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“Go-Shops vs. No-Shops: Evidence and Implications”

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ABSTRACT

Go-shop provisions have changed the way in which private equity firms execute public-company buyouts. While there has been considerable practitioner commentary on go-shops in the three years since they first appeared, this paper presents the first systematic empirical evidence on this new dealmaking technology. Contrary to the claims of prior commentators, I find that: (1) go-shops yield *more* search in aggregate (pre- and post-signing) than the traditional no-shop route; (2) “pure” go-shop deals, in which there is no pre-signing canvass of the marketplace, yield a higher bidder 17% of the time; and (3) target shareholders receive approximately 5% higher returns through the pure go-shop process relative to the no-shop route. I also find no post-signing competition in go-shop management buyouts (MBOs), consistent with practitioner wisdom that MBO’s give incumbent managers a significant advantage over other potential buyers. Taken as a whole, these findings suggest that the Delaware courts should generally permit go-shops as a means of satisfying a sell-side board’s *Revlon* duties, but should pay close attention to their precise structure, particularly in the context of go-shop MBOs.

JEL Classifications: D44, G14, G32, G34, K22, L14

Go-Shops vs. No-Shops: Evidence and Implications

Guhan Subramanian *



"Look at this. Pet Products of America is trying to use the Holiday Catalogue to satisfy their go-shop!"

From: Debevoise & Plimpton Private Equity Report (May/June 2007)

The “go-shop” clause has emerged as an important new deal-making technology during the private equity boom of 2005-2007. Under the so-called *Revlon* duty, the seller’s board of directors must obtain the highest possible price in the sale of the company. Traditionally, the board would satisfy its *Revlon* duty by canvassing the market (through investment bankers), identifying serious bidders, holding a formal or informal auction among them, and signing a deal with the winning bidder. The merger agreement would typically include a “no shop” clause, which would prevent the target from talking to potential “deal jumpers,” unless the target board’s fiduciary duty required it to do so (a “fiduciary out”). The go-shop clause turns this traditional approach on its head: rather than canvassing the marketplace first, the seller negotiates with a single bidder, announces the deal, and then has 30-50 days to “go shop” to find a higher bidder. At the highest level, then, the traditional route involves a market canvass followed by exclusivity

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with the winning bidder; while the go-shop route in its purest form involves exclusivity with a bidder followed by a market canvass.

While there have been numerous practitioner commentaries on go-shop provisions in the three years since they first appeared, go-shop clauses have been ignored by academic commentators to date. This paper presents the first systematic empirical evidence on go-shop provisions in private equity deals, which account for the vast majority of all go-shops. I construct a new sample of all going-private deals between January 2006 and August 2007 that include a private equity sponsor (n=146), and examine the solicitation feature (no shop or go shop) in each deal. The data reveals two different kinds of go-shops: a “pure” go-shop, in which the seller negotiates exclusively with a single buyer and then shops after the deal is announced; and what I term an “add-on” go-shop, in which the go-shop provision is included after the target has already conducted a pre-signing canvass of the marketplace. While the contractual language in the merger agreement is generally the same across pure and add-on go-shops, the important difference in deal context has implications for the econometric analysis that follows. Specifically, when I compare go-shop deals to the traditional no-shop deals in my sample, I find that the pure go-shops (but not add-on go-shops) yield approximately 5% higher returns to target shareholders. This finding is in sharp contrast to the weight of practitioner commentary to date, which generally views the go-shop process as simply “window dressing” and “illusory.” I suggest an explanation for this finding that focuses on the potential benefits of exclusivity for both the buyer and the seller from the go-shop process, relative to the traditional no-shop route.

The narrow (doctrinal) implication of these findings is that go-shop provisions, appropriately structured, can satisfy a target board’s *Revlon* duties. The broader (transactional) implication is that go-shop provisions can be a “better mousetrap” in deal structuring – a “win win” for both buyer and seller. This conclusion would be consistent with the increasing use of go-shops over the past two years that I find in my sample. The final (policy) implication is that private equity firms are not stealing companies from the public shareholders at low-ball prices through go-shops, as some commentators suggest; rather, the go-shop process induces a full price from the first bidder, which is meaningfully shopped during the go-shop process.

While the evidence presented here suggests no reason for categorical skepticism of go-shops, the data does indicate some reason to be wary in the specific context of management buyouts

(MBOs). Non-MBOs with a pure go-shop clause are jumped 22% of the time, while MBO go-shops are never jumped. While the sample is small, this finding is consistent with practitioner impressions that potential bidders are generally unwilling to bid when management has publicly signed on with a preferred buyout partner.

Taken as a whole, these findings have implications for how sell-side boards should structure a meaningful go-shop process, and where the Delaware courts should focus their attention in determining whether a particular go-shop satisfies the selling board's *Revlon* duties. To date, practitioners and courts have focused on the length of the go-shop window and the magnitude of the breakup fee in assessing the viability of the go-shop process. The analysis presented here suggests additional features that boards should negotiate for and courts should look for, particularly in the context of MBOs: bifurcated breakup fees, no contractual match right or (even better) no ability to participate in the post-signing auction, a contractual commitment for the initial bidder to sell in to any higher offer that emerges during the go-shop period, and *ex ante* inducement fees for subsequent bidders, among other deal features. This proposal tracks the Delaware courts' general approach to conflict transactions, which begins with substantive fairness review of the transaction but gives up fairness review if appropriate procedural protections are in place.

The remainder of this paper proceeds as follows. Part I provides background on the private equity industry and the market factors that have influenced P/E deal process over the past two years. Part II provides a chronology of the relevant Delaware case law. Part III reviews the prior literature. Part IV presents the methodology and empirical results. Part V suggests implications of the empirical findings for sell-side boards of directors, transactional lawyers, and the Delaware courts. Part VI concludes.

I. Background

It is well-known that private equity (P/E) has become a major factor in global M&A over the past seven years. According to data from Dealogic's mergers and acquisitions database, P/E deal volume has grown at an astonishing 45% rate *per year* between 2001 and 2007. During this period P/E has gone from 6% of total global M&A deal volume to 24%. Despite this ferocious pace of investment, there remains a massive "overhang" of uninvested P/E capital, estimated to

be \$140 billion in November 2006¹ and \$250 billion in April 2007.² With feasible debt-to-equity ratios of 3-to-1 today, this overhang means that P/E firms collectively have a purchasing power of approximately \$1.0 trillion. To put this number in perspective, the total public capital in the United States is roughly \$10 trillion,³ implying that P/E investors have the ability to take private 10% of current U.S. public capital, before raising a single new dollar.

Of course, P/E firms are continuing to raise money, and investors are still clamoring to give it to them despite the recent slowdown in the credit markets. A recent survey of Chief Investment Officers of pension funds, foundations, and endowments indicates that these funds plan to increase their allocation to private equity over the next three years, from 4.0% to 6.3% of their total funds under management.⁴ This increase translates into an additional \$400 billion that is expected to flow into private equity, from baseline allocation levels that are already at unprecedented highs. This trend perhaps reflects the growing consensus among academics and practitioners that P/E firms, unlike hedge funds,⁵ create significant value for the companies that they invest in, on average, by attracting superior managers with high-powered incentives⁶ and then monitoring these managers with experienced, repeat-play directors drawn from P/E firms that have significant “skin in the game.”⁷ The value proposition of this business model has only

¹ See Erin White & Gregory Zuckerman, *The Private-Equity CEO*, WALL ST. J. (Nov. 11, 2006), at C1 (“More deals are coming: Private-equity firms have raised more than \$199 billion since the start of 2005 but have spent only \$56 billion.”);

² See *CapitalEyes*, BANK OF AMERICA BUSINESS CAPITAL (March/April 2007) (reporting “more than \$250 billion” overhang).

³ [check]

⁴ See Citigroup Global Markets study of “approximately 50 Chief Investment Officers of pension funds, foundations, and endowments regarding their views on alternative investments,” cited in Jenny Anderson, *For Private Equity, the Party Isn’t Over*, NEW YORK TIMES (Oct. 10, 2007) at C1.

⁵ See, e.g., Robin Greenwood & Michael Schor, *Hedge Fund Investor Activism and Takeovers*, Harvard Business School working paper (July 2007) (reporting abnormal returns not different from zero for hedge fund targets that remain independent a year after the activist investment).

⁶ See, e.g., Emily Thornton, *Going Private*, BUSINESSWEEK (Feb. 27, 2006) at 53, 54 (“The attractions [for top managers] are two-fold: money and freedom.”).

⁷ See, e.g., Felix Barber & Michael Goold, *The Strategic Secret of Private Equity*, HARV. BUS. REV. (Sept. 2007); Robert C. Pozen, *If Private Equity Sized Up Your Business*, HARV. BUS. REV. (Nov. 2007). For a vivid (and perhaps jarring) example of the contrast between public-company and private equity boards, see, e.g., White & Zuckerman, *supra* note 1, at C1 (“At Mr. Conde’s first meeting with his new bosses [at SunGard Data Systems], SunGard director David Roux, co-founder of one of the firms that bought the company, offered advice on how to train new clients. In three years running SunGard as a publicly traded company, Mr. Conde says he rarely heard such specific suggestions from directors.”).

increased with the enhanced disclosure and monitoring obligations imposed on public companies by the Sarbanes-Oxley Act of 2002.⁸

Another important feature of the P/E marketplace is the typical compensation structure for the P/E general partners (GPs). P/E funds typically charge their limited partner (LP) investors an annual management fee of 2% of assets under management, plus a “carried interest” of 20-25% of any profits from the fund’s investments. In the early days of private equity, when funds were relatively small, the 2% management fee was intended to pay the operating expenses of the P/E firm (“keeping the lights on”) and all of the “serious money” was to be made in the carried interest, thereby aligning the incentives of the P/E GPs with their LP investors. As fund sizes grew dramatically over time, management fee percentages dropped slightly,⁹ but did not fully reflect the economies of scale that result from distributing overhead expense over a larger fund base. The result is that management fees today go well beyond “keeping the lights on” to become a large piece of overall compensation for P/E firms. A recent study confirms this point, finding that P/E firms on average gained 60% of their overall compensation from management fees and only 40% from the carried interest.¹⁰ The implication is that P/E firms are unlikely to release committed capital back to their limited partners, even if the recent downturn in the debt markets significantly reduces the number of attractive investments, because of the firms’ incentives to maximize assets under management, thereby maximizing management fees.

The massive pools of cash controlled by P/E firms have yielded frenzied competition among these firms to get deals. Stephen Schwartzman, head of private equity powerhouse Blackstone Group, reports that prices in P/E deals have risen to “nosebleed territory.”¹¹ Price-earnings trends confirm this impression.¹² With too much money chasing too few deals, full-blown auctions have become ubiquitous, leading P/E firms to increasingly search for ways to gain exclusivity – that is, one-on-one negotiations with a prospective target. Not only does exclusivity potentially allow a P/E buyer to pay a lower price, but it also reduces the possibility

⁸ A point perhaps best put by David Bonderman of Texas Pacific Group: “Our best friends have been Messrs. Sarbanes, Oxley, and Spitzer. When it becomes uncomfortable for executives in public markets, we are a source of alternative capital, but a more expensive one.” Deborah Orr, *The New Titans*, FORBES (April 19, 2004).

