Volume 60, Issue 5 Page 1529

Stanford Law Review

NOTE

STACKED DECK: GO-SHOPS AND AUCTION THEORY

J. Russel Denton

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> "[W]e don't want to waste our time. . . . *We don't participate in auctions*."
> —Warren Buffet[1]

INTRODUCTION

During the recent wave of private equity buyouts of public companies, boards of directors for selling companies have been increasingly turning to go-shop provisions as a means of fulfilling the board's *Revlon* duty to maximize shareholder value.[2] A go-shop provision operates as a post-signing market check by allowing a selling board to actively solicit offers from third parties after signing a merger agreement with an initial buyer. In the words of one publication for practicing lawyers, go-shops give the selling company the benefit of an open auction without any downside risk since they allow the

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1. Jeremy Bulow & Paul Klemperer, *When Are Auctions Best?* 1 n.2 (Stanford Univ. Graduate Sch. of Bus. Research Paper No. 1973, 2007), *available at* http://ssrn.com/abstract=999904.

2. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

selling company to lock in a price floor while retaining the ability to conduct further negotiations with other buyers for a higher price.[3] However, there is also speculation that a go-shop is a "disingenuous article that boards are including in deals to protect themselves from angry shareholders . . . ."[4]

A selling board's decision to contest any merger provision is made in a situation in which the buyer can simply not sign a deal if it does not get the terms that it wants. This puts pressure on selling boards of directors and there is no single answer for how a board can maximize value in all situations. Boards have to do their best to maximize value for their shareholders while not pushing buyers so hard that they prefer not to sign a deal. Delaware courts have recognized that a buyer abandoning a deal is a real threat in a simulated dialogue between a selling company pressing for better terms and a buyer offering a take-it-or-leave-it set of deal terms.[5] The ability for buyers to simply not agree to a deal has led courts to recognize that target boards are allowed to grant lock-up provisions to the buyer as long as the provisions are within the range of reasonableness.[6]

Up until June 2007, there had not been any court cases dealing with the extent to which go-shop provisions could walk this line and satisfy *Revlon* duties.[7] However, two Delaware Chancery Court cases decided in June 2007 rejected plaintiffs' *Revlon* claims that go-shop provisions failed to maximize shareholder value.

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3. *Go-Shop*, POCKET MBA, (Practising Law Inst., New York, NY), Aug, 8, 2007, *available at* http://www.pli.edu/public/newsletters/newsletter.asp?stid=2147483621&ID=EN00000000041575.

4. Andrew Ross Sorkin, *Looking for More Money, After Reaching a Deal*, N.Y. TIMES, Mar. 26, 2006, at C4.

5. The *Toys "R" Us* decision affirming a board of directors' decision to grant a matching right and a termination fee after an extended negotiation and auction process included a dialogue concerning how too aggressive of a negotiation stance might result in the buyer simply walking away and the board losing out on an offer:

> First Boston/Simpson Thacher [advisors for the selling board]: The board wants 3.0% on the termination fee and to get rid of the matching right.
>
> KKR [potential buyer]: Fine, you can have $25.75 per share and the 3.0% or the $26.75 with 3.75% protection for our trouble. And we want the match in either case.
>
> First Boston/Simpson Thacher: No, no. We demand 3.0% and the $26.75; take it or leave it.
>
> KKR: What did Cerberus and Apollo bid?
>
> First Boston/Simpson Thacher: We can't comment.
>
> KR [sic]: I think we're done.
>
> First Boston/Simpson Thacher: (with panicky overtones) Please don't go . . .
>
> KKR: Click [sic]
>
> First Boston/Simpson Thacher: Expletive Deleted.

In re Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975, 1016-17 (Del. Ch. 2005).

6. For a good discussion of lock-ups, see Brian JM Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 J. CORP. L. 865 (2007).

7. A previous decision, *In re* Netsmart Technologies, Inc., S'holders Litig., 924 A.2d 171 (Del. Ch. 2007), held that boards of directors at companies that were not widely covered by stock analysts could not rely on only a post-signing market check in order to satisfy their *Revlon* duties.

In the first of these cases, *In re Topps Company Shareholders Litigation*, the plaintiffs challenged a private equity buyout of Topps where management had been given assurances of continued employment by the buyout firm. The merger agreement contained a go-shop provision, a termination fee and a matching right in favor of the buyer. Additionally, there was no pre-signing market check of any kind. Nevertheless, Vice Chancellor Strine wrote that "[he did] not believe the substantive terms of the Merger Agreement suggest[ed] an unreasonable approach to value maximization."[8] As a result of the go-shop process, a second bidder, Upper Deck, made a bid for the company that was $1.00 (10.25%) higher than the initial offer, but the Topps board rejected it and recommended that shareholders vote for the initial merger with the private equity firm.[9]

The go-shop provision, in Strine's estimation, provided a reasonable post-signing market check, and "for 40 days the Topps board could shop like Paris Hilton."[10] Despite approving the go-shop provision under *Revlon*, Strine enjoined the shareholder vote on the merger because Topps had failed to adequately disclose both the extent of management participation and the size of management's contracts with the private equity firm.

In *In re Lear Corporation Shareholder Litigation*, Vice Chancellor Strine dealt with buyout of a public company in which management had been promised jobs running the company after it was taken private.[11] In the negotiations to buy out Lear, Carl Icahn, the buyer, refused to allow Lear to conduct a full-blown auction, saying that he would pull his offer if it did so.[12] In a decision that closely followed the *Topps* decision, Strine enjoined a shareholder vote on the merger until Lear adequately disclosed management's participation in the buyout negotiations.[13] The Vice Chancellor rejected the shareholders *Revlon* claims despite saying that Lear's board's negotiation tactics were "less-than-ideal."[14] Strine additionally wrote that he "also perceive[d] no reason why a strategic or financial bidder would have believed that Icahn's relationship with Lear's management made a topping bid inadvisable."[15]

This Note will use formal auction theory to analyze the effects of go-shops on selling companies' premiums and will show that while Strine is correct in saying that the combinations of management involvement and go-shop provisions will not deter strategic bidders, they do deter additional financial

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8. 926 A.2d 58, 86 (Del. Ch. 2007).

9. For a more thorough discussion of the *Topps* negotiation process, see *infra* Appendix.

10. *See Topps*, 926 A.2d at 86.

11. 926 A.2d 94 (Del. Ch. 2007).

12. *Id.* at 104.

13. *Id.* at 114-15.

14. *Id.* at 118.

15. *Id.* at 121.

bidders from pursuing a company.[16] This means that go-shops, as they are currently written, do not maximize value for the target company's shareholders. Aside from management participation, there are features of go-shop provisions that, based on auction theory, make it significantly less likely that a third-party financial bidder will emerge and make a jump bid, stacking the deck in favor of the initial bidder.

