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The Go-shop “Lure”: Go-shop v. No-shop in Merger and Acquisition in Public Company

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Abstract:

In March 2013, one of the world biggest PC retailers, Dell, announced its privatization plan, in which adopted the go-shop clause. Although used by many public companies in merger and acquisition, the go-shop clause in fact developed from Revlon duty, that board of director must act in good faith to maximize the shareholders’ interests in the deal.

Generally speaking, since traditional no-shop clause without “fiduciary out” provision in merger agreement conflict with board’s Revlon duty, consequently, if running successfully, the go-shop clause is the best tool for shareholders to maximize their interests. However, court imputes many restrictions on the board involving with go-shop deal. In Netsmart shareholder litigations, Delaware Court of Chancery held that even there is a “fiduciary out” clause, the target board still violated Revlon duty against shareholders. According to this case, the board’s fiduciary duty and the future application scope of the go-shop clause become even more vague and complex than before, along with the diversified risks attached to the go-shop deal.

This paper will mainly compare the go-shop and no-shop clause in public company’s merger and acquisition, then along with spinning the go-shop “lure”, where specified the potential risks in go-shop deal. Finally, the author will discuss
several proposals when dealing with deals containing either go-shop or no-shop clause.

**Keywords**: Merger and Acquisition; Revlon Duty; “Fiduciary out”; Go-shop; No-shop;
Since 1986, Delaware Supreme Court ruled in *Revlon v. MacAndrews* that board of directors in public company had to bear another duty called “Revlon duty” cited as a precedent by subsequently cases. From then on, Revlon case became a milestone in corporate governance, which is a substantial duty attached on the board, companied with other mandatory duties on the board in public company regulated by both federal law and state law in U.S.

### I. Revlon, Omnicare, and Netsmart

In *Revlon v. MacAndrews* was a battle between dissenting shareholders and the company, the Delaware Supreme Court made a final decision that in certain limited circumstances indicating that the sale or break-up of the company is inevitable, the fiduciary obligation of the directors of a target company are narrowed significantly, the singular responsibility of the board being to maximize immediate shareholder\(^1\) value by securing the highest price available.\(^2\) In the deal, the role of the board of directors transformed from “defenders of the corporate bastion to auctioneers charged with getting the best price for the shareholders at a sale of the company”. In such a context, that conduct can not be judicially reviewed pursuant to the traditional business judgment rule, but instead will be scrutinized for reasonableness in relation to this discrete obligation.\(^3\)

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1. In this paper, the author uses shareholder instead of stockholder for consistency. However, the original text used by court was “stockholder”.
Colloquially, board of a public company that is “in Revlon mode” acquires certain Revlon duties, which requires the company to be auctioned or sold to the highest bidder.\(^4\) Held by Delaware Court of Chancery, by granted the request relief, it found that the Revlon directors had acted to lock up the Forstmann deal by way of the challenged deal provisions out of concern for their potential liability to Revlon disaffected and potentially litigious note-holders, a concern that would be allayed by Forstmanns agreement to restore the full value of the notes in connection with the new deal.\(^5\) The Court of Chancery found that, by thus pursuing their personal interests rather than maximizing the sale price for the benefit of the shareholders, the Revlon directors had breached their duty of loyalty.\(^6\) Affirmed by the Delaware Supreme Court, who subsequently developed into some new ideas reasoned that, the break-up of the company or its sale to one suitor or another became inevitable, and the board clearly recognized that the company was for sale.\(^7\) Now it was no longer charged with protecting the shareholders and the corporate entity from perceived threats to its ability to continue to perform, but instead became obligated to maximize the company’s immediate monetized value for the benefit of shareholders.\(^8\)

Today, there are three levels of judicial review when an action is brought under the allegation of a breach of fiduciary duties. As the court in *Golden Cycle v. Allan* stated, these levels are: “(1) the deferential business judgment rule, (2) the Unocal or Revlon enhanced judicial scrutiny standard, and (3) the stringent standard

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\(^4\) Id.

\(^5\) Id.

\(^6\) *In re Revlon, Inc. Shareholders Litig.*, 990 A.2d 940, 1023 (Del. Ch. 2010).

\(^7\) See Eisenberg, at 1295.