⁹ See, e.g., Barber & Goold, *supra* note 7, at 55 (reporting management fees of “1.5% to 2% of assets under management” for “large” buyout funds).

¹⁰ See Andrew Metrick & Ayako Yasuda, *The Economics of Private Equity Funds* (working paper September 2007).

¹¹ Peter Smith, *Buy-out Industry Warned on Prices*, FIN. TIMES (Feb. 21, 2006).

¹² See Thornton, *supra* note 6, at 58 (reporting average price-to-earnings multiples of 9-to-1 in 2005 Q4, compared to 6-to-1 in 2000).

that the P/E buyer will walk away empty-handed (i.e., not closing the deal) after making significant investments of both time and money in the due diligence process.

Exclusivity, though, has been elusive. In private-company deals, P/E firms canvass the marketplace relentlessly to identify potential sellers. One Boston-based private equity firm, for example, employs dozens of recent college graduates to cold-call entrepreneurs in the hopes of finding a potential seller before other buyers appear. Even in the needle-in-a-haystack situation where this firm identifies such a seller, a common next step is for the seller to retain an investment banker who will canvass the marketplace – thus eliminating or at least severely diminishing any first-mover advantage that the P/E firm might have had.

In public-company deals, exclusivity is even more difficult to achieve because the target board has a fiduciary duty to maximize the price that it receives in a sale of the company. The traditional way in which boards fulfill this “*Revlon* duty” (named after the 1986 Delaware Supreme Court opinion where the duty was first articulated) is by canvassing the market, then signing a merger agreement with the highest bidder.¹³ In public-company deals, then, the conventional wisdom historically has been that the board of directors has a legal obligation to *not* grant exclusivity in a P/E buyout. Once a full canvass of the market has taken place and the deal has been announced, the merger agreement typically includes a “no shop” (sometimes called a “window shop”) clause, in which the target agrees to not actively solicit other buyers. The target board with nevertheless insist on a “fiduciary out,” which allows the board to negotiate with a third-party who might be able to make a superior offer. If a higher bidder emerges during this post-announcement period, the target will be required to pay the initial bidder a breakup fee, typically amounting to 2-4% of the deal value.¹⁴

Enter the go-shop clause, which turns the traditional negotiation process for public-company buyouts on its head. A P/E buyer will approach a target with an indication of interest. Rather than canvassing the marketplace at this point, the target will grant the buyer an exclusive negotiating period in exchange for signed confidentiality and standstill agreements. If the parties reach agreement during this exclusive negotiating period, the deal is announced. The go-shop

¹³ For more detail on the traditional deal process, see Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L. J. 621 (2003).

¹⁴ See John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory & Evidence*, 53 STAN. L. REV. 307 (2000) (providing empirical evidence on the magnitude of breakup fees in a sample of public-company acquisitions announced between 1988 and 1998).

provision in the merger agreement provides the seller with the right to then solicit other buyers for 30-60 days, in sharp contrast to the traditional “no shop” deal. The merger agreement will usually include a “bifurcated” breakup fee: a lower amount, typically 1-2% of the equity value of the deal, if a higher offer emerges during the go-shop period; and a higher amount, typically 2-4% of the deal value, if a higher offer emerges after the go-shop period expires but before the initial deal closes.

If a higher offer emerges before the go-shop period expires, the target board will designate the new bidder as an “Excluded Party” (“excluded” because it is exempt from paying the higher breakup fee if it reaches a deal to buy the target). Under the “match right” that is typically included in the initial merger agreement, the target board must then negotiate for either 3 or 5 days, “in good faith,” with the initial bidder to see if the initial bidder can match the terms offered by the Excluded Party. The seller may go back and forth several more times, but each new bid by the Excluded Party triggers a new 3 or 5 day match right for the initial bidder. If the Excluded Party wins the auction in the end, the target board will pay the reduced breakup fee to the initial bidder. The length of the go-shop period, the magnitude of the two breakup fees, and whether the initial bidder gets a “match right” for any subsequent offer are all heavily negotiated points between the P/E buyer and the target during the exclusive negotiating period.

At the highest level, in both the no-shop and go-shop processes, the target canvasses the market to see if there is a higher-value bidder. The critical difference lies in when this market check takes place: in the traditional no-shop route, the market check takes place before signing; while in the go-shop process the market check takes place after the deal is signed and announced. The timing difference has three important implications for the deal process. First, a pre-signing market check places all bidders on a level playing field with respect to the economics of the transaction; in contrast, a post-signing market check gives the announced bidder a slight leg up because of the breakup fee that is payable by any subsequent bidder. Even though the breakup fee is modest as a fraction of deal value, the combination of the fee and the first bidder’s match right may deter a prospective bidder.¹⁵ Second, a pre-signing market check gives all bidders the same timeline for making bids; in contrast, a post-signing market check requires potential bidders to demonstrate a reasonable likelihood of making a superior proposal before the

¹⁵ See Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 J. CORP. L. 691 (2000).

expiration of the go-shop period, which in some cases can be a tight timeframe. Third, and perhaps most importantly, in a pre-signing market check the board and management have a legal obligation to maintain a level playing field among all bidders; in contrast, in a post-deal market check process the board has implicitly or explicitly given a preferred status to the announced bidder. This inside track is particularly valuable when management is part of the buyout group and/or has announced its intention to stay on post-buyout to run the company. Bidders who may have been willing to make a bid during a pre-bid market check may be deterred when the initial bidder is perceived to have management “locked up.”¹⁶ For any or all of these reasons, then, the timing of the market check (pre-deal versus post-deal) can have implications for whether the highest-value buyer is identified, and, related, whether the target achieves the highest feasible price.

II. Evolution of Deal Process Case Law

In 1985, the Delaware Supreme Court held in *Revlon v. MacAndrews & Forbes Holdings, Inc.*, that when a “sale or break-up” of the company becomes “inevitable,” the directors’ duties shift from “defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders in the sale of the company.”¹⁷ Virtually all P/E buyouts are subject to examination under the *Revlon* standard because target shareholders are typically getting cashed out of the company. In addition, management buyouts are subject to entire fairness review, requiring the buyer to show both fair price and fair process.

Despite the auctioneering language in the original *Revlon* decision, subsequent cases clarified that the basic duty is to maximize immediate shareholder value but that there is no “standard formula”¹⁸ that a board had to follow. In 1989, the Delaware Supreme Court’s opinion in *Barkan v. Amsted Industries, Inc.*¹⁹ provided further clarification on the substantive requirements imposed by *Revlon*: first, a level playing field among bidders;²⁰ and second, a “market check” to

¹⁶ See, e.g., Steven M. Davidoff, *Harman’s Shopping Spree*, M&A Law Prof Blog (April 26, 2007) (“[I]n neither case [Columbia HCA and Freescale] did competitors emerge, likely due to the involvement of management in the initial deal.”).

¹⁷ *Revlon*, 506 A.2d at 182.

¹⁸ *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1286 (Del. 1989).

¹⁹ 567 A.2d 1279 (Del. 1989).

²⁰ “[W]hen several suitors are actively bidding for control of a corporation, the directors may not use defensive tactics that destroy the auction process. . . . When multiple bidders are competing for control . . . fairness forbids

ensure that the board was getting the best possible deal for its shareholders,²¹ with a narrow exemption for situations in which the board already had “a body of reliable evidence with which to evaluate the fairness of the transaction.”²²

Until very recently, the trajectory of the case law has been toward greater flexibility in the process that a board may use to full its *Revlon* duties (or, put differently, a watering down of the requirements imposed by *Revlon*).²³ The evolution began with *In re Fort Howard Corp. Shareholders Litigation*,²⁴ two years after *Revlon*, in which the sell-side board did not engage in a pre-signing market check, but the press release announcing the deal invited alternative proposals and the breakup fee was a relatively modest 1.9% of the equity value of the deal. The Delaware Chancery Court rejected the plaintiffs’ claim that this deal process violated the selling board’s *Revlon* duties, thereby endorsing the possibility of an “implicit market check.”

Practitioners since then have tested the boundaries of what constitutes a valid implicit market check.²⁵ In *In re Penanco Energy*²⁶ and *In re MONY Group*,²⁷ the target board conducted no pre-signing canvass of the marketplace, following the *Fort Howard* blueprint, but the breakup fees were 3.0% and 3.3% of equity value, respectively, and there were no invitations in the press releases for alternative bids. In *Pennaco*, the merger agreement also included a “match right,” a relatively new deal term at the time, which gave the buyer a three-day exclusive negotiation period with Pennaco if a higher bidder emerged.²⁸ The Delaware Chancery Court nevertheless approved both deals under the *Revlon* standard.

directors from using defensive mechanisms to thwart an auction or to favor one bidder over another.” *Id.* at 1286-87.

²¹ “When the board is considering a single offer and has no reliable grounds upon which to judge its adequacy . . . fairness demands a canvas of the market to determine if higher bids may be elicited.” *Id.* at 1287.

²² *Id.*

²³ See WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 558-59 (2nd ed. 2007).

²⁴ 1988 WL 83147 (Del. Ch. Aug. 8, 1988).

²⁵ *Cf.* Coates & Subramanian, *supra* note 14, at 334 n. 90 (quoting Richard Beattie, Managing Partner, Simpson, Thacher & Bartlett: “The percentage that is okay has slowly risen. A year ago, two years ago, people were talking about two percent, two-and-a-half percent. Now, you hear them talking about three, three-and-a-half percent. Some are even saying four percent. You sit there and ask, ‘On what basis are you doing that? Where did you get that number?’ There hasn’t been a specific challenge, so everybody pushes the envelope.”).

²⁶ 787 A.2d 691 (Del. Ch. 2001).

²⁷ 852 A.2d 9 (Del. Ch. 2004).

²⁸ See AGREEMENT AND PLAN OF MERGER BETWEEN MARATHON OIL AND PENNACO ENERGY, §5.02(a) (Dec. 22, 2000).

Continuing in this line of cases, *In re Toys “R” Us Shareholder Litigation*²⁹ involved a fifteen month strategic review process at the well-known toy retailer. The Toys “R” Us board initially focused on the sale of the toys business, then shifted to a sale of the entire company (consisting of the lagging toys business and the hugely successful Babies “R” Us business). The board solicited bids from the same four buyers that had been identified as interested in buying the toys business, even though the set of potential buyers for the entire company was likely to be different. The deal contained a 3.75% breakup fee (amounting to \$247.5 million), and a match right against any potential third-party bidder. Despite the convoluted search process and the significant deal protection, the Delaware Chancery Court held that the board had satisfied its *Revlon* duties.³⁰

The latest development in the articulation of *Revlon* duties reverses this trajectory, albeit in a potentially narrow context. *In re Netsmart Technologies Inc. Shareholder Litigation*³¹ involved the sale of Netsmart, a microcap company in the behavioral healthcare information technology marketplace. The board sold the company to a P/E group after an auction among seven P/E investors but no strategic buyers. Plaintiffs challenged the deal under *Revlon*, claiming that the board should have solicited strategic buyers as well; defendants responded that the relatively small breakup fee facilitated an implicit market check for potential strategic buyers. Surprisingly, the Delaware Chancery Court granted a preliminary injunction against the deal, acknowledging that the implicit market check was a well-accepted technique but drawing a distinction between a large-cap deal and a micro-cap deal such as Netsmart: “The mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics.”³²

Against this general backdrop, two recent decisions in the Delaware Chancery Court have examined go-shop provisions in P/E deals, though neither of these decisions articulated principles that might provide general guidance for transactional lawyers and bankers who

²⁹ 877 A.2d 975 (Del. Ch. 2005).

