
Go-Shop Clauses in the United States and Canada: Window Dressing or a Useful Market Check?

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The “go-shop” clause is one of the significant transaction structuring trends that has emerged in this latest booming M&A cycle in the United States and Canada. Public company merger and acquisition agreements have traditionally contained “no-shop” or non-solicitation clauses that prohibit a target company from actively soliciting competing bidders. Go-shop clauses are the opposite of this. They permit a target company to canvass the market for other purchasers who may offer a superior price. Go-shops have been increasingly used in US going-private transactions in the last few years and have recently appeared in Canadian transactions. They are typically used to assist the target’s board of directors in satisfying its fiduciary obligation to maximize shareholder value in circumstances in which the target company has not sufficiently canvassed the market before entering into a transaction agreement. However, there is a difference of opinion in the market commentary regarding whether go-shops merely serve as fiduciary duty window dressing or constitute a useful market check.

BOARD DUTIES WHEN A COMPANY IS FOR SALE

In both the United States and Canada, when a public company is for sale, its board of directors has a fiduciary duty to maximize shareholder value. Within those parameters, boards of directors have significant freedom to exercise their business judgment about what specific steps are necessary or sufficient to maximize shareholder value in the circumstances. Absent a high premium “knock-out” offer, an unrestricted auction is widely accepted as one of the most effective ways for a board of directors to satisfy its fiduciary duties. Where an auction is unattractive to the parties or impractical, some other kind of market check is likely to be desirable (especially where a deal does not represent much of a premium for shareholders) to enable the target’s board to conclude with confidence that a potential buyer is offering the highest price reasonably obtainable. Other market check mechanisms that are used from time to time include confidential limited canvasses of the most likely potential acquirors.

GO-SHOPS AS MARKET CHECKS IN THE UNITED STATES AND CANADA

Go-shops have emerged on the M&A scene over the last few years as an increasingly used market check mechanism. Go-shop provisions give the target company a specified period of time—typically 21 to 60 days immediately following execution of the transaction agreement—to seek out a higher-value transaction. Go-shops are typically used where an auction may not be attractive to the parties or is impracticable and the market has not been otherwise canvassed to give the board confidence that the incumbent deal represents the best reasonably available value for shareholders.

In the United States, go-shops have been used primarily in the context of going-private transactions involving the acquisition of public companies by private equity players. Examples include the transactions involving Bausch & Lomb, TXU Corp., Lear Corporation, Clear Channel Communications, Kerzner International, Freescale Semiconductor, Maytag Corporation, HCA, Harrah’s Entertainment and West Corp. In the case of private equity buyouts, go-shops have been used in lieu of a pre-agreement auction process, replacing it with a post-signing market check. A go-shop may be attractive to a target company where it is important to reach a deal quickly or where there would otherwise be a significant possibility of losing a seemingly attractive initial offer or experiencing a significant loss in value as a result of a failed public auction. Targets doing business in a competitively sensitive industry may find a go-shop to be attractive in order to avoid having competitors participate in or otherwise taking advantage of a public auction process. Private equity acquirors may prefer a go-shop in order to avoid participating in a drawn out and uncertain pre-signing auction process in which they may incur significant costs without any assurance of reaching a deal.

A recent large US private equity transaction with a go-shop is Carl Icahn’s \$5 billion buyout of Lear Corporation, a global

supplier of automobile seats, cockpits, and electronic parts. The merger agreement permitted Lear to solicit alternative acquisition proposals for a period of 45 days. Once the go-shop period expired, the customary non-solicitation or no-shop clause prohibited Lear from seeking out alternative transactions, although the company was permitted by the merger agreement to continue discussions with parties that it was negotiating with as of the end of the go-shop period. The Lear merger agreement also included the customary fiduciary-out clause, which allowed Lear's board of directors to respond to unsolicited, alternative transaction proposals during the no-shop period if the independent directors believed in good faith that a proposal was superior to the Icahn deal.

Go-shops have also recently begun to appear in Canadian transactions involving public company acquisitions by strategic buyers. These include Vector Capital's acquisition of Corel Corporation and Algonquin Power Income Fund's acquisition of AirSource Power Fund as well as its unsuccessful bid for Clean Power Income Fund. In the AirSource example, Algonquin (the offeror) was the external manager and founder of AirSource. Algonquin made an offer but gave the Liquidity Committee of AirSource the right to continue to solicit a superior transaction during the period that Algonquin's offer was open for acceptance.

In the Vector/Corel example, the parties entered into a non-disclosure and standstill agreement under which Corel agreed to support a Vector bid above a specified price (subject to receipt of a favourable fairness opinion). Corel had the right to solicit other offers while the parties were negotiating a definitive agreement. In the case of Algonquin's bid for Clean Power, the support agreement provided Clean Power a period of 45 days to solicit a superior offer. That agreement was subsequently terminated in favour of a superior offer from Macquarie Power and Infrastructure Income Fund. This case was a unique application of a go-shop provision in that prior to entering into the transaction agreement with Algonquin, Clean Power had already conducted a lengthy public auction process, and the value of the Algonquin units offered as consideration was below the market price of the Clean Power units at the time of the offer. In these circumstances, the Clean Power board was seeking additional comfort that the Algonquin transaction was the best option available.