\(^8\) *In re Revlon, Inc. Shareholders Litig.*, 990 A.2d 940, 1024 (Del. Ch. 2010).
of entire fairness”. Where more focus on Revlon duty, that when company is changing of control, board becomes seller instead of manager who should maximize company’s value and maximize the greatest interests that shareholders can benefit from the deal. The obligation of board is shifting to consider the ultimate interest of the shareholder, at the same time, to whom should also bear the fiduciary duty to the shareholder. Under this circumstance, board needs to balance between the interest of shareholders and the contractual duties in the merger agreement. If board concern the contractual duties more than maximize the shareholder’s interests, it will let the board to bear higher risk to breach their fiduciary duties against the shareholder. While, by adopting Sarbanes-Oxley Act, board’s oversight duties had increased, with continually sought a predictable path to satisfying its Revlon duty.

Traditionally, in M&A deal, public company usually choose “no-shop” deal to find potential buyer and close the deal. In no-shop deal, target board in preliminary section will endeavor large amount of efforts on market investigation, risk evaluation, soliciting potential buyers in order to get the highest bid. In no-shop deal, owing to the enormous works in the pre-stage, the total time used normally is longer than go-shop deal.

In Omnicare v. NCS, the Delaware Supreme Court ruled that NCS violated its Revlon duty to shareholders, especially to the minority shareholders, since the merger agreement it signed included no-shop clause but without fiduciary-out clause, where NCS cannot go out to solicit a higher bid but was restricted to the current buyer, where the court ruled this act violated the Revlon duty to shareholder in company’s


changing control process, failing to fulfill to maximize the interests that shareholder can enjoy, as well as blocked minority shareholders in voting, due to the voting on this deal had already been locked up.11 Meanwhile, the Delaware Supreme court held that an exclusive merger agreement, such as a no shop or best efforts clause, must include a fiduciary out clause.12

In In re Netsmart Technologies, Inc. Shareholders Litigation (“Netsmart”), the Delaware Court of Chancery granted in part and denied in part a motion for a preliminary injunction brought in connection with a merger between Netsmart Technologies, Inc. (“Netsmart”) and two private equity firms.13 Plaintiffs challenged both the sale process, claiming primarily that the Netsmart board improperly failed to search for potential strategic buyers, and the disclosures made in the proxy statement distributed in advance of the shareholder vote. The Court held that “[s]hareholders were likely to prevail on their claim that the board breached its Revlon duty by inadequately exploring the option of a strategic buyer”.14

In May 2006, Netsmart board began to consider selling Netsmart. The board formed a special committee of independent directors to protect the interests of non-management shareholders in connection with any sale of Netsmart. The special committee, however, continued to collaborate closely with Netsmart's chief executive officer and retained Netsmart's financial advisor, William Blair, as its own advisor. Based upon the advice of Blair, the special committee believed that the execution of a merger agreement with a “fiduciary out” provision and no preclusive deal protections would generate a reliable post-signing market check.\textsuperscript{15}

Having decided not to canvas the market for strategic buyers, after following soliciting outsider bidders, Insight, a private equity firm and Netsmart agreed to a merger at the price of $16.50 per share. In negotiating the merger agreement, the special committee sought the opportunity to actively shop Netsmart through the inclusion of a go-shop provision. Insight, though, would only agree to a “window shop” provision that allowed Netsmart to consider an unsolicited “Superior Proposal”.\textsuperscript{16}


Turning to the plaintiffs’ claim that the board lacked a reasonable basis for its decision not to take steps to explore whether strategic buyers might be interested in Netsmart, the Court found that plaintiffs had demonstrated a likelihood of success. The Court explained that Netsmart’s informal inquiries of potential strategic buyers over the prior decade were “hardly the stuff of a reliable market check”, especially because the market and the Company were very different in 2006 than they were in the late 1990s or early 2000s. The Court further determined that while implied post-agreement market checks had been considered reliable evidence of the absence of other bidders in the context of large-cap deals, the same would not necessarily be true with respect to micro-cap transactions. Indeed, in Netsmart’s circumstances, the Court stated that “[a]n inert, implicit post-signing market check does not … suffice as a reliable way to survey interest by strategic players.” Finally, the Court noted that there was a basis to believe that Netsmart’s management favored a transaction with a private equity buyer over one with a strategic buyer, given that the management team would be more likely to be retained in a private equity deal and more likely to receive additional equity incentives.