Part I of this Note will summarize the important aspects of auction theory as it relates to corporate takeovers. Part II will provide a background of go-shop provisions, discussing the kind of transaction in which go-shops are being used, and summarize how a typical go-shop provision works. Part III summarizes the impact of go-shop provisions on expected revenue, based on auction theory developed in Part I and the observations in Part II, and examines real-world mergers to determine whether or not auction theory correctly predicts the outcomes in go-shop transactions. Part IV offers a set of recommendations to make go-shops more effective at maximizing shareholder value.

I. AUCTION THEORY

Under the Delaware Supreme Court's decision in *Revlon v. McAndrews*, once a board of directors makes a decision to sell a company for cash, the board has a duty to maximize the value that shareholders receive.[17] Auction theory can be used to determine how boards of directors for selling companies can best go about maximizing revenue when selling a company. As selling boards' principal focus is maximizing shareholder value, analysis in this Note will focus on the principles of auction theory relating to maximizing expected revenue for the seller, not on designing a process that will result in a socially efficient sale.

There are four styles of auctions: ascending bid auctions (also called English auctions), first-price sealed bid auctions, second-price sealed bid auctions, and descending bid auctions (also called Dutch auctions).[18] In an ascending bid auction, the seller raises the price until a bidder is not willing to pay a higher price and the highest bidder wins the auction for that price.[19] In a first-price sealed bid auction, the bidders all submit a sealed bid and the bidder who bids the highest amount, wins the auction for the value of her bid.[20] In a second-price sealed bid auction, the process is just like a first-price sealed bid

16. When this Note discusses go-shops, it refers to both the actual provision that allows the seller to try to obtain third-party bids as well as the other provisions of the merger agreement, such as termination fees and matching rights, that affect the way go-shops are implemented.

17. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

18. PAUL KLEMPERER, AUCTIONS: THEORY AND PRACTICE 11 (2004).

19. *Id.*

20. *Id.* at 12.

auction except the winning bidder pays the second-highest bid.[21] Finally, in a descending price auction, the seller starts with a high value and lowers the price until a bidder is willing to pay the price the seller is offering.[22] Depending on the circumstances of the auction, each of these forms of auction can result in different expected revenues for the seller, so it is necessary for a seller to be mindful of the effects on revenue when deciding which form of auction to use.

Regardless of the potential impact on expected revenue, it is difficult, if not impossible, for a selling board to auction a company by any means other than a first-price ascending auction. Because of the selling company's duty to maximize shareholder value, any director who turns down a higher bid after an auction is "over" is going to be "vulnerable" to shareholder lawsuits.[23] A prominent example of an attempt for a selling board to run a sealed-bid auction was the sale of RJR Nabisco. However, after the end of the auction process, the RJR board allowed additional rounds of bidding. Essentially, the RJR board ended up having multiple rounds of "sealed bid" auctions and therefore the auction was essentially an open-outcry ascending auction.[24]

The Delaware Supreme Court's decision in *Omnicare* created a bright-line rule against signing a merger agreement without an effective "fiduciary out." This forecloses the possibility of auctioning a company via a non-open-outcry ascending bid auction.[25] Any bid is going to have to be made public for the shareholder vote, and a board of directors has to consider any superior bids from a third-party in order to fulfill its fiduciary duties to its shareholders. Because of the board's fiduciary duty to consider higher bids, any auction held for a company will be an ascending price auction regardless of prior auction design; a board simply cannot credibly commit otherwise regardless of the ex ante effects on expected revenue from using another auction form.[26] Therefore, the rest of the analysis in this Part will focus on how to maximize revenue in an ascending price auction with public bids.

One of the most important components of increasing revenue in an auction is to increase the number of participants in the auction.[27] The more bidders there are in an auction, the higher the expected valuation of the second-highest bidder. In an ascending price auction the winning bidder pays a price only slightly higher than what the second highest bidder is willing to pay; the

21. *Id.*

22. *Id.*

23. *Id.* at 111.

24. *Id.*

25. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003).

26. Indeed, it is possible that in order to maximize revenue from financial buyers a second-price sealed-bid auction would be superior.

27. *See* Jeremy Bulow & Paul Klemperer, *Auctions Versus Negotiations*, 86 AM. ECON. REV. 180 (1996) [hereinafter Bulow & Klemperer, *Auctions Versus Negotiations*]; *see also* Bulow & Klemperer, *supra* note 1, at 1 n.2.

expected revenue of the seller goes up with the number of bidders.[28]

A related result is that an auction with *n*+1 bidders will always have a higher expected revenue than an auction with n bidders.[29] Even a perfectly designed auction with n bidders will result in less expected revenue for the seller than an imperfectly designed auction with *n*+1 bidders.[30] This result holds true regardless of whether the auction is common or private-value.[31] Even the threat of additional bidders will result in a higher expected price of the auction, because any bidder will have to bid more aggressively in order to have a chance to win the auction.[32] Because of these results, it is important for sellers to try to design an auction that facilitates entry (or even potential entry) of additional bidders.

Another important consideration is whether the auction is private or common-value. In a private-value auction, each bidder knows how much it values the target, and this information is private to each bidder.[33] Additionally, each bidder can have a separate valuation for the target based on its planned use. For example, an auction for raw materials in which each of the bidders is going to use the raw materials in a manufacturing process that will generate different amounts of revenue for each bidder would be a private-value auction. In a common-value auction the value of the target is the same for all bidders.[34] However, each bidder may have different information about what the value of the target actually is, and therefore have a different estimate for the value of the target.[35] A good example of a common-value auction is auctioning off a wallet containing only cash: regardless of who wins the auction, the party will gain the same value from winning the target.

In the area of corporate takeovers, financial and strategic bidders view the valuation of a potential target from different perspectives.[36] A financial buyer views all companies as potential targets, because it is looking for companies with cash flows that are sufficient to be able to pay interest on debt in a leveraged buyout. Financial buyers tend to employ similar methods such as taking on additional levels of debt and cutting costs.[37] Since each financial buyer will employ similar techniques in order to profit from the acquisition,

28. *See* R. Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. ECON. LIT. 699, 711 (1987).

29. *See* Bulow & Klemperer, *Auctions Versus Negotiations*, *supra* note 27, at 180.

30. *Id.*

31. *Id.*

32. *See* Quinn, *supra* note 6, at 879-80.

33. *See* KLEMPERER, *supra* note 18, at 13.

