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Test-Driving a Hybrid Go-Shop

A number of recent high-profile strategic deals have featured a new form of hybrid "go-shop", combining the non-solicitation features of a "no-shop" with the bifurcated termination fee of a "go-shop."

By now dealmakers are no doubt familiar with the "go-shop" which gained popularity during the 2006-2008 LBO boom as an alternative formulation to the traditional "no-shop" in sale agreements for public company targets. In a number of recent strategic deals an interesting hybrid formulation has been used under which the traditional no-shop prohibitions on post-announcement active solicitation of competing offers apply but the bifurcated termination fee structure feature of the go-shop is used, with a lower break-up fee applying in the event the topping bid surfaces during a defined initial period after the deal signing.

Stepping back, no-shop or "non-solicit" clauses have long been a feature of public company merger agreements. Under basic fiduciary duty principles, in almost all instances the board of a public company that signs a sale agreement is not permitted to preclude the possibility of considering post-announcement competing proposals. The traditional merger agreement no-shop formulation has prohibited a target board from actively soliciting competing proposals, but permits a board to consider an inbound unsolicited inquiry from a potential topping bidder, with the target owing a break-up fee, usually about 3% of the deal value, in the event it terminates the first deal to accept the superior proposal. Historically, the view was that the no-shop structure, despite its prohibition on active marketing efforts, was sufficient to allow a target board to satisfy its obligation to conduct a market-check of its sale decision even in the absence of a pre-signing marketing effort.

During the LBO boom which often featured a frenzied rush to sign a sale deal with a single financial sponsor (often with equity participation by the management group), practitioners grew concerned about the adequacy of the post-signing market-check inherent in the traditional no-shop structure. The go-shop alternative, which developed with many subtle variations, almost always featured two primary twists on the no-shop structure: (1) an initial post-signing period during which the target board was permitted to actively solicit competing proposals, often followed by a period where the traditional no-shop prohibitions were activated and (2) a lower break-up fee (often about half the standard fee) that applied to deals that resulted from indications of interest during the active solicitation period. While the empirical evidence from the LBO boom suggests that go-shops were remarkably unsuccessful in generating competing offers, a few Delaware court decisions, most prominently in *Topps* and *Lear*, offered judicial support for the proposition that boards selling to private equity buyers could successfully fulfill their "market-check" obligations via a go-shop even in the absence of any pre-signing auction.

With the return of private equity dealmaking beginning in 2009, it has quickly become apparent that the predilection towards go-shops in sponsor buyouts is undiminished. One surprising development has been the leakage of this go-shop structure into deal agreements featuring strategic buyers such as Odyssey/Gentiva and Peet's Coffee/Diedrich. We suspect that this cross-over resulted from certain seller boards becoming increasingly nervous about the fiduciary implications of single-buyer sale processes even outside the private equity buyout arena, particularly where other obvious potential bidders may be lurking, notwithstanding the trend in Delaware courts in favor of not second-guessing a selling company's board's sale process especially in deals involving strategic buyers (see our recent M&A Update highlighting this trend).

Of particular interest is the hybrid go-shop that has appeared in a number of recent high-profile strategic deals, including Pfizer/Wyeth, Hewitt/Aon and Pfizer/King. While this hybrid model does not include the active marketing period of the traditional go-shop structure, it does include the reduced break-up fee for terminations for superior competing offers that surface on an unsolicited basis during a defined initial period (often 30 days) after announcement of the first deal. No doubt, these structures are an attempt to compromise

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between buyers' insistence on deal protection via a traditional no-shop structure and some sellers' resolve to burnish their market-check fiduciary credentials. The hybrid formulation strikes an interesting balance. It benefits the buyer by eliminating the significant distraction of target management and arguably unseemly public appearance resulting from the frenzied search for alternative buyers that characterize the standard go-shop, with the seller taking comfort that a public announcement of the initial deal is more than adequate notice to attract likely alternative bidders even in the absence of active solicitation. On the flip side, the seller preserves the key economic (and resulting fiduciary duty fulfillment) benefit of the reduced break-up fee for competing bids that surface quickly after announcement, with the buyer accepting that the relatively small difference between the reduced fee and the full termination fee is highly unlikely to be determinative of whether a competing bidder will surface with a superior proposal.

In the ever-evolving market for deal terms, it is as yet unclear whether the hybrid model will gain traction beyond this limited number of strategic deals. It also will be interesting to watch whether this structure leaks into the private equity buyout market displacing the traditional go-shop or opens the door further to alternatives to the traditional no-shop in a greater number of strategic deals. It is worth noting that the perceived value and structure of the go-shop, hybrid or not, may need to be reconsidered in light of the continuing proliferation of the tender offer structure and its facilitation of quicker sign-to-close timetables. That said, dealmakers should be mindful of these developments because, while the terms of any one deal will be largely driven by its specific facts and circumstances, both parties and courts often take note of trends in the wider market as they assess the adequacy of the path taken by the parties to satisfy the value-maximizing imperative imposed on target boards.

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