In this case, Delaware Court of Chancery used the objective test to determine whether the board had satisfied its Revlon duties to shareholders, especially the

17 Id.
18 Id.
19 Id.
21 Id. See also supra notes 24.
minority shareholders. The objective test used by the Court is that would a reasonable person in the target board’s position act as the same behavior as the Netsmart board. However, the Court of Chancery did hold that the Netsmart board satisfied the objective test on the board’s fiduciary duty, and fail the objective test on the Revlon duty. Since as a reasonable person in Netsmart board’s position would not depend on the circumstances ten years before to decide the strategies it should used in current deal to seek outsider bidders.

On the one hand, in Netsmart and Omnicare, no matter which method board choose to adopt, go-shop or no-shop, it all violated board’s fiduciary duty. On the other hand, target board no matter chooses go-shop deal or no-shop deal, must all complied with board’ fiduciary duty to shareholder, especially in takeover the Revlon duty. Although one case deal with go-shop, the other deal with no-shop, notwithstanding which method was chosen, courts always focused on the balance between shareholder controlling power in the public company and board’s fiduciary duty, where both cases fail to maximize the shareholder’s interests from court’s prescription. In addition, one of the most important issues held by Delaware Court of Chancery to decide the board’s duty is whether the objective test be satisfied or not, which from a reasonable person’s point of view had the board accomplish its Revlon duty to shareholder, that also suppose some ideas to the public company in structuring a merger agreement in a go-shop deal.

II. Go-shop v. No-shop

As discussed above, respect to Revlon duty, the target board must obtain the
highest price for the shareholders in the deal.\textsuperscript{22} Nevertheless, traditionally, the merger agreement normally includes a “no-shop” clause, which prevent the target company from soliciting with potential outside bidders,\textsuperscript{23} even prevent the target company to passively accept the offer made by the outside bidders, unless the board in target company fiduciary duty required it to do so, regulated by a clause called “fiduciary out”, where permit the board to solicit from outside bidders in order to reach a superior offer.\textsuperscript{24} Greatly influenced by the private equity boom, the use of the go-shop clause in deals has recently gained prominence.\textsuperscript{25} Increasingly, the target board had inserted the go-shop clause into the merger agreement, ultimately reversing the conventional wisdom that once a deal was signed the parties agreed to deal exclusively with each other and refrained from looking for other partners.\textsuperscript{26}

Normally, go-shop clause will include an approach that, instead canvassing the market first, the target company negotiates with a single bidder first, announces the deal, and then has 30-50 days to “go-shop” to find a higher bidder.\textsuperscript{27} Furthermore, the doctrine implication is that the go-shop clause, if appropriately structured can


\textsuperscript{23} This is a mandatory obligation for public company in US, required by SEC and 1934 Security Exchange Act. This obligation is called “disclosure obligation” in China.

\textsuperscript{24} Fiduciary out clause is a provision that permits the board of directors to terminate a proposed merger if a better deal arises with another party. See also Subramaniam, at 734. See also supra notes 6.


\textsuperscript{26} See Egan, at 202.

\textsuperscript{27} See Subramaniam, at 730.
satisfy the target board’s Revlon duty. In a boarder implication, the go-shop clause can be a “better mousetrap” in deal structuring, which can reach a “win-win” for both buyer and seller.\textsuperscript{28} The go-shop process induces a full price from the first bidder, which is meaningfully shopped post-signing,\textsuperscript{29} which gives implications for the target board in structuring the go-shop clause through negotiating with buyers.\textsuperscript{30} These ideas also force court to focus on determining whether a particular go-shop clause satisfied the target board’s Revlon duty.\textsuperscript{31} This increased scrutiny compelling the target board to react by employing the go-shop clause in order to perform a more active role.\textsuperscript{32} Because of legal protection provided to the board on the traditional business judgment presumptions, it is possible for the go-shop clause become more prevalent compared to the no-shop clause for keeping the board remaining cautious in increasing shareholder activism and heightening regulations.\textsuperscript{33}

Nevertheless, with all benefits to the target board, it must take increasing precautions to ensure management of board is not giving the store away by using shareholder’s money, which is a important issue in Delaware General Corporation

\textsuperscript{28} See Subramaniam, at 731.