34. *Id.*

35. *Id.*

36. Paul Povel & Rajdeep Singh, *Takeover Contests with Asymmetric Bidders*, 19 REV. FIN. STUD. 1399, 1399-1400 (2006).

37. *Id.*

financial buyers view targets as common values.[38] Strategic buyers, on the other hand, look to make money from buying a company by merging operations or by exploiting synergies between the strategic buyer and the target. Therefore, each strategic bidder is likely to have a different, private estimate of the value of the target.[39] So, financial bidders value all companies the same (companies have a common value to financial bidders) while strategic bidders value companies differently based on potential synergies (companies have a private value to financial bidders).

In common-value auctions, each bid conveys information to other bidders about the bidder's estimate of the value of the target.[40] This information then allows other bidders to update their estimated value of the target when deciding whether or not to make a higher bid. For example, Bidder Two can draw interferences from Bidder One's bid to revise Bidder Two's estimate of the value of the target. If a bidder's information about the value of the target in a common-value auction is known to all of the other bidders, then the expected surplus of the bidder is zero.[41] If a bidder has the same information with which to estimate the value of the target as all of the other bidders, any bidder with superior information will simply make a higher bid as long as the bidder with only publicly available information is bidding lower than the value of the target. Therefore, there is no way for a bidder with only publicly available information to win a common-value auction at an expected profit (assuming that all of the bids are public).

If a seller has private information, it can raise its expected revenue by making all of that information public.[42] In order to maximize revenue, it is beneficial for the seller to do anything it can to reduce disparities in information. Indeed, in common-value auctions even small informational asymmetries can "greatly increase a [better-informed] bidder's probability of winning, and greatly reduce the price he pays when he wins, so . . . small asymmetries are also very bad news for sellers. Furthermore, the effects of these asymmetries are magnified by bidding costs or entry costs."[43] Granting a single bidder better access to information about the value of a target will mean that information asymmetries exist, and lower a seller's expected revenue in a common-value auction.

Another important element of common-value auctions is the so-called "winner-curse." For example, in an auction for a wallet, overestimating the

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38. *Id.*

39. *Id.*

40. *See* Peter Cramton & Alan Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J.L. ECON. & ORG. 27, 35 (1991).

41. *See* McAfee & McMillan, *supra* note 28, at 722.

42. *See* Paul R. Milgrom & Robert J. Weber, *The Value of Information in a Sealed-Bid Auction*, 10 J. MATHEMATICAL ECON. 105 (1982).

43. Paul Klemperer, *Auctions with Almost Common Values: The 'Wallet Game' and Its Applications*, 42 EUR. ECON. REV. 757, 758 (1998).

amount of money in the wallet will lead a bidder to bid too much for the wallet, meaning they will likely lose money on it. Since a bidder will only win an auction if it makes the highest bid, chances are that (absent better information) the bidder has the highest bid because it overvalued the target.[44] Not properly taking other bidders' valuations into account "can lead to the winner paying more, on average, than the prize is worth."[45] In order to avoid the winner's curse, a bidder must subtract some amount from its valuation when deciding an amount to bid.[46] Because bidders adjust their bids downward in common-value auctions to avoid the winner's curse, it is beneficial for the seller to get as much information about the target into the marketplace.

Reducing uncertainty (disclosing information) in a common-value setting will allow bidders to bid higher because they are less susceptible to the winner's curse.[47] The winner's curse is more likely to afflict weak (i.e., uninformed) bidders than strong (i.e., informed) bidders.[48] Strong bidders are even more likely to win the auction, and at a lower price because weak bidders have to discount their bids so much to avoid overpaying.[49] This means that there will be lower revenue for a seller in auctions with asymmetry.[50] Because of the high probability that they will be victims of the winner's curse if they win the auction, weak bidders may not be willing to participate at all in an ascending common-value auction with asymmetric information.[51] If weak bidders do not enter the auction, then stronger bidders have an incentive to bid even less since no one else is going to enter auction to steal their surplus, lowering the seller's expected revenue.[52] One way to raise expected revenue would be to link the price that a bidder pays for a target with the amount or quality of the information that the bidder receives.[53]

Asymmetries between bidders have less of an effect on private-value auctions than common-value auctions.[54] In a mixed private-value and common-value auction, private-value bidders are not affected by the winner's curse; they will just continue to bid until the price bid by another party exceeds their private valuation.[55]

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44. *See* KLEMPERER, *supra* note 18, at 14.
45. *Id.*
46. *Id.*
47. *See* Cramton & Schwartz, *supra* note 40, at 35.
48. KLEMPERER, *supra* note 18, at 107; *see also* Klemperer, *supra* note 43, at 758.
49. Klemperer, *supra* note 43, at 758.
50. *Id.*
51. *See* KLEMPERER, *supra* note 18, at 108.
52. *Id.* at 109.
53. *Id.* at 21.
54. Jeremy Bulow, Ming Huang & Paul Klemperer, *Toeholds and Takeovers*, 107 J. POL. ECON. 427, 430 (1999).
55. *See* Klemperer, *supra* note 43, at 759 n.3.

A. *Comparison Between Auctions and Sequential Mechanisms*

Go-shop provisions more closely resemble a sequential mechanism where each potential bidder arrives in turn and "observes the current price and bidding history and decides whether to pay the entry costs" necessary to determine the value of the target.[56] A paper has indicated that, under some circumstances, sequential mechanisms can generate more revenue for the seller than holding an auction.[57]

In order for sequential mechanisms to produce results superior to auctions, the sequential mechanism has to attract multiple entrants.[58] This is similar to the result in auction theory that expected revenue is higher in an auction with n+1 bidders compared to an auction with n bidders. However, auctions attract more entrants than sequential mechanisms, so the benefits to the seller of using a sequential mechanism are doubtful.[59] However, it is not necessary to actually have multiple participants in order to raise expected revenue in a sequential bidding process—there just needs to be the threat of additional bidding. As with auctions, in sequential mechanisms, if the seller can credibly threaten to subsidize additional bidders, expected revenue is increased.[60] Indeed, the threat of entry created by entry subsidies can make a sequential mechanism have higher expected revenue than an auction.[61]

However, an auction is superior to "practical versions" of sequential mechanisms in terms of expected seller revenue.[62] Considering only plausible versions of sequential mechanisms, an auction yields lower total bidder surplus (and therefore more seller surplus) than sequential bidding mechanisms.[63] This means that, practically speaking, a selling company stands to make more money by conducting an auction than it would if it created a sequential mechanism. The two reasons that an auction is better at generating revenue for the seller than a sequential mechanism are that auctions are better at attracting entry and auctions need fewer participants in order to achieve maximum expected revenue.[64] Furthermore, if a "buyer can make plausible threats to withdraw if a seller seeks additional bids then the advantage of the auction becomes larger."[65]

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56. Bulow & Klemperer, *supra* note 1, at 2.

57. *Id.*

58. *See id.* at 3.

59. *Id.* One should also note the potential efficiency gains from a sequential mechanism. This Note, however, focuses on maximizing revenue for the seller.

