 A.2d at 707 n.27 (citing *McMillan v. Intercargo Corp.*, C.A. No. 16963, Strine, V.C. (Apr. 20, 2000); *Matador Capital Management Corp. v. BRC Holdings, Inc.*, 729 A.2d 280 (Del. Ch. 1998); *Goodwin v. Live Entertainment, Inc.*, 1999 WL 64265 (Del. Ch. Jan. 25, 1999)); *MONY*, 852 A.2d at 24 (citing *Kysor Indus. v. Margaux, Inc.*, 674 A.2d 889 (Del. Super. 1996)).

<sup>18</sup> *Pennaco*, 787 A.2d at 703 (noting that the target company filed a form 8-K and attached the merger agreement which “gave the marketplace knowledge of Pennaco’s ability to speak with rival bidders and the standard nature of the termination fee”); *MONY*, 852 A.2d at 18 (noting that the transaction was announced on September 17, 2003).

termination fee (approximately 2% or less of the equity value). Practitioners also understood that other deal protections, such as a matching right, should be kept to a minimum. However, in *Pennaco* and *MONY*, the Delaware courts seemed to relax each of those requirements: it permitted a higher termination fee (closer to the amount generally seen in fully shopped transactions), a press release that failed to invite competing bids (presumably less of an issue in today's market, which more efficiently reports such information from publicly available filings), and matching rights (which, while generally permissible, may discourage competing bids).

### **Emergence of Go Shop Provisions**

After the *Pennaco* and *MONY* decisions, post-agreement market checks began fading into the background and a new approach – the go-shop provision – started to take hold. A typical go-shop provision<sup>19</sup> permits a target company to solicit proposals and enter into discussions or negotiations with other potential bidders during a limited period of time (typically 30-50 days) following the execution of the merger agreement.<sup>20</sup> The target company is permitted to exchange confidential information with a potential bidder, subject to the execution of a confidentiality agreement that is substantially on the same terms and conditions as the confidentiality agreement executed by the initial bidder. Any non-public information provided or made available to a competing bidder typically must also be provided or made available to the initial bidder.

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<sup>19</sup> Examples of thirty (30) go-shop provisions are set forth in the document entitled “Transactions Containing Go-Shop Provisions,” a copy of which is attached hereto.

<sup>20</sup> The length of the go-shop period has increased over time. In 2007, the average go-shop period for transactions announced in 2007 was 42 days. By comparison, for all transactions prior to 2007 that had a go-shop, the average go-shop period was 33 days.

Increasingly, go-shops also provide for a bifurcated termination fee – a lower fee payable if the target terminates for a competing bidder who is identified during the go-shop period and a traditional termination fee if the target terminates for a competing bidder who is identified after the go-shop period ends. For example, while only 67% of the 2006 go-shop transactions surveyed by the authors also included a bifurcated termination fee, every 2007 go-shop transaction included a bifurcated termination fee. Moreover, the termination fees during the go-shop period are, on average, between one-third and two-thirds of the full termination fee payable after the go-shop ends.

### **The Intended Benefits of Go-Shops**

The target's desire for a bifurcated fee with a significantly lower termination fee payable during the go-shop should not be surprising – it enhances the effectiveness of the target's go-shop by making the potential competing bidder's "entry costs" lower than would exist with a traditional no-shop provision and corresponding full termination fee. If the reduced termination fee generates more interest in the target company than a traditional no-shop provision, then a superior offer may be more likely to emerge during the go-shop period.

By virtue of its ability to canvass the market following the execution of a definitive agreement, the board of directors may be in a better position to gauge the level of interest of other potential bidders, using the agreed upon purchase price as a floor. As a result, the target company's board of directors should have a greater level of comfort that they have satisfied their fiduciary obligations to the company and its stockholders, including their duty under *Revlon* to secure the best transaction reasonably available. (If a superior offer fails to materialize during the go-shop period, the board of directors presumably would point to such

failure as evidence that it has obtained the highest possible value for the company.) Moreover, as noted above, a go-shop also permits the target company to agree to be acquired without having to conduct a full auction or pre-agreement market check, thus avoiding a number of undesirable consequences.<sup>21</sup>

A go-shop provision may also hold some appeal for potential bidders. For example, by agreeing to include a go-shop provision, a bidder avoids engaging in a potentially costly auction process. In addition, target companies generally have been willing to provide the initial bidder with the right to match any competing bid that is made during the go-shop period.<sup>22</sup> Finally, since a go-shop actively encourages jumping bids, the transaction (assuming it is not jumped) may be more defensible than a transaction that is simply subject to a traditional no-shop provision.<sup>23</sup>

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<sup>21</sup> In general, auctions and pre-agreement market checks give rise to a certain amount of uncertainty. For example, there is a risk that if the company conducts an open auction that either results in no bidders or the submission of bids at a lower than expected price, the market value of the company could be negatively affected. In addition, there may be important business reasons for forgoing a pre-agreement market check, such as customer and employee retention and preventing the disclosure of confidential information to potential strategic bidders in an auction process. *See, e.g., Van de Walle v. Unimation, Inc.*, 1991 WL 29303, at \*18 n.15 (Del. Ch. May 7, 1991) (“Plaintiff argues that there was no valid market test, because there was no public invitation to bid for Unimation. However, there is no rule requiring Unimation’s directors to sell the company according to a standard formula ...To publicly announce that Unimation was for sale would have created no added benefit and could well have been detrimental.”). Finally, private equity bidders frequently insist that the target not engage in a pre-agreement market check.