\textsuperscript{29} See Subramaniam, at 734.

\textsuperscript{30} See supra notes 23. See also Subramaniam, at 734.


Law, 34 where indicated a complicated problem on power distribution between shareholder and directors.35 In general, on the one hand, shareholder is focusing on restricting board’s power. On the other hand, shareholder is giving broad discretions to the board. As a consequences, a host of cases emerged up concerning the relationships between shareholders and directors, such as Charlestown Boots v. Dusmore, CA Inc. v. AFSCME, Blasius v. Atlas, etc. 36 All ruled by the Delaware Supreme Court, it developed into the default business judgment rule to give favorable presumption to the board on conducting in good faith, due care, and honest belief manner, where the target board not only must maximize shareholder’s interest, but also must conduct in compliance with its fiduciary duties.

Presumably, in both the no-shop and go-shop deal, the target board canvasses the market to see if there is a higher-value bidder. The difference between the go-shop and no-shop lies in the timing of the market check by the target board. 37 In no-shop deal, the market check takes place before signing the merger agreement; while in go-shop deal, the market check takes place after signing the merger agreement. 38 By giving important implications for the deal, in no-shop agreement, all bidders are on a level playing field with respect to the economics of the transaction, gives all bidders the same timeline for making bids, and the target board has a legal obligation to

34 In this paper, the author uses “company” instead of “corporation” for consistency. But in fact, in Delaware, courts use “corporation”.

35 See Eisenberg, at 359.

36 See Eisenberg, at 371-490.

37 See Subramaniam, at 736.

38 Id.
maintain a level playing field among all bidders. However, in go-shop deal, the announced bidder has slight leg up because of the termination fees, where the combination of the fee and the first bidder’s match right may deter a prospective bidder. Meanwhile, potential bidder also requires demonstrating a reasonable likelihood of making a superior proposal with a preferred status given by the target board that is particularly valuable when bidder has announced its intention to stay on running the target company.

III. The Go-shop “Lure”

Compared with no-shop deal, because of efficiency and alternativeness, go-shop is more commonly adopted by public company in M&A deal. Certainly, a bunch

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39 From here, in no-shop deal, the target board needs to find the buyer at the first place when they decide to sell the company. After compared the bids from all potential buyers, the target board made final decisions. In this situation, all the potential buyers like in the tendering process, are in the same level to make the most appropriate bid which most suitable they believed. Id. See also supra notes 13.

40 Different from the no-shop deal, in go-shop deal, after identify an announced buyer, the target board still have time to find and solicit with outside potential buyers. Meanwhile, the target board still can use the bid that made by the announce buyer to solicit a higher bid from the third party. By disclosing the existing bid to the third party, it would be easier for the target board negotiating the price with the third party. At this stage, the announced buyer could also face the risk for being recognized as a “stalking horse”. The only protection for the announced buyer is the termination fee. However, this fee compared with the potential deal is really a tiny amount. Whether could this termination fee (or break-up fee) would protect the announced buyer does not have a definite answer, but need to analyze based on particular facts. Id. See also supra notes 36, 37.

of public companies also choose no-shop from time to time. Nevertheless, along
with developing from no-shop and Revlon duty, go-shop is facing many criticism,
most of which on criticizing the target board accepted inadequate initial offers that
always go unchallenged, which further emphasize the importance of a target board
making an initial informed decision to accept an offer and soliciting additional bidder
in good faith.

Asserting that the go-shop clause permit target board to justify uniformed
decisions and accept inadequate initial bids, generally most opening bids are
significantly lower than the best prices those bidders are prepared to pay. A higher
bid cannot be obtained because of the usage of go-shop clause. Moreover, the go-shop
solicitation period is too short to get a deal for most public companies. As has been
noted, when challenged as breaching Revlon duty to obtain the best value reasonably
available, directors in the target board may only and always rely on the go-shop
clause to escape their personal liabilities.