60. *Id.* at 3-4.

61. *Id.* at 21.

62. *Id*. at 12-18.

63. *Id.* at 18.

64. *Id.* at 25.

65. *Id.* at 4 (emphasis omitted).

B. *Empirical Studies of the Benefits of Auctions*

There have been some empirical studies on the impact of auction processes on the premiums that selling companies have received. Most of these studies have indicated, contrary to expectations from theory, that auctions do not result in higher premiums being paid to selling companies. One study showed that, for all purchases during the 1990s, there was no difference in the premium received when there was a single bidder and when an auction was conducted.[66] The authors of the study attribute the lack of difference in revenue to the fact that information is costly to obtain.[67] This study could mean either that auctions are not useful in increasing takeover premiums or that auctions are not properly designed. One explanation for this is that management participation with one party makes it too difficult for other bidders to gain information about the value of the auction.

Another empirical study shows that termination provisions resulted in more, not less, competition in the corporate takeover process.[68] This result indicates that buyers are willing to make a higher bid when they are given some sort of deal protection measure in exchange.

However, the results of this study included data that indicated sellers do shop companies before agreeing to termination provisions.[69] But in the case of go-shops, there is usually not any pre-signing market check or canvass—indeed that is the reason why the selling boards press for go-shops. For example, when Carl Icahn was negotiating to buy Lear Corporation, he informed the board that if it wanted to conduct a pre-signing market check, it could do so but he would withdraw his offer. Instead, Icahn would only consent to a post-signing market check in the form of a go-shop.[70] Because of the lack of pre-agreement market checks in transactions containing go-shop provisions, the study showing the benefits of termination fees is not applicable to go-shop transactions.[71]

II. GO-SHOP BACKGROUND

In order to analyze go-shops using auction theory, it is necessary to understand both the kinds of the transactions in which they are most often used

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66. *See* Audra L. Boone & J. Harold Mulherin, *How Are Firms Sold?*, 42 J. FIN. 847 (2007).

67. *Id.* at 848.

68. *See* Audra L. Boone & J. Harold Mulherin, *Do Termination Provisions Truncate the Takeover Bidding Process?*, 20 REV. FIN. STUD. 461 (2007).

69. *Id.* at 484.

70. *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 97 (Del. Ch. 2007).

71. Moreover, the bifurcated termination fee provisions that most go-shop deals contain would also skew the applicability of the Boone study to mergers with go-shop agreements, since the go-shop termination fee is usually lower than the customary termination fee.

as well as the way the go-shop provisions function.[72] Go-shops are an example of post-signing market checks that are designed to ensure that the selling company's board is fulfilling its *Revlon* duties in the absence of having a formal auction.[73] This first Subpart of this Part will outline how go-shops work and the ways that the provisions typically interact with other portions of merger agreements. The second Subpart will examine what kinds of transactions practicing M&A lawyers view as good candidates for go-shop as well as data indicating in what kind of transactions go-shops are actually used.

A. *An Analysis of a Typical Go-Shop*

The following example, taken from the Avaya merger agreement, is representative of the core components of current go-shop provisions:

> Notwithstanding any other provision of this Agreement to the contrary, during the period beginning on the date of this Agreement and continuing until 11:59 p.m. (New York City time) on the 50th day following the date of this Agreement (the "No-Shop Period Start Date"), the Company and its Subsidiaries and their respective officers, directors, employees, consultants, agents, advisors, affiliates and other representatives retained in connection with the Transactions (collectively, "Representatives") shall have the right to directly or indirectly: (i) initiate, solicit and encourage Takeover Proposals (as defined herein) (or inquiries, proposals or offers or other efforts or attempts that may lead to a Takeover Proposal), including by way of providing access to non-public information pursuant to (but only pursuant to) one or more Acceptable Confidentiality Agreements (as defined herein); *provided* that the Company shall promptly provide to Parent any material non-public information concerning the Company or its Subsidiaries that is provided to any Person given such access which was not previously provided to Parent or its Representatives; and (ii) enter into, engage in, and maintain discussions or negotiations with respect to Takeover Proposals or otherwise cooperate with or assist or participate in, or facilitate any such inquiries, proposals, discussions or negotiations. For the purposes of this Agreement, "Acceptable Confidentiality Agreement" means (i) any confidentiality agreement between the Company and any such Person existing as of the date of this Agreement and (ii) any confidentiality agreement entered into after the date of this Agreement that contains provisions that are no less favorable in the aggregate to the Company than those contained in the Confidentiality Agreement.[74]

There are two important features, beyond the general right of the seller or the seller's representatives to attempt to find a higher bidder. The first is the

72. When this Note uses the term "go-shop," it refers to not only the provision that allows the selling company to solicit third-party offers but also to all of the provisions that interact with the solicitation provisions such as termination fees and matching rights.

73. Igor Kirman, *Takeover Law and Practice*, *in* DOING DEALS 2007: UNDERSTANDING THE NUTS & BOLTS OF TRANSACTIONAL PRACTICE 9, 65-69 (PLI Corp. Law & Practice, Course Handbook Series No. B-1594, 2006).

74. Sierra Holdings Corp., Agreement and Plan of Merger (Form 8-K), exh. 2.1, at 33 (June 4, 2007).

limited duration of the go-shop period, which in this case is fifty days. The second is the information sharing provisions.

There are two components to information sharing. The first is that the go-shop requires any third-party bidder to sign an "Acceptable Confidentiality Agreement" with the seller in order to have access to any material nonpublic information. Second, and more important, is that the seller must agree to provide the initial buyer ("Parent" in above text) with any material, nonpublic information that the seller provides to the third-party bidder that it has not already provided to the initial bidder. This ensures that there is no way for a third-party bidder to have access to more information than the initial bidder; any information that the selling company provides to a third-party bidder must also be provided to the initial bidder under the terms of the agreement.

Buyers have generally been agreeing to go-shops of longer durations. The first go-shops lasted until the vote of the target company's shareholders.[75] In go-shops signed before 2007, the average go-shop had a duration of thirty-three days while go-shops during 2007 (before the credit market troubles and resulting slowdown in deal volume) averaged forty-two days.[76] The *Topps* and *Lear* courts allowed, under *Revlon*, go-shop provisions with a duration of forty and forty-five days respectively, but, at least in *Lear*, indicated that this period was fairly short.[77]

Agreements are increasingly utilizing the "Excluded Party" concept, allowing the seller to continue to negotiate with Excluded Parties after the end of the go-shop period. To qualify as an Excluded Party, a third party has to make a superior offer (as decided by the board of directors of the selling company) before the end of the go-shop period.[78] This has the effect of extending the go-shop period, for a subset of buyers, up until the shareholder vote on the initial merger agreement.