³⁰ It should be noted that I served as an expert witness for the plaintiffs in this litigation, providing empirical evidence that the breakup fee was large and theoretical reasons why a match right should deter potential bidders.

³¹ 924 A.2d 171 (Del. Ch. 2007).

³² *Id.* at 197.

structure go-shops. In *In re Topps Company Shareholders Litigation*,³³ Vice Chancellor Strine held that a 40-day go-shop period, despite the existence of a match right and a 4.3% breakup fee after the go-shop period expired, did not violate the target board's *Revlon* duties. ("For 40 days, the Topps board could shop like Paris Hilton."³⁴). In contrast, in *In re Lear Corporation Shareholder Litigation*,³⁵ issued just one day later, V.C. Strine looked far more skeptically on the go-shop provision because the Lear go-shop required the board to "get the whole shebang done [i.e., discovery of a Superior Proposal, expiration of the 10-day match right, termination of the initial agreement, and a signed-up agreement with the new bidder] within the 45-day window."³⁶ In both *Topps* and *Lear*, the Court refused to grant a preliminary injunction against the deal on the *Revlon* claims, but granted the plaintiffs' request for a preliminary injunction until certain disclosure problems were cured.

In short the current state of play regarding go-shop provisions and *Revlon* duties seems to be this: an evolution toward greater deference to the target board's discretion in managing the deal process, with a slight "pinprick" in this reasonableness assessment with *Netsmart*; and, applying this overall approach to the specific context of go-shops, a split-decision in *Topps* and *Lear*, in which the go-shop was unproblematic in *Topps* but apparently closer to the line in *Lear*.

III. Prior Literature

Mirroring the case law, the prior literature is divided on go-shop clauses. On one hand, several commentators argue that the proliferation of go-shop clauses is a manifestation of seller bargaining power in a world of frenzied buy-side competition.³⁷ Under this view, the go-shop

³³ 2007 WL 1732586 (Del. Ch. June 2007).

³⁴ *Id.* at *26.

³⁵ 926 A.2d 94 (Del. Ch. 2007).

³⁶ *Id.* at 119. Vice Chancellor Strine continued in his usual entertaining way: "It is conceivable, I suppose, that this could occur if a ravenous bidder had simply been waiting for an explicit invitation to swallow up Lear. But if that sort of Kobayashi-like buyer existed, it might have reasonably been expected to emerge before the Merger Agreement with Icahn was signed based on Lear's lack of a rights plan and the publicity given to Icahn's prior investments in the company." *Id.*

³⁷ See, e.g., *Why More Sellers Are Using a "Go-Shop" Clause*, CAPITAL EYES (May/June 2007) ("M&A lawyers say [go-shop clauses] are likely to remain popular as sellers seek to include this provision in more deals."); Steve Rosenbush, *Private Equity Slugfest*, BUSINESSWEEK (Feb. 13, 2007) ("Target companies are figuring out ways to elicit more competition. One technique is the so-called 'go-shop' provision."); Mark W. Peters et. al, *The Increasingly Popular 'Go-Shop' Provision – Why Now?*, MERGERS & ACQUISITIONS (May 2007) ("The existing seller's market environment may help account for the recent popularity of the go-shop provision."); *A Review of Merger Agreement Provisions in Going Private Transactions*, MERGERMETRICS.COM (March 23, 2007) (arguing

clause is seller-friendly because it replaces the usual “no shop” with a “go shop,” which can only work to the seller’s advantage. This view, if correct, would imply higher returns for target shareholders in deals with go-shop clauses, either because higher prices and go-shop clause incidence are both positively correlated with seller bargaining power, or because the go-shop increases the likelihood of a subsequent (higher) bid, or both.³⁸

On the other hand, some commentators argue that go-shop clauses work primarily to the buyer’s advantage, because the addition of a go-shop clause gives the target board an excuse to curtail (or eliminate completely) pre-deal shopping, and the subsequent go-shop period is illusory.³⁹ The go-shop period can be illusory if the sell-side investment bankers do not do an

that proliferation of go-shop clauses indicates “a strengthening of the target’s negotiating position”). *See generally* DEBEVOISE & PLIMPTON PRIVATE EQUITY REPORT (Fall 2006) (“The business press perceives go-shop provisions as another example of how the competitive M&A market is changing acquisition agreements in favor of targets.”).

³⁸ There is a further potential beneficial effect of go-shop clauses, one not currently articulated in the practitioner literature but supported by conversations with P/E investors and their advisors. In a traditional deal process, a P/E investor spends a fixed cost C in order to make a firm bid, but only recoups that cost in the event that it wins the deal. In an auction, the likelihood of winning might be quite low. In the absence of any special advantage, for example, a P/E firm should estimate a $1/n$ chance of winning, where n is the total number of bidders. Thus the P/E firm will only bid when the expected profit from the deal multiplied by the likelihood of winning is greater than the bid costs; or rearranging terms, when the profits from the deal are greater than Cn . In the P/E world C can be quite high, due to out-of-pocket costs such as lawyer, banker, and accountant fees, as well as (more importantly, for most P/E firms) the opportunity cost of having its investment professionals spending time investigating a particular deal. As discussed previously n can be large as well – it is not uncommon for seven or eight P/E firms to express serious interest in a target company that has announced it is for sale. Thus the traditional deal process is likely to deter many P/E bidders. The problem of bidder inducement was the subject of a classic debate in the early 1980s. *Compare* Easterbrok & Fischel with Bebchuk, Gilson. The go-shop provision can be seen as the latest response to this problem. In this context, a go-shop provision may yield positive shareholder wealth effects by inducing an initial bidder to come to the table. The initial bidder still invests C to investigate the target, but exclusivity substantially increases the likelihood of a deal. If another bidder successfully jumps the deal during the go-shop window, the initial bidder loses C but (in contrast to the traditional route) gains B , the breakup fee. This fee typically amounts to 1-2% of deal value, usually sufficient to cover the bidder’s out-of-pocket expenses and some fraction of opportunity cost. Thus the go-shop clause may have desirable *ex ante* effects by mitigating the (potentially severe) bidder deterrence problem. It is interesting to note a parallel between the go-shop process and Section 363 of the Bankruptcy Code. Section 363 requires a debtor to obtain the highest price available in the sale of assets, but in doing so the debtor is permitted to sign-up a deal with a so-called stalking horse bidder, who receives modest deal protection and other preferential treatment, before the debtor conducts the full-scale auction. For an example of a successful auction under Section 363, in which a stalking horse bid was then subject to intense competition from eight bidders in a full-blown auction, *see* GUHAN SUBRAMANIAN & ELIOT SHERMAN, CABLE & WIRELESS AMERICA (HBS case study 9-908-004) (July 5, 2007) (describing sale of Cable & Wireless America under Section 363).

³⁹ *See, e.g.,* Andrew Ross Sorkin, *Looking for More Money, After Reaching a Deal*, NEW YORK TIMES (Mar. 26, 2006) (“The question, though, is why a company wouldn’t hold an open auction to begin with? . . . [M]ore often than not, it would seem that an open auction is the best way to go. . . . [T]he biggest problem with a go-shop provision is that by default, other potential bidders start at a huge disadvantage.”); Steven M. Davidoff, M&A Law Prof Blog (April 26, 2007) (“[I]nvestors have increasingly come to see “go-shop” provisions as cover for unduly large break-up fees and the significant advantage and head-start provided by management participation.”), available at http://lawprofessors.typepad.com/mergers/2007/04/harmans_shoppin.html; Tom Taulli, *ACS Buyout: A Second Bite at the Apple?*, BLOGGINGBUYOUTS (June 12, 2007) (“[I]t’s usually the case that a ‘go shop’ doesn’t amount to

adequate job of canvassing the marketplace during the go-shop period.⁴⁰ Alternatively, or in addition, the go-shop period can be illusory if potential bidders are deterred by the breakup fee, the relatively short time period to make a bid, and/or the existence of an inside bidder who will typically have the right to match any higher offer that might appear. Under one version of this view, the P/E buyer promises management lucrative post-buyout employment agreements and management puts a go-shop clause into the merger agreement as “window dressing” to provide cover against judicial scrutiny. This view implies lower returns for target shareholders in deals with go-shop clauses, either because the lucrative management contracts come at the expense of shareholders, or because the bidder who gains exclusivity is unlikely to be the highest bidder, or both.

Despite the large practitioner literature that has emerged over the past two years on go-shops, there has been no systematic investigation of go-shop provisions beyond basic descriptive statistics.⁴¹ Fundamental empirical questions remain unanswered: Are go-shop deals different from no-shop deals? What fraction of go-shop deals yield a higher bidder? Is the existence of a go-shop clause correlated either positively or negatively with target shareholder returns? In the next Part I seek to answer these and other questions.

IV. Empirical Findings

I use Thomson Financial’s mergers & acquisitions database to identify all buyouts of U.S. public companies larger than \$50 million in value announced between January 1, 2006 and August 31, 2007, in which at least one private equity firm was part of the buyout group. I exclude acquisitions out of bankruptcy because of the mandatory process rules in this context and the oversight required by the Bankruptcy Court. I also exclude deals with a controlling

much anyway.”), available at <http://www.bloggingbuyouts.com/2007/06/12/acs-buyout-a-second-bite-at-the-apple>. Cf. Mark A. Morton & Roxanne L. Houtman, *Go-Shops: Market Check Magic or Mirage?*, Potter, Anderson & Corroon memorandum to clients (May 2007) (“[O]ur practical experience suggests that while go-shops may be beneficial in some circumstances, they may serve as mere window dressing in other cases. . . . [W]hy should one assume that a go-shop will serve to canvass the market . . . if no one ever makes a competing bid?”).

⁴⁰ *Investment Banks’ Brave, New, Conflicted World*, NEW YORK TIMES (Mar. 29, 2007).

⁴¹ See, e.g., Morton & Houtman, *supra* note 39 (“[T]he authors are not aware of any empirical analysis of go-shops. . . .”). See also M. Lipton, T.N. Mervis & P.K. Rowe, *Private Equity and the Board of Directors*, WACHTELL, LIPTON, ROSEN & KATZ MEMORANDUM TO CLIENTS, at 4 (“[T]here is no empirical evidence supporting the view that go-shops are ineffective, and there is at least anecdotal evidence (Maytag, Catalina Marketing, EGL) that private equity firms are willing to top publicly announced deals.”) (emphasis in original). More systematic evidence on this question is presented in Table 3 *infra*.

shareholder, using a control threshold of 35%,⁴² because any shopping process would not be meaningful in these deals unless the controller agreed to sell its shares into a higher-value competing bid (which is rare). The final sample includes 146 buyouts.