In addition, some critics spine that when the target board approached with an
offer from a buyer or a bidder, particularly a buyer preselected by the board, may fail
to sufficiently consider whether the company should even be sold because of a

42 As discussed in the second section. See also supra notes 35,36.
43 See also Sautter, at 17.
44 Elliott J. Weiss, The Board of Directors, Management, and Corporate Takeovers: Opportunities and
for-corporate-control-shareholder-rights-stakeholder-interests-and-managerial-
responsibilities/oclc/22451714 November 17, 2013.
dependence on the go-shop’s permitted post-signing market check.\textsuperscript{45} A board may incorrectly rely on the go-shop clause as satisfying its Revlon duty to obtain the greatest value for shareholder instead of taking action in good faith to solicit bids during the designated time frame.\textsuperscript{46}

Whereas, besides the critics, even though broadly adopted, the go-shop deal has many risks against public company. Counted to the disclosure obligation of the public company, the top three risks are highly exposure, low price, and more vulnerable to small company. Go-shop seems become a “lure” to public company.

First of all, go-shop will expose the target and initial buyer into disclosure risks. Since the mandated disclosure requirement on the substantial changes of public company to file 8K to SEC, when the target and initial buyer reached to the initial merger agreement, it needs to disclose this on-going transaction to public.\textsuperscript{47} Many details of the deal transformed from confidential into transparent, including parties’ identities, sale price, on-going negotiation process, amount of stocks, and the merger strategy and so on.\textsuperscript{48} Meantime, not only the target company is exposed its potential sale project, but also the initial buyer is also exposed its ambitions on the future development and expansion directions. Giving valuable confidential information to competitors may alter the position of the company in future competitions. While disclosing the on-going merger plan or acquisition plan may compel shareholder


\textsuperscript{46} See Eisenberg, at 1293.


\textsuperscript{48} Id.
worried about the company which may cause the structural risk to minority shareholders to sell their shares in short-term without careful consideration, affect company’s share price in return.  

Furthermore, many critics against go-shop deal is its price will lower than the no-shop deal in practice, which may also attribute to the disclosure requirement of public company. When the price of this deal is accessible to public, the potential buyers have already built up a safe-line in the offer. When the target board soliciting the bid during the go-shop period, these potential buyers would squash the price as lowest as possible, or demand additional closing conditions, such as due diligence out etc. Especially to the target board who do not satisfy with current bid, on the one hand reluctant to accept this moderate bid, on the other hand afraid losing the current bid and failed in sale, which will significantly affect the investor’s confidence on the target company and consequently affect the share price and shareholder’s interests ultimately.

Additionally, in contrast with frequently merger of large public company, small public company would be more vulnerable to the go-shop deal, because of greater pressure impute on small public company. Due to small potential market either in suppliers line or in customers demand, when disclosure its potential sale plan, usually, the suppliers and customers will doubt the capacity and future development


50 See also Sautter, at 16.

of the company, which subsequently will lose some current customers or suppliers, and created an even worse situation for company in future development.

Notwithstanding, fewer alternatives are available to small companies than large public companies. Different from large company, owing to short of funds, partners, and potential customers, small company does not have many development directions.\(^{52}\) Once exposed the potential merger plan, particularly expose the sale price of the company, there would be less negotiable spaces for company to choose. Moreover, because of lacking stronger insurance protection, small company is more vulnerable when facing with hostile takeover from competitors and company looters, in which accountable to the lower price and comparative easy transferable.\(^{53}\)

IV. Proposals on Satisfied Board’s Revlon Duty in both the Go-shop and No-shop Deal for Public Company

Either in go-shop or no-shop deal, in order to satisfy the target board’s Revlon duty, which is to maximize the shareholder’s interests and reach the highest price deal with buyer, some proposals will be spine subsequently.

First of all, notwithstanding, in no-shop deal, the target board must include a “fiduciary out” clause in the merger agreement, but which is also same in the go-shop deal. In *Omnicare*, where the Court held that “fiduciary out” clause should be included, by failed doing so, board need to liable for violating its fiduciary duty and Revlon duty to shareholders, especially to the minority shareholders.\(^{54}\) Just as

\(^{52}\) See also Fillippell, at 315.