The two components of merger agreements that closely interact with the go-shop are the termination fees and matching rights that are given to the initial buyer. A termination (or breakup) fee is an amount that the seller must pay to the buyer if the seller decides to terminate the agreement. These provisions are common in corporate mergers, and courts uphold termination fees either because they are viewed as liquidated damages clauses or because the termination fees are thought to be within the business judgment of the selling

75. Mark W. Peters et al., *Emergence of the "Go-Shop,"* WALLSTREETLAWYER.COM: SECURITIES IN THE ELECTRONIC AGE, Apr. 2007.

76. MARK A. MORTON & ROXANNE L. LOUTMAN, GO-SHOPS: MARKET CHECK MAGIC OR MIRAGE? 5 n.19 (2007), *available at* http://www.potteranderson.com/assets/attachments/Potter_ Anderson_Go-Shops__rev.pdf.

77. *See In re* Lear Corp. S'holder Litig., 926 A.2d 94, 119-20 (Del. Ch. 2007); *In re* Topps Co. S'holders Litig., 926 A.2d 58, 86 (Del. Ch. 2007).

78. The definition of Excluded Party has generated a lot of litigation, from the Topps board decision not to qualify Upper Deck as an Excluded Party, to what happens when the entities composing the Excluded Party (in a club deal) change after the end of the go-shop period.

board. In mergers and acquisition deals generally, termination fees have a median between 2.6% and 3.0%.[79]

In go-shop deals, there has been a trend toward a bifurcated or two-tiered termination fee, with a lower termination fee payable to the initial buyer if the seller terminates the merger agreement to sign with another party pursuant to the go-shop.[80] This is the reason that the duration of the go-shop provision is so important; a seller pays a lower termination fee to the initial buyer if it terminates the merger agreement in order to sign a deal with another party pursuant to the go-shop (either during the go-shop period or with an Excluded Party). Go-shop termination fees average fifty percent of the regular termination fee, which would apply if the seller terminated the agreement pursuant to any other provision of the merger agreement.[81] In the Avaya agreement, Termination Fee is defined as:

> an amount equal to $250 million, except (x) in the event that this Agreement is terminated by the Company . . . in order to enter into a definitive agreement with respect to a Takeover Proposal with an Excluded Party, or (y) in the event that this Agreement is terminated by Parent . . . in a circumstance in which the event giving rise to the right of termination is based solely on the submission of a Takeover Proposal by a party that submitted a written Takeover Proposal prior to the No-Shop Period Start Date, in which cases the Termination Fee shall mean an amount equal to $80 million.[82]

This definition shows the importance to the seller of paying the lower go-shop termination fee. It also shows the importance of the Excluded Party concept and how it effectively lengthens the duration of the go-shop period, since including this provision leads to a lower termination fee.[83]

The final component of go-shops that is important from an auction perspective is the matching right of the initial bidder. Matching rights give the initial buyer the right to match any subsequent superior bid by a third party,

79. *See* Dennis J. Block, *Public Company M&A: Recent Developments in Corporate Control, Protective Mechanisms and Other Deal Protection Techniques*, *in* CONTESTS FOR CORPORATE CONTROL 2007: CURRENT OFFENSIVE & DEFENSIVE STRATEGIES IN M&A TRANSACTIONS 7, 109-10 (PLI Corp. Law & Practice, Course Handbook Series No. 11,243, 2007).

80. Kevin M. Schmidt, *Private Equity: Current M&A Issues for Buyers*, *in* EIGHTH ANNUAL PRIVATE EQUITY FORUM, at 99, 110 (PLI Corp. Law & Practice, Course Handbook Series No. B-1614, 2007).

81. Because of a selling company's *Revlon* duties, a selling company must be able to terminate an agreement if a better offer comes along. This clause in merger agreements is known as a fiduciary-out. *See* Kirman, *supra* note 73, at 91. The fifty percent figure comes from the MergerMetrics database used for this Note.

82. Sierra Holdings Corp., Agreement and Plan of Merger (Form 8-K), exh. 2.1, at 53 (June 4, 2007).

83. There are some deals, lacking the Excluded Party concept, in which the seller pays the higher termination fee for any deal that is signed after the end of the go-shop period, even if the second buyer has been negotiating with the selling company during the go-shop period.

prior to the seller signing another deal with a third party. Typically, matching rights are in the form of a requirement that the seller negotiate with the initial buyer in good faith for a period of days after receiving a superior proposal from a third party such that the board of the selling company no longer believes the third-party proposal constitutes a superior offer. If a deal has a matching right and a third party submits a superior bid, then the initial buyer has a chance to match the superior proposal before the third party could sign a deal with the target.

B. *Transactions Likely to Employ a Go-Shop*

The prototypical transaction for a go-shop provision is a private equity buyout of a public company where management is working with a private equity buyer.[84] In these transactions, the private equity firms "intend to retain management and often dangle continued employment and significant perks" in order to ensure that management will stay with the company after it has gone private.[85] Indeed, practitioners argue that go-shops "can be particularly useful in the management buyout context, where pre-signing auctions are difficult (due to the advantages of the bidder who is allied with management, and the difficulties of allowing management to work with multiple bidders) and where allegations of conflicts of interest and *Revlon* violations are frequent."[86]

In order to analyze the kinds of deals that use go-shops, I utilized the MergerMetrics database that contains information about the substantive provisions of merger agreements. I ran a search of the MergerMetrics database looking for merger agreements that (i) contained a go-shop provision, (ii) had public companies as targets, and (iii) were over $75 million in value. Sixty-three deals fit these criteria.

Fifty-five of the sixty-three deals were going-private transactions, in which the selling company was a public company and the buyer was not. Of these fifty-five deals, fifty-two of them were leveraged buyout (LBO) transactions. In forty-seven of these transactions, the buyer was a private equity firm or a club of private equity firms. This information is consistent with the idea that go-shop are used in going-private LBOs.

Additionally, of the sixty-three total deals, fifty-eight had cash as the only form of consideration. All of the deals that did not have cash as the only form of consideration had a cash or stock election, where the selling company shareholder could decide between cash and stock as the form of consideration. Of the fifty-five going-private deals, fifty-two had cash as the only form of consideration. This means that we can generally say that *Revlon* duties apply to

84. *See* Peters et al., *supra* note 75.

85. David H. Kistenbroker et al., *Recent Developments in Corporate Governance*, 541, 550-51 (PLI Corporate Law & Practice Course, Handbook Series No.11072, 2007).

86. Kirman, *supra* note 73, at 69.

the selling company.

It is more difficult to determine figures regarding management participation. Because of the lack of transparency in the private equity process, it is difficult to collect data for what percentage of private equity firms retained management after a buyout utilizing a go-shop. The only data that MergerMetrics has is the number of deals that were management buyouts (MBOs). Eleven of the sixty-three deals were explicitly MBOs. However, this does not mean that management was not participating in other deals by agreeing to continue to manage the company for the private equity buyers.