This timeframe has the desirable feature of capturing all P/E deals in a “chapter” of P/E history: from the very beginning of the regular usage of the go-shop technology⁴³ to what many perceive to be the meltdown of the P/E marketplace in the second half of 2007, due to ripple effects from the sub-prime mortgage crisis to the credit markets overall.⁴⁴ One implication of this point is that the sample includes the full set of comparable transactions. While there will of course be more P/E deals and go-shop deals in the future, these future deals may not be directly comparable to the deals under examination here due to the significantly different market environment going forward.

For each deal I examine the seller’s press release, the merger agreement, the proxy statement issued in conjunction with the merger, and other SEC filings (primarily 14A and 14D-9 filings) to capture various features of the deal process, including, most importantly, the seller’s post-deal solicitation rights (no shop or go shop), and the pre-signing and post-signing market canvasses that were conducted. Daily stock price data comes from Datastream.

A. Go-Shop Incidence and Structuring

Table 1 shows the number of deals that were announced in each month of the sample period, broken down by the deal process used.

[insert Table 1 about here]

Table 1 shows that go-shops have appeared in one-third of deals (50 out of 146), roughly consistent with practitioner estimates,⁴⁵ though this aggregate statistic masks significant growth

⁴² See Guhan Subramanian, *Post-Siliconix Freeze-outs: Theory & Evidence*, 36 J. LEG. STUD. 1 (2007) (providing theoretical justification and case law supporting 35% threshold for control stake).

⁴³ According to data from Morton & Houtman, *supra* note 39, there were only seven go-shop deals before the beginning of my sample period, with the first appearing in Welsh, Carson, Anderson & Stowe’s buyout of U.S. Oncology in March 2004. Because the private equity deal environment became considerably more heated during 2006-07, I use the shorter timeframe to ensure comparability between the go-shop and no-shop samples.

⁴⁴ See, e.g., MORGAN STANLEY/JPMORGAN PRESENTATION TO CLIENTS, p.12 (Nov. 13, 2007) (slide titled “Global Deal Flow Has Dwindled in Recent Months”). The study notes that August and September were the first months in 2007 that had fewer deals larger than \$100 million than the corresponding months in 2006.

⁴⁵ See, e.g., *CapitalEyes*, *supra* note 2, quoting Robert Townsend, a partner at Morrison & Forester (estimating a 25% incidence of go-shops in P/E deals); MergerMetrics, *A Review of Merger Agreement Provisions in Going Private Transactions* (Mar. 23, 2007) (reporting 32% go-shop incidence in private equity deals announced between

in the use of the go-shop technology during the sample period. For example, go-shops appeared in 20% of deals (9 out of 46) during the first half of the sample period (January to September 2006), and 41% of deals (41 out of 100) in the second half of the sample period (October 2006 to August 2007). In addition, Table 1 shows that, because go-shop deals tend to be larger than no-shop deals, go-shop deals account for almost half of private-equity deal volume (46%) during the sample period.

Merging my sample with recent practitioner data⁴⁶ reveals that private equity firms account for the vast majority of go-shop provisions – 50 out of 57 deals during the sample period (89%), which is far greater than private equity’s share of M&A deals overall. If deal volume rather than number of deals is considered, private equity accounts for virtually all (99%) of go-shops. One possible explanation for P/E’s disproportionate use of go-shops is that these firms might value exclusivity more than strategic buyers, due to the sense among P/E buyers that they have no natural edge over other P/E firms and therefore are playing a common value game. If P/E firms are generally using the same valuation models and have the same discount rates, the only source of differentiation across firms would be access to management and/or expectations about future cash flows (the latter source of differentiation of course raising winner’s curse concerns). In contrast strategic buyers typically have synergies with the target that provide at least the possibility for private value, thereby making these firms less concerned about competitors and (potentially) less interested in exclusivity. Another explanation, not necessarily mutually exclusive, is that private equity lawyers, in search of exclusivity for their clients, have introduced a new deal technology that will disseminate over time to strategic deals as well – that is, in equilibrium go-shop provisions will appear with equal likelihood in P/E and strategic deals.

Digging deeper into the go-shop sub-sample, Figure 1 documents the number of bidders contacted before signing.

[insert Figure 1 about here]

The data in Figure 1 reveals an important difference between go-shops: 60% (30 out of 50) are “pure” go-shops, where the target negotiates with a single bidder during the pre-signing

January and March 2007). *See also* WEIL GOTSHAL SPONSOR-BACKED GOING PRIVATE TRANSACTIONS REPORT (reporting 24% go-shop incidence among 85 P/E deals announced between October 1, 2005 and December 31, 2006).

⁴⁶ *See* Morton & Houtman, *supra* note 39.

period. The remaining 40% of go-shops (20 out of 50) are what I term “add on” go-shops, where the go-shop period was in addition to at least some degree of pre-signing shopping.⁴⁷ Because pure go-shops seem conceptually different from add-on go-shops, I examine the two kinds of transactions separately in most of the analyses that follow.

Table 2 provides summary statistics on deal characteristics according to the deal process that was used: traditional no shop; add-on go-shop; and pure go-shop.

[insert Table 2 about here]

Examining first deal characteristics, Table 2 shows that go-shop deals are larger on average than no-shop deals, and this difference is significant at 90% confidence. This finding is loosely consistent with the theory recently articulated by the Delaware Chancery Court, that explicit shopping is less important for larger deals because the market is more likely to be aware that such companies are for sale.⁴⁸ Put differently, practitioners can afford to be more innovative in shopping processes in large deals because potential buyers (guided by highly-motivated investment bankers) are likely to be informed that the company is in play.

Table 2 also shows that approximately half of all targets in the no-shop sample are incorporated in Delaware, in proportion to the overall fraction of U.S. public companies that are incorporated in that state.⁴⁹ Though the difference is not statistically significant, it is interesting to note that Delaware targets are over-represented in the go-shop sample. This finding might be due simply to the fact that Delaware companies are larger than non-Delaware companies, on average,⁵⁰ so the different incorporation mix simply reflects the size differential noted above. More interestingly, the over-representation of Delaware targets in the go-shop sample might reflect a greater willingness among practitioners to innovate with deal process in that state, given the sophistication of the courts that would be assessing such innovation.

⁴⁷ See also WEIL GOTSHAL SPONSOR-BACKED TRANSACTIONS REPORT, *supra* note 45 (“Surprisingly, one-half of the transactions with a go-shop had some form of pre-signing market check.”). *But see* Morton & Houtman, *supra* note 39, at n.1 (“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.”).

⁴⁸ See *In re NetSmart Technologies Inc. Shareholders Litigation*, 924 A.2d 171, 197 (suggesting that an implicit market check may be viable in large-cap deals but not small-cap deals).

⁴⁹ See Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PENN. L. REV. 1795 (2002).

⁵⁰ See Guhan Subramanian, *The Disappearing Delaware Effect*, 20 JLEO 32 (2004).

On management involvement, MBO's are over-represented in the go-shop sample, though not meaningfully so. This finding cuts against practitioner perceptions that managers are highly attracted to the go-shop process because it allows them to buy the company from the public shareholders "on the cheap."⁵¹ Finally, Table 2 shows important differences in who initiates the transaction across the various deal processes. No-shop deals are initiated by the buy-side (though not necessarily by the eventual buyer) in 53% of deals, and by the seller in the remaining 47% of deals.⁵² The fraction that are initiated on the buy-side increases to nearly 70% in the add-on go-shop deals, and to 93% in the pure go-shop deals. These findings are consistent with the practitioner playbook on pure go-shops, in which a buyer approaches a potential seller and insists on exclusivity in exchange for a go-shop period after the deal is announced. I return to the implications of this finding for target shareholder returns analysis in Part IV.C below.

Moving to the pre-signing solicitation process, Table 2 shows large but perhaps unsurprising differences across no-shops and go-shops. Examining first the traditional no-shop process, Table 2 shows that 34.2 buyers are contacted on average,⁵³ of which 18.4 signed confidentiality agreements and 4.1 made bids. Among the 96 deals in the no-shop sub-sample, only one deal (Blackstone's purchase of Hilton in July 2007) involved exclusive one-on-one negotiations during the pre-signing process. However, this deal does not fit the mold of a traditional "implicit market check" process because of the large breakup fee (\$560 million, or 2.8% of the deal value) in the deal, the absence of any post-signing solicitation right beyond the standard "fiduciary out," and the lack of any invitation in the press release for competing proposals. Hilton's proxy statement indicates that Hilton did not engage in a pre-signing market check because Blackstone threatened to walk away if Hilton canvassed the market, and the deterioration of the credit markets during the negotiation made other it unlikely that other bidders would have come forward if such a canvass had been attempted.⁵⁴ Therefore, there are no examples of an implicit market check in the no-shop sample; rather, the overall picture is one of robust competition

⁵¹ See, e.g., Davidoff, *supra* note 39 ("[I]nvestors have increasingly come to see 'go-shop' provisions as cover for unduly large break-up fees and the significant advantage and head-start provided by management participation.").

⁵² For reasons that are described in more detail below, buyouts initiated by management are classified as being initiated on the buy-side. See *infra* Part IV.C.

⁵³ This finding is roughly consistent with the only other study I am aware of that examines the pre-signing solicitation process. See Audra L. Boone & J. Harold Mulherin, *How Are Firms Sold?*, 62 J. FIN. 847 (2007) (examining a sample of 202 acquisitions for cash between 1998 and 2003 and reporting 21 buyers contacted, on average).

⁵⁴ See Hilton Hotels Corp., DEFM14A (Aug. 8, 2007) at 25-28.

among buyers during the pre-signing process. This (non)finding is consistent with practitioner impressions that, despite the judicial validation by the Delaware courts, an implicit market check is more vulnerable to challenge than the traditional canvassing of the marketplace.

Among add-on go-shops, Table 2 shows that 15.9 potential buyers were contacted on average, of whom 8.4 signed confidentiality agreements and 2.9 made bids. This picture of the add-on deal process is significantly different from the no-shop deal process, at each step along the way to a signed deal. It suggests that the add-on go-shop process may be something of a “halfway house” between the standard no-shop process and the pure go-shop process, in which sellers trade off some amount of pre-signing shopping in exchange for a signed deal; or, alternatively, buyers are able to short-circuit some amount of pre-signing shopping with the offer of a go-shop. Finally, the pure go-shop column is definitional: 1 buyer is contacted (or contacts the seller); this buyer signs a confidentiality agreement, conducts due diligence, and the deal is announced.