<sup>22</sup> Interestingly, the merger agreement in one recent transaction (Triad Hospitals) denied the initial buyer a matching right during the go-shop period. While that limitation remains novel, one might expect targets to start negotiating for such a limitation. Since go-shops are generally used when a target has not been fully shopped, a target might reasonably argue that a matching right, if included, would unfairly give the initial bidder a “leg up” that would chill the interests of other potential competing bidders.

<sup>23</sup> *Cf. In re Netsmart Technologies, Inc. S’holders Litig.*, 2007 WL 926213 (Del. Ch. March 14, 2007).

## Go-Shop Provisions: Effective Tools or Window Dressing?

Although private equity firms are increasingly turning towards the exclusive negotiation/go-shop model, target companies have become increasingly effective at negotiating more meaningful go-shop provisions, securing longer solicitation periods and, more often than not, lower termination fees for termination of transactions during the go-shop period. The question remains, however, whether the go-shop provision is effective, as an alternative to the traditional pre-agreement market check, or is it merely window dressing?

Our review of go-shop transactions since 2004 reveals that the risk that the deal will be jumped is remarkably low. When balanced against increased deal certainty, that risk may be viewed as insignificant given the potential benefits. In fact, only one transaction covered by our survey (Triad Hospitals) was successfully jumped during its go-shop period<sup>24</sup> and that jumping bidder was a strategic buyer. We are unaware of any successful jumping bid by a private equity bidder during a go-shop period, which lends credence to the argument that private equity firms are generally unwilling to submit jumping bids once another private equity buyer has signed up the deal. More generally, however, one may ask whether practitioners, buyers and sellers – and more importantly, the courts – should be willing to draw any favorable inference from the existing of a go-shop if the reality is that competing bidders (of all kinds) are extraordinarily unlikely to submit a superior offer during a go-shop period. Put another way,

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<sup>24</sup> In our survey, we note two other transactions in which successful jumping bids occurred, each of which is distinguishable from the Triad Hospitals transaction. In 2004, Hollywood Entertainment Corporation agreed to be acquired by Movie Gallery after initially executing a merger agreement with Carso Holdings Corporation. However, the go-shop provision in that transaction provided that the Hollywood could solicit superior offers *until the date of the stockholder meeting*. In 2005, Maytag Corporation agreed to be acquired by Whirlpool after initially executing a merger agreement with a consortium of private equity bidders led by Ripplewood Holdings. In the Maytag transaction, Whirlpool submitted its bid *after* the expiration of the go-shop period.

why should one assume that a go-shop will serve to canvass the market (and attain the best possible value for the target company and its stockholders) if no one ever makes a competing bid?

Additional reasons to question the effectiveness of a go-shop may exist when a private equity buyer has negotiated material terms of the transaction with the CEO or other key executives of a target company before the board of directors becomes involved. While a superior offer remains possible, will the fact that the initial bidder has reach agreement with the CEO cause other potential bidders to be hesitant to bid because of the perception that management may be less willing to fairly negotiate with a third-party? In such cases, is it reasonable to expect that a go-shop provision adds anything meaningful? Will the go-shop serve to cleanse the process flaws? One reasoned Delaware decision suggests, rather firmly, answers to each of these questions.

In *In re SS&C Technologies, Inc., Shareholders Litigation*, the CEO of a Delaware corporation, with the assistance of investment bankers hired by the company, discussed a possible acquisition of the company with six private equity firms, subject to the CEO's right to "make a significant investment in the acquisition entity."<sup>25</sup> The CEO presented the board of directors with the preferred bidder's offer, which was subsequently negotiated and accepted by the special committee. When considering a proposed settlement of the litigation, Vice Chancellor Lamb observed that the CEO's and board's conduct raised a number of questions regarding "whether, given [the CEO's] precommitment to a deal with [acquiror], the board of directors was ever in a position to objectively consider whether or not a sale of the

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<sup>25</sup> 911 A.2d 816, 818 (Del. Ch. 2006).

enterprise should take place.”<sup>26</sup> The Court also expressed its skepticism whether, given the CEO’s agreement to consummate a transaction with the initial bidder, the special committee was in a position to solicit competing bids, particularly from potential bidders that would not have been interested in retaining management. Where a CEO’s conduct corrupts the sales process, as it did in *SS&C*, it seems unlikely that the existence of a go-shop will provide any meaningful additional comfort to the Court.

## **Conclusion**

Ultimately, the value of a go-shop provision is directly tied to the context in which the Target board of directors determines to negotiate for it. Assuming the target company’s board of directors has a thorough knowledge of the market and a corresponding belief that the go-shop will make a material difference,<sup>27</sup> a go-shop provision may be a valuable (and viable) alternative to the traditional post-agreement market check.<sup>28</sup> However, where the sole purpose of a go-shop provision is to attempt to cleanse a transaction that has been tainted by the CEO’s role, practitioners and directors should draw little comfort from the use of a go-shop and should anticipate a skeptical judicial reception.

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<sup>26</sup> *Id.* at 820.

<sup>27</sup> For example, if the target board concluded that a post-signing market check would be unlikely to stimulate a hostile bid for a poorly covered microcap company in the same way that it has worked to attract topping bids in large-cap strategic deals, then a go-shop provision may make a material difference in the effectiveness of the target board’s sales process. *Cf. In re Netsmart Technologies, Inc. S’holders Litig.*, 2007 WL 926213 (Del. Ch. March 14, 2007) (target negotiated for, but failed to obtain, go-shop period, even though the target was a poorly covered microcap company and management had previously received little interest from potential acquirors).

<sup>28</sup> *Barkan*, 567 A.2d at 1287 (“When, however, the directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market.”).

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