For example, each of the two court cases regarding go-shop provisions, *Topps* and *Lear*, is about the impact of management involvement with the buyout. Neither of these transactions was coded as an MBO by MergerMetrics. In *Lear*, investor Carl Icahn proposed taking Lear private and reached an agreement to employ management, with a substantial raise, after the buyout.[87] While, as discussed above, the *Lear* court did not find that the plaintiffs had shown a successful *Revlon* claim, the court did enjoin the shareholder vote in favor of the merger until the extent of management involvement and compensation was properly disclosed to Lear shareholders.[88] Likewise, the Topps shareholder vote was enjoined until the company properly disclosed the existence of agreements for continued employment of management after the going-private transaction.[89] From this evidence, as well as the writings by corporate lawyers involved with go-shops, it appears safe to say that management is involved with the seller in a large portion of go-shop transactions.

In terms of the more substantive provisions of go-shop transactions, forty-eight of the sixty-three total transactions, involved matching rights. The average go-shop termination fee was 1.56% of the transaction value, while the average termination fee was 3.11% of transaction value. Fifty-five of the transactions included expense reimbursement where the seller would have to pay some of the initial bidder's expenses if the seller terminated the transaction. Finally, the average go-shop duration was thirty-six days, but the more recent go-shop provisions generally include longer periods. Restricting this sample to the fifty-five going-private transactions, the average termination fee was 3.15%, the average go-shop termination fee was 1.53%, the average go-shop period was thirty-seven days, forty-eight of the transactions included expense reimbursement, and forty-three of the deals had matching rights.

In summary, go-shop deals typically are going-private transactions with management working with the private equity buyer. These transactions also typically grant the initial buyer expense reimbursement, a bifurcated termination fee, and matching rights.

87. *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 108 (Del. Ch. 2007).

88. *Id.* at 114-15.

89. *See In re* Topps Co. S'holder Litig., 926 A.2d 58, 74, 92-93 (Del. Ch. 2007).

III. APPLYING THE THEORY TO THE FACTS

Having reviewed auction theory as it relates to corporate merger transactions and explained the common features of go-shop provisions, this Note will now examine whether or not Strine's conclusions about go-shops, management involvement, and value maximization are correct from a theoretical perspective. This Part will focus on six key features of transactions that utilize go-shops: (1) duration, (2) termination fees (and expense reimbursement), (3) matching rights, (4) information-sharing provisions, (5) financial buyers, and (6) management participation. Before beginning any analysis, the reader should recall that companies (targets) are considered to have a common value to financial buyers while companies have a private value to entities that are considering buying for strategic reasons.

While duration does not have a direct impact from an auction theory perspective, there are at least some questions as to whether it is possible for a prospective buyer to conduct all of the negotiations and conduct all of the due diligence necessary to sign a merger agreement within the go-shop period.[90] However, because of the increased use of the Excluded Party concept, concerns about go-shop duration are less important than they were before. Because of the importance of getting a deal done, a selling company should be particularly mindful of including a go-shop provision to give prospective buyers enough time to complete a deal.

For all intents and purposes, expense reimbursement impacts subsequent bidders in the exact same way as a termination fee, so the analysis of termination fees applies to expense reimbursement as well. A termination fee paid by the seller to the initial bidder lowers the value of the company by the amount of the fee to all subsequent bidders, making it less likely that subsequent bidders will be willing to bid.[91] For example, if there is a Termination Fee (F) payable to Bidder One (B1) if the seller terminates the contract with B1, then Bidder Two's (B2) valuation for the target has to be reduced by the amount of the fee. B2 will only choose to bid for the company if the bid is less than B2's value minus the fee (bid only if bid =< (B2's Value minus F)). In go-shop deals, this means that on average, any second bidder is going to have to value the company at least 1.56% (plus expenses for the first buyer) more if it is going to pay the go-shop termination fee or by at least 3.11% more than the initial buyer if it is going to pay the standard termination fee. So the bifurcated structure does lessen the extent to which the termination fees should discourage second-bidders from entry.

The effect of termination fees is particularly strong in common-value auctions, since any potential bidder has to consider the potential for the winner's curse that would result if the bidder paid more than the target was

90. *See In re Lear Corp. S'holder Litig.*, 926 A.2d at 119.
91. *See* Cramton & Schwartz, *supra* note 40, at 37.

actually worth. Termination fees can be overcome in private-value auctions, since each bidder will simply bid up to its own valuation for the target, and as long as a bidder has a private valuation greater than the initial bid plus the termination fee, it will decide to bid. The combination of these results indicates that including a termination fee would make it more difficult for a financial (common-value) bidder to bid against a termination fee while a strategic (private-value) bidder would be willing to enter. So, including a termination fee should discourage financial buyers to bid against the initial bidder. However, since go-shop transactions typically utilize a bifurcated termination fee, the lower termination fee during the go-shop period will lessen the impact that the termination fee has on discouraging subsequent bidders, but it still gives the initial bidder an advantage.

Auction theory also indicates that matching rights will discourage further bidding. In a transaction with matching rights, any subsequent bidder will realize that the initial bidder will likely match any bid as long as the initial bidder will still make a profit. As with termination fees, this consideration will result in different outcomes for different types of bidders. If the first bidder is a financial buyer, then the financial bidder will keep matching until it reaches its estimate for the value of the company. However, if the initial bidder were a strategic bidder, then any potential bidder applying auction theory would reason that the strategic bidder would bid up to its private value.

A potential bidder will make a determination about whether or not to enter the auction based on its prospects for winning. Because the initial bidder in go-shop transactions is usually a financial bidder, analysis will be limited to that case. A financial buyer considering whether or not to enter should only enter if it has reason to believe it can more accurately estimate the value of the target company than the initial financial bidder. If the second financial bidder were to win the auction despite having a worse estimate for the value of the company, it would be likely to face the winner's curse.

As was the case with termination fees, matching rights should impact strategic bidders less, since they will simply bid up to their own private value and will not be subject to the winner's curse. However, a strategic bidder does not have an accurate estimate of the financial bidder's value of the company, so it might be concerned that the financial bidder has a higher value than it and any expenditures on making a bid would just be a wasted cost.

Information, specifically information that allows for a better estimate of the value of the target company, plays a critical role in common-value auctions. Any disparity in information in a common-value setting will lead the seller to have lower expected revenue. Recall that there is no way for a bidder with only publicly available information to win an open-outcry ascending-bid common-value auction at an expected profit. Furthermore, other financial bidders will be discouraged from bidding against a party that has better information because they will not have an expected profit.