Perhaps more interesting is the post-signing solicitation process. Table 2 shows that in the no-shop process, the seller does not contact any further bidders (as is required by the merger agreement), but an unsolicited bidder appears approximately 8% of the time. This finding is consistent with prior work finding a 8-12% jump rate in the typical market canvass/no shop process. In contrast, in go-shop deals the seller’s bankers contact a very large number of potential buyers: 33.4 on average in the add-on go-shop case, and 40.1 in the pure go-shop case. When pre-signing and post-signing canvassing are considered together, go-shop deals actually solicit more potential buyers than the no-shop deals: 49.3 are solicited in add-on go-shops (= 15.9 + 33.4) and 41.1 are solicited in the pure go-shops (1.0 + 40.1), compared to 34.2 in the no-shops. This finding would cut against perceptions that the go-shop process is illusory. However, a striking finding is the number of potential buyers who sign confidentiality agreements during the post-signing go-shop process: 2.1 in add-on go-shops, and 3.2 in pure go-shops, far fewer than the 18.4 buyers who sign confidentiality agreements in no-shop deals. After examining this non-public information, the go-shop successfully generates another offer 5% of the time in an add-on go-shop, and 17% of the time in a pure go-shop, directionally consistent with the intuition that the go-shop should yield a higher-value buyer more often when there has been no pre-signing shopping.

In short, the overall assessment of the go-shop solicitation process is mixed: *more* potential buyers contacted in go-shop deals than in no-shop deals, but substantially *fewer* bidders signing confidentiality agreements. One straightforward explanation for these results is that the “bird in hand” that exists in a go-shop deal creates a price floor, and potential buyers who are below this floor will decline to go forward. The puzzle is why these prospective bidders should drop out before gaining access to confidential information; that is, before they would know with any certainty whether their offer would be higher or lower than the outstanding offer. Far more understandable would be an equal number signing confidentiality agreements in go-shop deals, but fewer actual bids in the go-shop sample compared to the no-shop sample. In fact, the announced deal should send a signal to the marketplace that the company is worth *at least* the announced deal price, and therefore more (not fewer) bidders should be interested in signing confidentiality agreements. The concern of course is that the announced deal in a go-shop process does more than create a price floor; it also deters potential higher-value bidders from even conducting due diligence because of the non-level playing field created by the breakup fee and match right, in addition to other deal protection features.

The final section in Table 2 presents further details on the structuring of the add-on and pure go-shops. The go-shop term (as distinct from the deal itself) is initiated by the seller nearly three-quarters of the time in add-on go-shops, compared to pure go-shops which are initiated by the seller only half the time. Although this difference is not statistically significant, it is directionally consistent with the intuition that add-on go-shops are more likely to be a manifestation of seller bargaining power than pure go-shops. Table 2 further shows that virtually all go-shop deals (85%) have a bifurcated termination fee, with an initial fee that is 56% of the fee that is in effect after the go-shop period expires. Interestingly, the breakup fees in the pure go-shop context are not meaningfully smaller than the fees in the add-on go-shop sample. One would expect smaller fees in the pure go-shop case due to the greater reliance on the post-signing solicitation process. Nevertheless, the final two rows in Table 2 show areas where the pure go-shop process does seem to have more viability than the add-on go-shop process: a statistically significant lower incidence of match rights (59% versus 84%) and a longer go-shop window (41 days versus 34 days). These statistics suggest that target boards (and perhaps buyers too) understand the importance of preserving a meaningful solicitation process in a pure go-shop context, and structure the go-shop accordingly.

B. Go-Shop Outcomes

Table 3 continues the inquiry within the go-shop sample by documenting the instances of “successful” go-shops in the sample, where a successful go-shop is defined as one in which another bidder emerged during the go-shop period.

[insert Table 3 about here]

Table 3 shows that a higher bidder appeared in six deals, far more frequently than prior commentators have suggested,⁵⁵ but consistent with practitioner reports that go-shop windows provide a meaningful look for third parties. For example, a senior managing director at a major P/E firm reports:

We looked at every go-shop target . . . every single one in the last two and a half years. We had plenty of time to counter-bid, and in each case . . . we found the signed deal to be off-the-charts too high and walked away. But if we wanted to counter-bid we had plenty of time to do it. . . . Go-shops are totally meaningful. There were deals like TXU and Kinder Morgan that we didn’t know about until they were announced, although we had heard rumors about them. And then we had an opportunity to participate, and we looked very hard at both and said ‘no thanks.’ . . . Both the strategic universe and the private equity universe would be reticent to come in during a classic no-shop process [after a signed deal is announced]. We just wouldn’t do it. But when you put a ‘For Sale’ sign on the door, and say come get me, then people drop everything and look because they are being invited in.

Three of the deal jumpers were strategic buyers (Community Health Systems, Advanced Medical Optics, and Brands Holdings), two were other financial buyers (Hellman & Friedman Capital Partners and Veritas Capital), and one was unspecified in the proxy statement. The most striking feature of Table 3 is the last column: none of the successful go-shops involved management buyouts, or, conversely, all of the successful go-shops involved targets that did not have management involvement in the initial buyout group. This finding cannot be explained by

⁵⁵ See, e.g., Morton & Houtman, *supra* note 39, at 6 (“Our review of go-shop transactions since 2004 [thru May 2007] reveals that the risk that the deal will be jumped is remarkably low. . . . In fact, only one transaction covered by our survey (Triad Hospitals) was successfully jumped during its go-shop period. . . . [W]hy should one assume that a go-shop will serve to canvass the market . . . if no one ever makes a competing bid?”); Comments of Public Company CEO Who Used Go-Shop to Go Private (Nov. 13, 2007) (“There are very very few situations in which something has happened during the go-shop. . . . So I love the instrument, it’s a wonderful idea, . . . but what I question is why haven’t more deals been topped during that period of time?”). See also *supra* note 39. One potential reason for the mis-perception among practitioners might be that all of the successful go-shops occurred in 2007. Because practitioners’ perceptions of the marketplace are formed largely through anecdotal experience rather than through systematic survey, there is good reason to believe that practitioner perception will lag reality.

higher premia in go-shop MBOs: in unreported analyses I find no meaningful differences in premiums received or returns to target shareholders between go-shop MBOs and go-shop non-MBOs.

A closer analysis of each of the management buyouts reveals that in no deal did a third-party bidder even sign a confidentiality agreement, much less make a bid. The closest thing to a third-party bid against a management buy-out involved Kerzner's MBO in 2006. In that deal, an unspecified party ("Bidder A" in the proxy) approached the seller's banker (JPMorgan) and requested an "inducement fee," which would reimburse Bidder A for its out-of-pocket expenses in the event that it made a bid of at least \$78.00 per share cash, and would pay Bidder A 4% of its bid if Bidder A's offer was facially higher than the management group's bid but Kerzner had still not signed a merger agreement with it. According to the proxy, Bidder A was insistent on an inducement fee "due to its concerns that the investor group had a natural advantage over other bidders from its pre-existing knowledge of the company and established relationships with governmental authorities and joint venture partners."⁵⁶ The special committee of independent directors rejected this proposal, but made a counter-proposal on the inducement fee issue. Bidder A viewed this counter-offer as providing inadequate compensation for the non-level playing field, and withdrew from the process.

The Kerzner process indicates how bidders are wary of entering a deal where management has an inside track. This anecdote is consistent with the overall evidence. Among non-MBO's, an Excluded Party emerges in 6.3% of add-on go-shop deals (1 out of 16), and in 21.7% of pure go-shop deals (5 out of 23). Among MBOs, none of the go-shops (0 out of 11) produced an Excluded Party. While the numbers are admittedly small and the differences are not statistically significant, the evidence is consistent with practitioner impressions and the Kerzner anecdote regarding the difficulty of jumping a go-shop MBO.

Interestingly, the reluctance to jump an MBO does not seem to apply to the pre-signing phase. Because my sample begins with signed merger agreements it does not capture the phenomenon in which management "tees up" the company for acquisition by a third party. Prior studies, however, report robust competition during the pre-signing phase in public-company

⁵⁶ Kerzner International SC13E-3 (July 19, 2006) at 18.

MBO's.⁵⁷ As discussed in Part II, post-signing competition with a management group may be more difficult than pre-signing competition due to the presence of a breakup fee, a match right, and/or the “time clock” for conducting due diligence and making an offer.

C. Target Shareholder Returns

I now examine returns to target shareholders by the deal process used. For each deal, I calculate cumulative buy-and-hold abnormal returns, net of the Datastream total market return index,⁵⁸ from 60 days prior to deal announcement through 30 days after announcement. I use a non-symmetric event window around the announcement date for two reasons. On the front-end, a long pre-announcement window is important to minimize the possibility of bias due to greater leakage (and therefore pre-announcement run-up) in the no-shop deals compared to the go-shop deals.⁵⁹ Without a sufficiently long pre-announcement window, this potential differential would bias returns in favor of the go-shop deals, which (by assumption) have lower run-up and therefore would be perceived to have higher shareholder returns. On the back-end, as noted above the very end of the time frame under analysis (July/August 2007) is problematic because of rapidly tightening credit, which caused “turmoil” in many transactions announced during that period.⁶⁰ As shown in Table 1, go-shop deals have become more frequent over time, reaching approximately 50% of announced transactions by the end of the sample period. Therefore, the credit crisis has had a disproportionate influence on go-shop deals compared to no-shop deals. In order to minimize this effect and focus instead on the more important question of value extracted by the target board of directors, I end the announcement window at 30 days after deal announcement. Although not all go-shop periods have expired by that time, conversations with practitioners suggest that virtually all of the shopping is completed within 30 days after the announcement of the deal.

⁵⁷ See Sarah W. Peck, *The Influence of Professional Investors on the Failure of Management Buyout Attempts*, 40 J. FIN. ECON. 267, 273 (1996) (reporting a 23 % jump rate for a sample of 111 public-company MBO's between 1984 and 1987); John C. Coates IV, *An Empirical Assessment of MBO Bids: Techniques, Outcomes, and Delaware Corporate Law* (working paper 2005) (reporting a 40% jump rate for a sample of public-company MBO's between 1988 and 1999).

⁵⁸ Other indices, such as the Datastream S&P composite index, yield similar results.

⁵⁹ See, e.g., Freescale Semiconductor Inc., Form DEFM14A (Oct. 19, 2006) at 23 (noting “increased possibility of a leak (and potential detrimental effects of a leak) by seeking and holding discussions with multiple third parties”).

⁶⁰ JPMORGAN/MORGAN STANLEY PRESENTATION TO CLIENTS, *supra* note 43, at 11. To take some notable examples, Myers Industries, First Data Corporation, and Harman International are all transactions at the end of the sample period that were negatively influenced by the credit crisis.

If go-shop clauses are an effective tool for identifying the highest-value buyer and extracting full value from it, then returns to target shareholders should be higher (or at least not lower) in go-shop deals than in the traditional no-shop route. If instead go-shop deals deter potentially higher-value bidders, then target shareholder returns should be lower in the go-shop sample than in the no-shop sample. Figure 2 shows cumulative daily abnormal returns for the full sample, according to the deal process used.