\(^{54}\) See Eisenberg, at 1288. See also supra notes 27.
Netsmart, the target board had to include the “fiduciary out” clause in the merger agreement, along with the “go-shop” clause to satisfy its fiduciary duty to the company and to the shareholders.55

Furthermore, the target board shall set up a special committee constituted with independent disinterested outside directors to manage the entire merger process, including negotiating with the current buyers, giving the best effort to solicit with higher price offer, hiring independent outside audit firm, law firm, bankers and financial advisors to giving professional advices, appropriately maintaining record and minute for every meeting, excluding the interest-related directors from the decision-making process, establishing a “Chinese wall” between interest-related director from the independent committee, asking minority shareholders’ opinions on the merger, and making the final plan and handing it to the target board for approval.56 If the board does not approve the recommended proposal, the whole process should be re-starting, that the independent committee should re-going through the entire process from the starting point. From the perspective on how to making the best decisions for shareholders, especially for the minority shareholders, the special committee may consider the former deals, but based on the current circumstances would be more rational for the board to make the decision.

In addition, although hardly to perform, when making decisions the target board may hand the merger agreement first to the minority shareholders for approval; if approved by the minority shareholder; then, it turns to the majority shareholder to approve, where in the traditional procedure, in normal circumstance, only need a

55 See supra notes 53.

56 All these suggestions are derived from the hostile takeover cases from the Eisenberg, and the class from business organization and this course.
majority approval could the merger agreement be approved by the shareholders. Likewise as going private, giving the minority shareholders’ first approval right would protect the target board from being sued by the minority shareholder by alleging that the board did not concerned the interests of the minority shareholders.57

Last but not the least, the target board in public company shall follow with its disclosure obligation strictly, by not only filing the documentations to the SEC, but also disclosing the whole decision-making process and relevant documentations to shareholders either by the notice or by the proxy statement, where owing to that the minority shareholders have less information than the majority shareholders, while majority shareholders knew less than the board.58 Even though shareholder could request the information, actively and voluntarily disclosing the information to the shareholder would give more reasonable standings to the board to demonstrate that it had satisfied board’s fiduciary duty.

V. Conclusion

Even though, the go-shop clause gives the target board more preferences on balancing among the board’s broad discretions, the interest of company, the interest of majority shareholders, and the interest of minority shareholders. Many critics

57 This idea is generated from the last class of this course. See also supra notes 56. Moreover, all these proposals need be researched in a further degree, such as the feasibility research and constructional research, etc.

58 For example, in China, most public company are required to place all the disclosed information (disclosure information to CSRC, China Securities Regulatory Commission) in the main office venue of the company, by which the investor can reach the information easily without file an application to the secretary of the company to reach these information. The author believes in U.S. that is the same obligation for the public company, but not quite sure the exact requirement by SEC.
imposed on the go-shop clause. For example, it is proved that the short soliciting period in go-shop deal is difficult for the target board to solicit outside bidders efficiently and successfully, which also hard for the target board to find a higher offer and presume that the board had act in good faith.

Moreover, board’s fiduciary duty and Revlon duty requires putting more reasonable investigations and valuations on the go-shop deal. Cases ruled by the Delaware courts suggest the board need to bear more responsibilities and more discretions than before on making significant decisions. Nowadays, merely including the “fiduciary out” clause is not enough for court to give business judgment presumption on the board any longer, where some courts prefer to use the objective test to determine whether the board had fulfill its fiduciary duty and Revlon duty to shareholders, especially to the minority shareholders.

Because of highly disclosure requirement on public company, the one of distinguished feature, when adopting the go-shop deal, public company need to bear higher risks than other merger modes, such as highly exposed information which may easily be used by competitors, low price which may hurt shareholder’s interests and violate board’s fiduciary duty instead, and to small company which will apply more pressures and burdens. Therefore, Go-shop clause is a “lure” to the board in public company, which is not as superb as originally suggested.

Consequently, no matter public company adopted go-shop or no-shop deal, due to the extensive utilization and dispersive risks, probably it would be more rational for the board to include a “fiduciary out” clause in the merger agreement, to set up a special committee all consisted with disinterested and independent outside directors to allow the minority shareholder approving the merger agreement first, and
to require the board fully disclose the material information to shareholders, and to make decisions on this moment and at this circumstance.
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