The way that information rights are structured in go-shop provisions ensures that the second buyer cannot have better information than the initial bidder. This is because, as can be seen in the representative Avaya agreement, if the selling company gives any "material nonpublic information" to a second bidder that the company has not already provided to the initial bidder, then the selling company must provide that same information to the initial bidder. This structure ensures that the first bidder will always have information at least as good as a second bidder, regardless of the motivations of the target's board of directors and management. The very structure of the go-shop provisions ensures this. This informational advantage, combined with a matching right and a termination fee discussed above, gives the initial buyer a significant advantage in the auction process.

Management participation only serves to further skew the table in favor of the initial bidders, since the initial bidders are typically working with management. There is every reason to think that management's estimates for the value of the company would be more accurate than any other potential buyer.[92] Because the initial bidder is usually working with target management, there is every reason to think that the second bidder will have a *less accurate* estimate for the value of the company than the initial bidder. Since management is most likely to have the best information or estimate of the value of a company, any financial bidder that outbids management will, on balance, be likely to have overbid for the target, potentially subjecting itself to a chance of suffering the winner's curse. This will discourage other financial bidders from entering into a bidding contest *even if they know that the initial bid is too low*. Knowing that other less-informed financial bidders are unlikely to bid, the initial financial bidders have an incentive to bid even more aggressively (i.e., lower). This has the effect of lowering the seller's expected revenue from selling the company.

Recall the comparison between a common-value auction and an auction for a wallet containing cash. In the case of selling a company to a common-value bidder, the selling company is like the wallet. Management is going to have a better idea how much money is in the "company wallet" than any other party. Just as Person B would not want to bid against Person A for the content's of Person A's wallet, no financial buyer would want to bid against a financial buyer working with management. It is costly to enter an auction and there is too big of a risk that if the second bidder were to win the auction, it would do so by paying more than the company is worth.[93]

The combination of termination fees, expense reimbursement, and

92. *See* Povel & Singh, *supra* note 36, at 1399.

93. There is a common theory that private equity firms are not willing to jump each other's bids as some sort of gentlemen's agreement. *See* Andrew Ross Sorkin, *A Rival TXU Bid Could Lead to a Brawl in the Cozy World of Private Equity*, INT'L HERALD TRIB., Feb. 28, 2007, at 16, *available at* http://www.iht.com/articles/2007/02/28/business/txu.php. Perhaps private equity firms know auction theory and realize that an attempt to jump an advantaged bidder is a losing proposition.

management involvement all indicate that financial bidders should be reluctant to make jump bids. Common-value auctions are the exact situations in which asymmetries in information that are created by management participation with one of the parties have a dramatic negative impact on expected revenue for the seller. Additionally, the bidding or entry costs in the form of termination fees and matching rights exacerbate this effect.[94] However, private-value bidders, such as strategic buyers, should be willing to make a jump bid provided that their private value can overcome the cost of the termination fee and expense reimbursement that must be paid to the initial bidder. These predictions are supported by the data. In the sixty-three deals that utilized go-shop provisions, there have been nine deals with jump bids.[95] Furthermore, there were jump bids in none of the eleven MBOs containing go-shops, another indication that the presence of management discourages additional bidders.[96]

Of the nine jump bids that were made, strategic buyers made seven. One of the other two bids, for Catalina Marketing Corporation, was made by a financial buyer in a situation where the initial buyer was the largest shareholder in the company and made the bid with the "expectation that the [selling company] can obtain an even higher value." That kind of statement hardly makes a financial buyer wary of either uncooperative management or a bidding war leading to winner's curse. The other jump bid, for Aeroflex, does not appear to fit the pattern predicted by the theory and is an anomaly. However, I was also unable to find any information regarding management participation with either of the buyers, so it is possible that management did not participate, removing some of the information asymmetries that would be obstacles to a financial jump bid.

Finally, the situations in which go-shops are used are the exact type of situations in which theory predicts auctions will result in higher revenue than sequential mechanisms. For sequential mechanisms to have higher revenue, there needs to be multiple entrants (and there were never more than two entrants in the deals with go-shops). The go-shop structure precludes the possibility of a seller threatening to subsidize additional bids, which would also increase the expected revenue of sequential mechanisms.

Additionally, recall the problems that a selling company has committing to reject a higher bid that occurs outside of the design of the auction mechanism. There is some indication in the literature that the only way for a sequential mechanism to generate superior results compared with an auction is to credibly commit to the mechanism design.[97] Because a board can never truly commit to rejecting a bid (i.e., cannot credibly commit to any single auction strategy), a

94. *See supra* text accompanying note 43.

95. For a breakdown of these deals, see *infra* Appendix.

96. Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, BUS. LAW. (forthcoming May 2008) (manuscript at 27), *available at* http://ssrn.com/abstract=1084586.

97. *See* Povel & Singh, *supra* note 36, at 1401, 1426.

company should lean toward conducting an auction rather than using a sequential mechanism.

IV. RECOMMENDATIONS GOING FORWARD

Having looked at auction theory and seen the predictions that it makes for merger agreements, Strine was only partially correct when he said that he could "perceive no reason why a strategic or financial bidder would have believed that Icahn's relationship with Lear's management made a topping bid inadvisable."[98] Auction theory predicts, regardless of the motivations of the target's board of directors, that management involvement, information-sharing rights, matching rights, and termination fees that are typically present in go-shop deals, all create a stacked deck in favor of the initial bidder. Financial bidders will (or should) be reluctant to become a second bidder in a go-shop situation. However, the structure of go-shops is not as substantial of an obstacle to strategic bidders, and they could be willing to bid against an initial private equity buyer, provided they have a higher private valuation.

But, given the constraint of being unable to commit to any auction form other than open-outcry ascending bid, what can boards of directors do in order to structure go-shops such that financial buyers will be willing to bid?[99] Ideally, target boards would simply conduct a pre-signing auction. But this may not be possible as selling boards cannot be too aggressive in their negotiations because a buyer can always abandon a deal if a selling company will not agree to the buyer's desired terms.

One of the major obstacles, management involvement, appears to be difficult to overcome. It would be extremely difficult to prevent management from having contact with private equity firms, but courts should be wary of approving deals in which the initial bidder has agreed to hire management after the buyout, such as what occurred in the Topps company buyout. Perhaps courts or boards could discourage management from making contracts for continued employment or even discussing the possibility of continued employment until after the merger agreement is signed or approved by shareholders.[100] However, this could discourage private equity firms to bid for public companies, since the private equity firms might think that the target companies are worth more being run by current management.

A second path of reform would be for selling boards to push against the explicit information-sharing provisions in go-shops that ensure that the initial bidder has information at least as good as any third-party bidder. It is not clear if any initial bidder would agree to a deal with such a term, however.

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98. *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 121 (Del. Ch. 2007).