[insert Figure 2 about here]

Figure 2 shows no meaningful difference in target shareholder returns between no-shop deals and add-on go-shop deals; but directionally higher abnormal returns in the pure go-shop sample. This evidence cuts against the conventional wisdom that pure go-shops are particularly suspect (from a target shareholder perspective) because they involve no pre-signing market check. To the contrary, the evidence presented in Figure 2 suggests that there may be something about pure go-shops (but not add-on go-shops) that allows the target board to extract more from a potential acquirer, despite the absence of any competition in the pre-signing process.

As a secondary point, Figure 2 shows no statistically significant difference by deal process in pre-deal run-up, again inconsistent with conventional wisdom among practitioners. One possible explanation for this finding is that the pre-deal run-up in target companies in general is not due to the leakage of inside information, but rather due to analyst assessment of public information that the company is likely to be a takeover candidate. If correct, this conclusion would suggest that the perceived benefit of go-shop processes as a way of reducing pre-deal run-up is small at best.

The results presented in Figure 2 are of course problematic due to potential selection effects between the go-shop and no-shop samples. The summary statistics presented in Tables 1 and 2 identify three important sources of potential bias. First, Table 1 shows that go-shop deals occur, on average, later in the sample period than no-shop deals. If overall market conditions and market pricing changed during the 20-month window of analysis, then this timing difference could skew the calculation of target shareholder returns between the go-shop and no-shop samples. Second, Table 2 shows that go-shop deals are larger on average than no-shop deals. This effect would serve to bias the relative returns in go-shop deals downward, since deal premia are generally declining in deal size.

Third, Table 2 shows that go-shop deals are far more likely to be initiated on the buy-side than on the sell-side. It is possible (perhaps even plausible) that deals initiated on the buy-side reflect undervalued companies in the marketplace, while deals initiated on the sell-side reflect overvalued companies in the marketplace.⁶¹ If correct, this pattern would imply higher potential returns in deals initiated on the buy-side because the baseline price (i.e., market price) is lower than intrinsic value. One mitigating factor is the negotiation process itself. Because all the deals in the sample are negotiated acquisitions, in which the buyer signs a confidentiality agreement in order to gain access to the target's books and records, the usual informational asymmetry between seller and buyer is minimized (and perhaps eliminated) through the due diligence process. In negotiation terms the seller will resist offers that do not reflect a full (non-public) value for the company, while the buyer will resist offers that reflect an over-valuation of the company. Nevertheless, to the extent that the negotiation process does not fully overcome the initial information asymmetry between seller and buyer, the hypothesized effect would serve to increase the perceived relative returns in go-shop deals because go-shop deals are far more likely to be initiated on the buy-side.

In order to control for these potential biases, I construct a propensity score for each deal based on deal timing (natural log of the number of days since January 1, 2006), deal size (natural log of deal value), and deal initiator (=1 if initiated on the buy-side). Because MBO's would be prone to the under-valuation story rather than the over-valuation story (because management is, on net, on the buy-side of the transaction) MBO's are classified as initiating on the buy-side. For each pure go-shop deal in the sample (n=30), I identify the no-shop deal that has the closest propensity score, using the absolute value of the difference in scores. Because add-on go-shops did not have meaningfully different target shareholder returns than the no-shop deals, and also are quite different in terms of deal process from the no-shop sample, these deals are excluded from the analysis. I then construct portfolios of the pure go-shop deals and the matched-pair no-shop deals, using the same methodology as in Figure 2. Figure 3 shows the cumulative abnormal buy-and-hold returns for these two portfolios.

[insert Figure 3 about here]

⁶¹ I thank Bob Mnookin for this point. Note that this hypothesis is consistent with the semi-strong version of the efficient market hypothesis.

Consistent with the overall findings from Figure 2, Figure 3 shows that average target shareholder returns in go-shop deals are approximately 5% higher than target returns in no-shop deals. This difference in portfolio CARs is statistically significant at 95% confidence, using a standard t-test to compare mean returns at 30 days after bid announcement. The propensity score matching technique used in the Figure 3 analysis attempts to control for known differences in deal size, deal timing, and deal initiation between the go-shop and no-shop samples. As with virtually any analysis of this kind, there may be other, as yet undiscovered, sources of bias between the go-shop and no-shop samples. Nevertheless, the results presented here at least call into question the weight of practitioner commentary that pure go-shops allow the buyer to steal the company from the public shareholders “on the cheap.”

To the contrary, the evidence presented here suggests that there may be something about pure go-shops (but not add-on go-shops) that allows the target board to extract more from a potential acquirer, despite the absence of any competition in the pre-signing process. The question then becomes where, precisely, does this additional value come from. The simple explanation offered by some prior commentators, that go-shops simply reflect sell-side bargaining power, is inconsistent with the distinction reported here between add-on go-shops and pure go-shops. A more subtle explanation appears from a close review of the proxy statements in the pure go-shop deals. On the sell-side, the proxy statements frequently document the seller’s interest in exclusivity as a means of minimizing disruption, as well as the benefits of the “bird in hand” that arises from a go-shop process.⁶² On the buy-side, the proxy statements frequently document the initial bidder’s willingness to pay more in order to maintain exclusivity in the deal.⁶³ These

⁶² See, e.g., Nuveen Investments DEFM14A (Aug. 14, 2007) (“The Disinterested Directors and Goldman Sachs further discussed whether the attractiveness of [the offer from Madison Dearborn] was sufficiently high that the benefit that might be gained by conducting a pre-signing market check would not outweigh the potentially adverse consequences to our operations that might result as a result of undertaking such a process. Among other things, the Disinterested Directors considered the uncertainty that could result from a pre-signing market check, which could cause financial advisors and consultants to suspend recommending our products and services to their clients, affect the stability of our relationships with members of our investment teams and impair our ability to retain key employees should any of these individuals become aware of a market check.”); CDW Corp. DEFM14A (July 13, 2007) (“Our board decided not to authorize contact with any strategic buyer [or any other buyer] until a post-signing ‘go-shop’ period because of concerns of furnishing proprietary information about our company to competitors and prospective competitors before it was clear that an attractive price for our company could be achieved. . . .”).

⁶³ See, e.g., Aeroflex DEFM14A (June 22, 2007) at 24 (“After discussion, the special committee asked TWP [its bankers] to communicate to the initial bidding group that . . . Aeroflex was likely to engage in a pre-signing ‘market check’ of the proposed transaction price but might be prepared to forgo this if the proposed share per share price were to be revised to \$16.50 or more.”); Jameson Inns Inc. DEFM14A (June 29, 2006) at 18 (“JMP Securities [investment bankers for the seller] further indicated that there was a direct correlation between the purchase price the

sources of value creation are consistent with a presentation made by senior M&A practitioners at the Harvard Law School in November 2007, which lists “establish floor” and “leverage against bidder based on threat of competition” as benefits of the go-shop process compared to the traditional no-shop route.⁶⁴ The evidence presented in Figure 3 suggests that the economic value of these benefits might translate into approximately 5% higher returns for target shareholders.

V. Discussion

At the highest level, the data indicates that not all go-shops are created equal, and courts should therefore continue their case-by-case assessment of go-shops rather than issuing a categorical pronouncement on their validity as a matter of Delaware corporate law. Add-on go-shops should be presumptive legal, if the pre-deal market canvass resembles the market canvass in the traditional no-shop process, because the add-on shopping can only yield a higher price than what the traditional process would have achieved. Pure go-shops are potentially more problematic, due to the absence of a pre-signing market check. The evidence presented here indicates that a pure go-shop can be a valuable tool for extracting the highest possible price in the sale of the company. A close examination of the proxy statements in pure go-shop deals provides anecdotal evidence that might explain this counter-intuitive finding. In many instances, *both* seller and buyer will value exclusivity in the negotiation process, thereby creating

board of directors would be willing to accept and our opportunity to solicit or receive a competing offer superior to the terms of the merger agreement that may be agreed by the board and JER.”); HUB International DEFM14A (May 4, 2007) at 10 (“[R]epresentatives of Apax explained that they did not want to participate in an auction process. . . . At the end of the meeting, representatives of Apax advised Mr. Hughes that, subject to further due diligence, they were prepared to present Hub a proposal within ten business days. In addition, Apax requested that for the remainder of the week, Mr. Hughes not contact any other party regarding a potential transaction. Mr. Hughes agreed that he would not make any such solicitations with the view that this would improve Apax’s proposal.”); Nuveen Investments DEFM14A (Aug. 14, 2007) at 29 (“[The special committee] informed Madison Dearborn that the special committee might be willing to consider an offer in the range of \$62.00 to \$65.00 per share subject to a concurrent market check, but if Madison Dearborn wished to negotiate a transaction on an exclusive basis for a limited period of time, Madison Dearborn would have to increase its proposed purchase price to at least \$65.00 per share. [Two days later], Madison Dearborn delivered a revised indication of interest to the special committee that included a proposed purchase price of \$65.00 per share.”); Spirit Finance DEFM14A (June 1, 2007) at 19 (“[T]he Company advised Macquarie that the [\$14.16] offer price would likely be viewed by its board of directors to be insufficient to grant Macquarie the requested exclusive negotiation period and other terms requested, and suggested that a price of \$15.00 per share would be more likely to be acceptable to the Company’s board of directors. [Three days later] Macquarie submitted a revised draft MOU indicating . . . a price of \$14.50 per share.”).

⁶⁴ The presenters were: Eileen Nugent, Head of the Private Equity Practice at Skadden, Arps, Slate, Meagher & Flom; Robert L. Friedman, Senior Managing Director at the Blackstone Group; and Louis J. D’Ambrosio, CEO of Avaya, Inc., which had just recently gone private using a go-shop process.

value that can be divided between the parties.⁶⁵ The potential “win-win” nature of the go-shop technology suggests that it might be a “better mousetrap” than the traditional method for selling companies that are in *Revlon* mode. If correct, we would expect to see further dissemination of the go-shop technology in the future. The trajectory of go-shop dissemination thus far is consistent with this prediction.

While the source of the gains on the sell-side are intuitively plausible, the proposed buy-side benefits raise a puzzle: why would a P/E buyer pay more for exclusivity, when it can pay less, on average, by engaging in the traditional pre-signing auction process? One possibility is that P/E buyers over-value exclusivity, perhaps not realizing that bidders in an open auction will rationally under-invest in due diligence and therefore shade their bids because of their uncertainty in the valuation of the target. Another possible explanation arises from the compensation structure of P/E buyers. As described in Part II, the 2% management fee creates incentives for P/E buyers to invest capital rather than return it to their limited partner investors. Table 2 shows that in the traditional no-shop process the sell-side advisors contact 34 buyers, of whom 18 sign confidentiality agreements, on average. This means that a typical P/E buyer, with no source of private value in the auction, has a 3% chance of winning at the outset, and only a 6% chance of winning after investing in due diligence. In contrast, a P/E buyer who can negotiate exclusively with a seller in a pure go-shop deal has an 87.5% chance of closing the deal if management is not involved (with deal jumpers winning in only 3 out of 24 pure go-shop MBO’s) and a 100% chance of closing the deal if management is involved in the buyout group – far better odds if one’s primary goal is to close deals. Put another way, P/E firms are forced to play a “volume game” because of the enormous pools of capital that they have to invest.⁶⁶ The empirical evidence presented here indicates that the go-shop provision is a far more effective way of playing a volume game (i.e., deploying capital by closing deals) than the traditional no-shop route. The cost of course arises in lower returns for funds, on average, which will emerge as these funds are liquidated over the next 5-10 years. Thus the desirability of the go-shop clause from the buyer’s perspective may be, at least in part, a manifestation of agency problems between the GPs and LPs in private equity firms.