MIXED MARKET COMMENTARY ON GO-SHOPS

There is no consensus among market commentators regarding the effectiveness of go-shop clauses as a market check. On one hand, proponents of go-shop clauses view them as a valuable mechanism to facilitate a market check of a transaction where a public auction process is not desirable. On the other hand, the primary argument raised against go-shops is that they provide an unduly advantaged position to the party making the initial offer that impedes competing bidders. The fact that relatively few targets have succeeded in securing a superior offer during a go-shop period has reinforced the view of some commentators that go-shops are little more than window dressing aimed at protecting target companies and their directors from shareholder litigation. From the target's perspective, a go-shop right would not normally be the functional equivalent of a pre-signing auction. But where an auction may not be attractive to the target or would be impracticable, a robust go-shop right that is exercised diligently by the target can serve as a useful market check mechanism.

HOW TO MAKE GO-SHOP CLAUSES EFFECTIVE

Targets and acquirors should take into account the following considerations when negotiating and making use of go-shop provisions. These considerations should be assessed in the circumstances of each individual transaction and with the input of the parties' respective financial advisers.

Length of the Go-Shop Period

Go-shop periods usually range from 21 to 60 days immediately following execution of the transaction agreement. As one would expect, the longer the go-shop period, the more likely it is to provide a useful opportunity for a market check. Sufficient length for the go-shop period will depend on various factors, including the size and complexity of the target's business, the number of potential alternative buyers and their familiarity with the target, the ease with which financing can be arranged and the complexity of the issues to be negotiated. The go-shop period will effectively be extended if the agreement gives the target the right after the go-shop period ends to continue dealing with potential alternative buyers identified during the go-shop period.

The Universe of Alternative Buyers

Go-shop clauses will tend to be more effective the broader the universe of potential alternative buyers. However, an incumbent acquiror may seek to limit the universe of alternative buyers that a target may solicit in the go-shop period. For example, an incumbent acquiror may wish to exclude certain competitors of the target if they are expected to present a competitive threat to the target's business in the future. Similarly, a private equity buyer may wish to exclude other financial bidders from the go-shop process, restricting the target to soliciting strategic bidders. Such restrictions may dilute the go-shop's usefulness as a market check.

Termination Fees

Another consideration relevant to the usefulness of a go-shop clause is the termination fee that would need to be paid to the incumbent acquiror. Many go-shop clauses are accompanied by a two-tiered termination fee that is lower during the go-shop period and then increases during the subsequent no-shop period. For example, in the pending buyout of Clear Channel by a private equity group led by Thomas H. Lee Partners and Bain Capital Partners, the termination fee will be \$500 million if Clear Channel's board exercises its fiduciary out during the no-shop period; but if a superior offer had arisen during the three-week go-shop period, the termination fee would have been \$300 million. The lower termination fee constitutes less of a barrier to potential competing bidders who would effectively end up paying the termination fee.

Sharing Information During the Go-Shop Period

Go-shop provisions generally require the target to promptly share with the incumbent buyer any material information given to new potential buyers. This is intended to keep competing bidders on an equal footing in their due diligence investigations. However, go-shop provisions have been varied in the amount of information about potential competing offers the target must share with the incumbent buyer. In some cases, the target is obliged to inform the incumbent buyer on a real-time basis during the go-shop period of the identity of any other potential buyer and the material terms being negotiated. In other cases, the target is required to inform the incumbent buyer only of the number and key terms of potentially superior transactions. Depending on the circumstances, the volume of information

about communications with other bidders could be overly burdensome to share, and sharing such information (beyond offers that could constitute superior proposals) could limit the effectiveness of the go-shop.

Matching Rights

During the traditional non-solicitation or no-shop period, transaction agreements typically provide the target company with a fiduciary out to accept a superior transaction. This is often accompanied by a right of the incumbent bidder to match the superior proposal. Since formal matching rights may chill the willingness of other suitors to make a competing offer, targets generally seek to avoid them during the go-shop period. Incumbent acquirors may feel sufficiently protected by their right to be informed of competing proposals (as described above) and the likelihood that the target would approach them to seek a higher offer in any event, given that they already have a negotiated agreement in place.

Diligent Exercise of the Go-Shop

Target companies should be sure to make good use of any go-shop rights by actively and thoughtfully searching for and engaging in discussions with alternative buyers, with the assistance of their financial advisers. If the target's officers or directors fail to diligently investigate the possibility of alternative

transactions or are overly distracted by decisions, events or deadlines related to the incumbent deal, they leave themselves open to criticism that the go-shop provision is merely window dressing. This is especially true where target management engaged in extensive negotiations with the incumbent acquiror before involving the board and/or where management has a significant pecuniary interest in the incumbent deal. Diligent exercise of the go-shop can help to minimize the impact of real or perceived conflicts of interest. In all cases, the solicitation process should be documented by the target to serve as evidence of its efforts to diligently undertake a market check.

CONCLUSION

We expect to see increased use of go-shop clauses in M&A transactions in the coming years. When employed in appropriate circumstances and properly structured and diligently exercised in a manner that provides a real opportunity to solicit a superior offer, go-shop clauses can provide a useful market check mechanism to the benefit of both targets and acquirors. However, if go-shops are employed primarily to entrench the position of an initial bidder or are structured in an overly restrictive manner, they are unlikely to serve as a useful market check and therefore would not be helpful in discharging the fiduciary duties of directors.



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