⁶⁵ See ROBERT H. MNOOKIN, SCOTT R. PEPPET & ANDREW S. TULUMELLO, BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES 16 (identifying “noncompetitive similarities” as a source of value creation in negotiations).

⁶⁶ I thank David Levine, JD/MBA '09, for this point.

While the data suggests a positive overall assessment of go-shops from the perspective of target shareholders, there is cause for concern in the subset of go-shops in which current management is part of the buyout group. The fact that no higher bidder has emerged in an MBO go-shop to date (after nearly two years of experience with go-shops, in a frenzied deal environment) suggests that third parties may be wary of entering a bidding contest, or that bankers might not conduct as thorough and energetic a search, when management has already picked its preferred buyout partner. A management team with difficult-to-acquire firm-specific skills and knowledge can use their inherent advantage to buy the company from the public shareholders at a lower price, by effectively committing to its favored buyout group and making clear its unwillingness to work with any other buyout group that might emerge during the go-shop process.

One potential solution would be a bright-line rule that management may not negotiate its employment contract with *any* buyout partner until the board has picked the bidder that delivers the most value for its shareholders. Indeed, the British City Code has adopted such a *per se* rule,⁶⁷ and it could readily be incorporated into the common law of Delaware through a straightforward application of the duty of loyalty. Consistent with this approach, the Delaware Chancery Court recently struck down a proposed settlement of shareholder litigation due to the CEO's precommitment to a deal with the acquirer (though this case was not in the go-shop context).⁶⁸ While this solution would likely create a more viable post-signing go-shop process in MBO's, there are serious problems with such an approach. The first is one of enforcement: a bright-line rule would prevent formal employment agreements between the buyout group and managers, but it could not prevent implicit understandings, or private conversations, that inevitably will result during the due diligence process. (This is a major critique of the U.K. rule, as applied.) A second problem is one of effectively capturing the deterring activity: while it is feasible to prohibit employment agreements between the buyout group and the management team, it is not feasible (at least without radical change in our current corporate law doctrine of conflict transactions) to prevent management from being part of the buyout group (that is, prohibiting MBO's). Because of the strong efficiency reasons to permit MBO's, prohibiting

⁶⁷ [confirm]

⁶⁸ See *In re SS&C Technologies, Inc. Shareholders Litigation*, 911 A.2d 816 (Del. Ch. 2006).

MBO's in the interest of encouraging third-party bidders during the go-shop process would seem to throw the baby out with the bathwater.

A third, and perhaps most important, problem arises on the buy-side. In many buyouts the current managers are essential to the deal, and the P/E firm will quite naturally be unwilling to proceed if the seller cannot "deliver" management (in the form of signed employment agreements) at the closing. Management too might look for alternatives outside the company if they are not guaranteed employment in the continuing enterprise. The irony, then, of prohibiting employment agreements in pure go-shop MBOs is that P/E firms will pay a lower price because management has left or might leave – precisely what such a rule is intended to avoid by facilitating third-party bids.

The better approach, then, is to regulate pure go-shop MBO deals through greater scrutiny of the specific features of the go-shop. As a starting point courts should look for (and therefore boards should insist on) what are becoming commonplace features in all go-shops, such as a longer (50-60 day) window to shop, the identification of a potential Superior Offer (rather than a completely signed deal) during the go-shop period, and a bifurcated termination fee. The Delaware courts have already sent strong signals that these are important features to ensure a meaningful go-shop process.⁶⁹ Practitioners also stress these elements in their guidance to clients.⁷⁰

In addition to these basic deal structuring points, courts should look for simple information rights (i.e., keeping the initial informed about higher bids that emerge), rather than the increasingly commonplace match right, in pure go-shop MBO's. Although Delaware courts have endorsed match rights in the buyout context,⁷¹ basic economic theory and the strong weight of practitioner anecdotal evidence indicates that match rights deter bids. Particularly in the case of a pure go-shop MBO, the Delaware courts should reverse course to consider a match right as a strong negative factor in the standard *Revlon* analysis.

⁶⁹ See *Topps* (commenting favorably on 45-day go-shop period and bifurcated termination fee); *Lear* (expressing skepticism about the go-shop due to the fact that the whole deal had to be signed up during go-shop period).

⁷⁰ See, e.g., Sharon Geraghty, *Emerging Trends in Deal Protection Techniques*, Torys LLP Memorandum to Clients (Nov. 16, 2006) ("The key negotiated elements of these go-shop provisions are the duration of the solicitation period and whether a break fee will have to be paid if the target is successful.").

⁷¹ See, e.g., *In re Pennaco Energy Shareholder Litigation*, 787 A.2d 691 (Del. Ch. 2001); *In re Toys "R" Us Shareholder Litigation*, 877 A.2d 975 (Del. Ch. 2005).

Even better, sell-side boards should push for a provision in the merger agreement that explicitly prevents the MBO group from participating in any post-signing auction.⁷² While Delaware courts have expressed a strong distaste for contractual precommitments that prevent a board from accepting a higher-value bid that appears later,⁷³ this go-shop structuring would induce the MBO group to put full value on the table in its initial bid. Delaware courts should formally acknowledge what is well-known among practitioners, that a loyal sell-side board will not necessarily keep itself open to higher bidders up until the moment of closing.

In addition to not deterring third-parties through match rights, Delaware courts should look favorably on inducement fees that are specified as part of the initial merger agreement. For example, a target board might extract a concession from the MBO group to reimburse out-of-pocket expenses for any third-party buyer who makes a bona fide superior proposal that is at least 5% higher than the deal price, even if the third party does not win in the end. This deal term would be a radical innovation because in every case that I am aware of an inducement fee is negotiated *ex post*, i.e., after a bidder appears. An *ex ante* inducement fee nevertheless should be part of the target board's negotiation toolkit, particularly in the go-shop MBO context, due to the strong (and correct) perception of a non-level playing field between the MBO group and potential third-party bidders.

If the MBO group already holds a significant stake in the target, sell-side boards should push for a contractual commitment by management to sell in to any higher offer that emerges during the go-shop period.⁷⁴ The corollary to this point is that sell-side boards should not allow the MBO group to lock up its shares with its buyout partner, because locked up inside shares would naturally deter third parties.⁷⁵ The weight given to these two deal features should increase as management's stake in the target increases. For example, consider a case where management

⁷² The only example in my sample of this kind of structure is Kerzner.

⁷³ See *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003). While it is of course not trivial to recommend a reversal of Delaware Supreme Court precedent, *Omnicare* was a highly unusual 3-2 decision that is perceived to be weak precedent among practitioners, academics, and even other judges. Post-*Omnicare* decisions in the Delaware Chancery Court have already cut back on its scope. See *Orman v. Cullman*, 2004 WL 2348395 (Del. Ch. Oct. 20, 2004). To formally renounce a doctrine that categorically prevents contractual precommitments in merger agreements would open the dealmaking space to permit innovations such as the one proposed in the text. Finally, the change in the membership of the Delaware Supreme Court since the *Omnicare* decision suggests that an explicit reversal is not implausible.

⁷⁴ Cf. *Lear* (Icahn agreed to sell his 26% stake into any non-matched superior offer, though this was not an MBO).

⁷⁵ See, e.g., Everlast Proxy Statement (Seth Horowitz, president of Everlast, agreed to vote his 19.2% stake in favor of the Hidary transaction and against any competing transaction).

holds 40%, initiates a going-private transaction using a pure go-shop process, and commits irrevocably to voting its shares for the deal with its preferred buyout partner. It would not seem unreasonable to invalidate the go-shop solely on the basis of the locked up shares, even if all other aspects of the sale process are pristine.

Finally, courts should take a close look at the negotiation process to ensure that something was extracted in exchange for exclusivity in a pure go-shop MBO, ideally, a higher price. This proposal mirrors prior policy recommendations that John Coates and I have made suggesting that target boards should extract something in exchange for deal protection in traditional arms-length M&A deals.⁷⁶ Even for a target board that does not wish to engage in a pre-deal market canvass for fear of disrupting the business, giving up the right to canvass the marketplace prior to signing has value and therefore should be paid for by the MBO group.

To summarize, Delaware courts should presume that an add-on go-shop process satisfies the target board's *Revlon* duties, unless the pre-signing process is so truncated as to more resemble a pure go-shop than the traditional no-shop route. Within the category of pure go-shops, and particularly in the case of pure go-shop MBO's, courts should scrutinize the specifics of the go-shop structure to determine the viability of the shopping process. Long go-shop windows, small and bifurcated breakup fees, information rights (rather than matching rights), *ex ante* inducement fees, and contractual commitments by the buyout group to sell into any higher offer should all weigh in favor of satisfying the *Revlon* requirement. By extension, target boards and their advisors should push for these deal terms in the context of a pure go-shop MBO. This insistence on specific process features would follow the approach that the Delaware courts have taken with respect to other types of conflict transactions.⁷⁷ In addition, the proposed distinction between go-shop MBO's and go-shop non-MBO's would track the well-developed distinction in corporate law between conflict transactions and non-conflict (arms-length) transactions. Conflict transactions are more suspect and therefore are subjected to higher scrutiny (namely, entire fairness review) by courts; but the Delaware courts have historically been willing to forego a

⁷⁶ See Coates & Subramanian, *supra* note 14.

⁷⁷ See, e.g., *In re Pure Resources, Inc. Shareholders Litigation*, 808 A.2d 421 (Del. Ch. 2002) (requiring a non-waivable majority-of-the-minority condition, a promise by the controlling shareholder to execute a prompt short-form merger at the deal price if it obtains more than 90% of the shares, and no "retributive threats" by the controlling shareholder in order for a tender offer freeze-out to be deemed non-coercive by the court).

substantive fairness inquiry if appropriate procedural protections are in place.⁷⁸ The formulation of go-shop doctrine proposed here takes precisely this approach.

VI. Conclusion

[to come]

⁷⁸ See ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 23, at 321-22.

Table 1: Go-Shop Incidence

This table provide statistics on go-shop incidence by month. The sample includes all buyouts of U.S. companies larger than \$50 million in value, announced between January 2006 and August 2007. Go-shop incidence is determined by examining the Solicitation section of the merger agreement. Statistics on total go-shop incidence come from Morton & Houtman, *Go-Shops: Market Check Magic or Mirage?*, Potter, Anderson & Corroon memorandum to clients (May 2007).

	By # of Deals			By Deal Volume (\$MM)		
	Go-Shops in Sample	No-Shops in Sample	Total Go-Shop Deals	Go-Shops in Sample	No-Shops in Sample	Total Go-Shop Deals
2006						
January	1	3	1	\$1,021	\$10,969	\$1,021
February	0	5	0		\$2,425	
March	1	5	1	\$3,181	\$8,272	\$3,181
April	0	2	0		\$516	
May	2	5	2	\$3,793	\$23,681	\$3,793
June	1	4	1	\$453	\$12,789	\$453
July	2	2	2	\$22,877	\$329	\$22,877
August	1	5	2	\$1,707	\$4,170	\$2,834
September	1	6	1	\$17,704	\$1,899	\$17,704
October	2	3	2	\$18,055	\$3,492	\$18,055
November	2	7	3	\$22,674	\$29,976	\$22,881
December	2	6	2	\$11,774	\$20,847	\$11,744
2007						
January	3	6	3	\$4,981	\$6,230	\$4,981
February	6	3	6	\$43,015	\$1,897	\$43,015
March	5	7	6	\$4,666	\$19,076	\$5,330
April	4	6	6	\$35,063	\$32,624	\$35,119
May	4	9	4	\$14,475	\$57,983	\$14,475
June	5	5	6	\$20,633	\$4,064	\$21,261
July	8	6	9	\$11,651	\$33,305	\$11,976
August	0	1				
TOTAL	50	96	57	\$237,722	\$275,625	\$240,729

Table 2: Summary Statistics

This table provide summary statistics by deal process. The sample includes all buyouts of U.S. companies larger than \$50 million in value, announced between January 2006 and August 2007. “Pure go-shop” deals are defined as deals in which the target negotiated exclusively with a single bidder, then conducted a market canvass during a post-announcement “go shop” period. “Add-on go-shop” deals are defined as deals in which the target conducted a market canvass pre-announcement but also engaged in a post-announcement market canvass pursuant to a go-shop clause. “No shop” deals are defined as all other deals, which involve the traditional pre-announcement market canvass followed by the inability for the target to shop further after the deal is announced. Target returns are defined as returns net of the S&P 500 index. * = statistically significant difference at 90% confidence; ** = statistically significant at 95% confidence; *** = statistically significant at 99% confidence.

Mean (Median)	No-Shop (n=96)	Add-on Go-Shop (n=20)	Pure Go-Shop (n=30)	All Deals (n=146)
Deal characteristics:				
Deal Size (\$MM)	\$2,802.1* (\$887.5)	\$5,915.2* (\$3,608.6)	\$4,043.0* (\$1,444.1)	\$3,461.7 (\$1,139.9)
Delaware incorporation	49.0%	70.0%	53.3%	52.7%
Buyout group includes management	14.6%	20.0%	23.3%	17.1%
Initiated by buy-side?	53.1%***	68.4%	92.6%***	63.8%
Pre-signing solicitation process:				
# of potential buyers contacted	34.2**	15.9**	1.0***	22.8
# signing confidentiality agreements	18.4**	8.4**	1.0***	12.4
# making bids	4.1**	2.9**	1.0***	3.1
Post-signing solicitation process:				
# of potential buyers contacted	0.0***	33.4***	40.1***	13.9
# signing confidentiality agreements	0.07***	2.1**	3.2***	1.1
# making bids	0.08**	0.05	0.17**	0.1
Go-shop structuring:				
Go-shop initiated by Seller		72.2%	51.7%	60.0%
Bifurcated termination fee?		84.2%	86.2%	85.4%
Breakup during go-shop period (% of enterprise value)		1.38% (1.12%)	1.31% (1.14%)	1.34% (1.13%)
Breakup fee after go-shop period % of enterprise value)		2.43% (2.50%)	2.34% (2.86%)	2.39% (2.71%)
Right to match third-party bidder?		84.2%*	58.6%*	68.8%
Length of go-shop period (days)		34.3 (30)	40.8 (45)	38.3 (40)

Table 3: “Successful” Go-Shops

This table lists all “successful” go-shops, where a successful go-shop is one in which at least one Excluded Party is identified during the go-shop period.

Ann. Date	Target	Acquirer	Deal Price	Excluded Party	Outcome	MBO?
2/4/2007	Triad Hospitals	CCMP Capital & Goldman Sachs Capital Partners	\$50.25	Community Health Systems	CHS wins at \$54.00; \$20 million breakup fee + \$20 million expense reimbursement paid	No
2/22/2007	Catalina Marketing Corp	ValueAct Capital Partners	\$32.10	Hellman & Friedman Capital Partners	H&F wins at \$32.50 per share; \$8.4 million breakup fee paid	No
2/26/2007	HUB International	Apax Partners & Morgan Stanley Principal Investments	\$40.00	Unspecified in proxy	Apax wins at \$41.50	No
3/2/2007	Aeroflex	General Atlantic & Francisco Partners	\$13.50	Veritas Capital	Veritas wins at \$14.50 per share; \$15 million breakup fee + \$7.5 million expense reimbursement paid	No
5/16/2007	Bausch & Lomb	Warburg Pincus	\$65.00	Advanced Medical Optics	Board rejects higher cash/stock offer from AMO	No
6/1/2007	Everlast Worldwide	Hidary Group	\$26.50	Brands Holdings	BH wins @ \$30.00	No

Figure 1: Number of Buyers Solicited Pre-Signing in Go-Shop Deals (n=50)

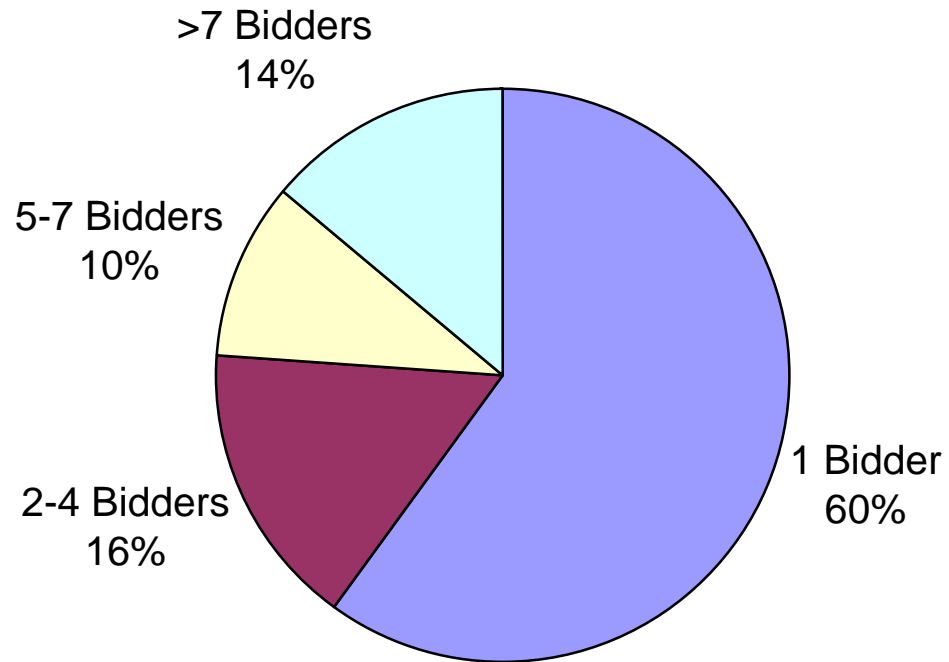


Figure 2: Cumulative Abnormal Returns for Target Shareholders by Deal Process

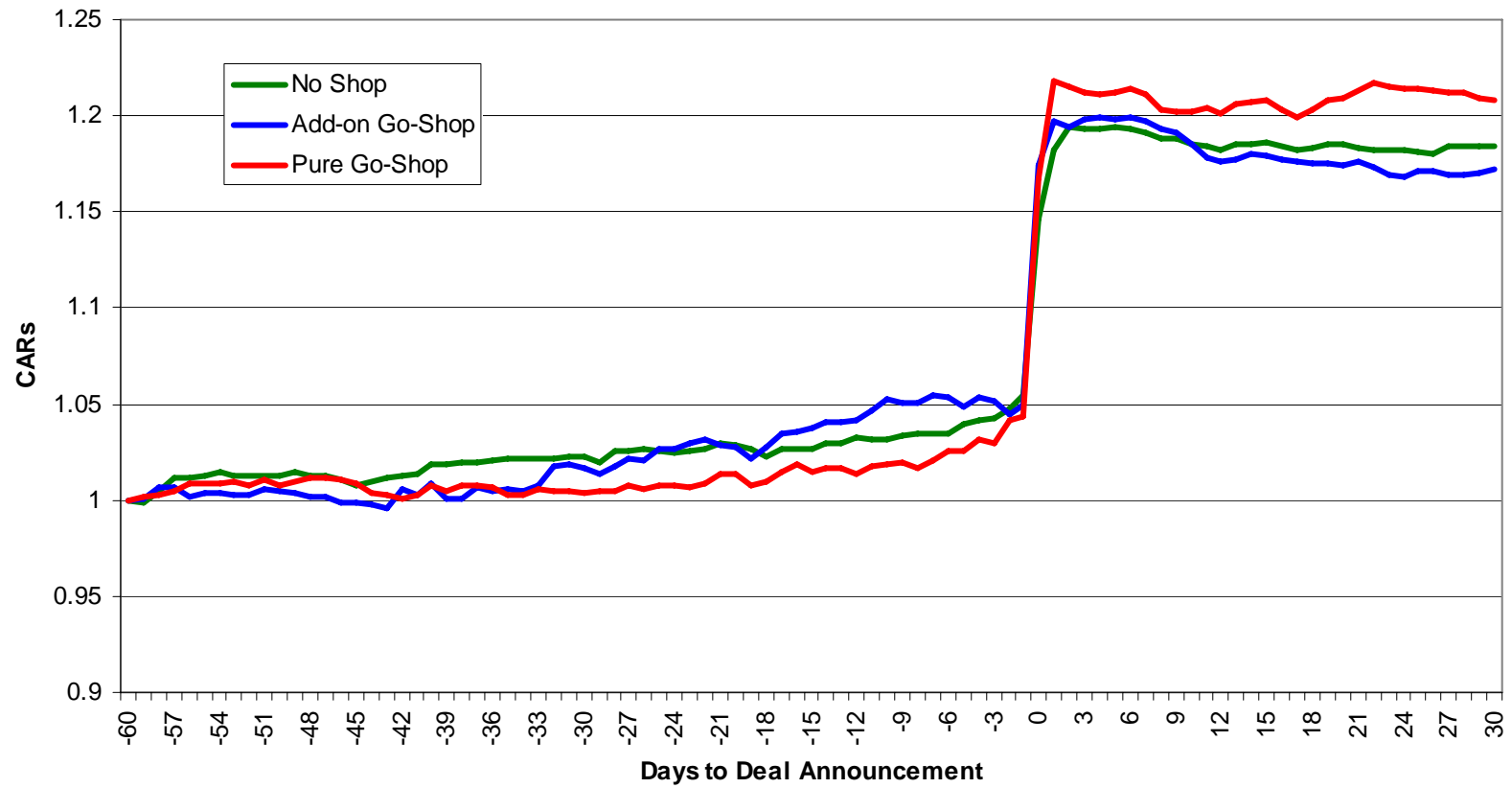


Figure 3: Cumulative Abnormal Returns for Target Shareholders by Deal Process (matched pair sample)