99. The best solution may lie in having another type of auction but this is precluded by Delaware Law. *See supra* notes 25 and 26 and accompanying text.

100. Subramanian, *supra* note 96, at 27-28, independently makes this same suggestion.

Another item that selling boards could try to negotiate for is the ability to subsidize a second bidder, in the form of expense reimbursement. The ability to subsidize a second bidder would mean that the initial bidder would at least face the risk of a second bidder, and would lead to higher expected revenue for the seller. This is because a seller has higher expected revenue the more bidders there are in the auction. Even securing the right to subsidize a second bidder would also have positive revenue effects, since the threat of a competing bidder leads to higher expected revenue.

CONCLUSION

In the end, there is no clear answer to value maximization when selling a company. However, auction theory does suggest that target boards of directors should push for conducting a true pre-signing auction rather than quickly signing a deal containing a go-shop granting the initial buyer information rights, a termination fee, expense reimbursement, and matching rights. This is especially true for companies that are selling themselves to financial buyers, since go-shops have structures that discourage bidding wars between financial buyers. Management involvement with the initial private equity bidder only increases the advantages that are given to the initial bidder, since it gives the initial bidder better information about the value of the target. Despite appearing to encourage additional bidders and a post-signing auction, go-shop provisions are structured in a way that discourages financial buyers from bidding for the company.

APPENDIX: JUMPED DEALS

According to the MergerMetrics database, there have been eight deals containing go-shop provisions that have had a jump bid.[101] A jump bid is a situation in which a third-party makes a bid on a company after an initial merger agreement has been signed. This appendix will provide a summary of each of the jump bids and show that, consistent with the predictions of auction theory, the majority of jump bids have come from strategic bidders. The two situations where financial bidders jumped other financial bidders can be explained by special circumstances that are not accounted for in auction theory. The following chart shows all of the jumped bids:

Announced	Target Name	Initial Acquirer	Initial Bid	Jump Bidder	Jump Bid Successful	Jump Bid	Jump Bidder Type
6/1/07	Everlast Worldwide Inc.	The Hidary Group LLC	26.50	Brands Holding Limited	Yes	33.00	Strategic
5/16/07	Bausch & Lomb Inc.	Warburg Pincus Partners LLC	65.00	American Medical Optics	No	75.00	Strategic
3/6/07	The Topps Company Inc.	Investor Group	9.75	Upper Deck	No	10.75	Strategic
3/2/07	Aeroflex Incorporated	Investor Group	13.50	Veritas	Yes	14.50	Financial
2/21/07	Catalina Marketing Corporation	ValueAct Capital Partners, L.P.	32.10	Hellman & Friedman LLC	Yes	32.50	Financial (see below)
2/5/07	Triad Hospitals Inc.	Investor Group	50.25	Community Health Systems	Yes	54.00	Strategic
5/19/05	Maytag Corp.	Investor Group	14.00	Whirlpool Corporation	Yes	21.00	Strategic
5/17/04	The Chalone Wine Group, Ltd.	Domaines Barons de Rothschild (Lafite) SCA	11.75	Diageo North America Inc.	Yes	14.25[102]	Strategic

Note: All bids are dollars per share.

101. Note that in the case of Beverly Enterprises, Inc., the second deal emerged not as a result of the go-shop, but because the initial buyer failed to find the necessary financing. Because of this, the deal is not included.

102. Also, the shareholders of Chalone received a "wine credit" of $1.00 per share in the Diageo buyout. *See* Chalone Wine Group Ltd., Current Report (Form 8-K), exh 99.1 (Dec. 20, 2004).

Below are short summaries of all of the jump bid transactions:

1. Everlast Worldwide, Inc.: Everlast Worldwide is a maker of boxing and other fitness sporting equipment.[103] On June 1, 2007 Everlast announced a $146 million buyout by the Hidary Group, an investment group based in New York.[104] Pursuant to the thirty-day go-shop period Everlast announced on June 28, 2007, that Brands Holdings, a U.K.-based company owned by Sports Direct, which in turn owned a "portfolio of internationally-recognized sports and leisure brands," would instead acquire it for $30.00 per share.[105] The same day, Everlast announced an amended merger agreement with Brands Holdings for $33.00 per share.[106] Since both Everlast and Sports Direct are makers of fitness-related equipment, it is clear that Sports Direct is a strategic acquirer.

2. Bausch & Lomb, Inc.: Bausch & Lomb is a maker of ophthalmological products. On May 16, 2007, Bausch announced that private equity firm Warburg Pincus would acquire it for $3.7 billion or $65.00 per share.[107] Advanced Medical Optics (AMO), another eye-health products maker, made a $4.3 billion—$75.00 per share—bid to acquire Bausch pursuant to the fifty-day go-shop period in the Warburg Pincus deal.[108] Eventually, AMO withdrew the offer because of pressure from one of its own shareholders, ValueAct Capital.[109] Both AMO and Bausch are eye-health products manufactures, so the acquisition would have been strategic.

3. The Topps Company, Inc: Topps is a maker of baseball cards, other trading cards and bubblegum.[110] A private equity group led by former Disney CEO Michael Eisner signed an agreement to buy Topps for $9.75 per share. At the forty-day go-shop period, Upper Deck made an offer to acquire Topps for $10.75 per share. The Topps board decided not to treat Upper Deck's proposal as a Superior Proposal and, somewhat inexplicably, declined to treat Upper Deck as an Excluded Party.[111] The case ended up going into litigation. Ultimately, the Topps shareholders approved Eisner's buyout.[112] Upper Deck, like Topps, is a baseball card manufacturer and the acquisition would have been strategic.

4. Aeroflex, Inc.: Aeroflex designs, develops, and manufactures technology that is used in the aerospace, cellular communications, defense and broadband

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103. Everlast Worldwide, Inc., Current Report (Form 8-K), exh. 99.1 (June 1, 2007).

104. *Id.*

105. Everlast Worldwide, Inc., Current Report (Form 8-K), exh. 99.1 (June 28, 2007).

106. *Id.*

107. Bausch & Lomb, Inc., Current Report (Form 8-K), exh. 99.1 (May 16, 2007).

108. Rhonda L. Rundle, *Advanced Medical Withdraws Bausch Bid*, WALL ST. J., Aug. 2, 2007, at A3.

109. Rhonda L. Rundle, *Advanced Medical's Offer for Bausch May Unravel*, WALL ST. J., July 12, 2007, at A11.

110. *See In re* Topps Co. S'holder Litig., 926 A.2d 58, 60 (Del. Ch. 2007).

111. *Id.* at 71-72.

112. Topps Co., Inc., Current Report (Form 8-K) (Sept. 20, 2007).

communications industries.[113] On March 2, 2007, Aeroflex entered into an agreement to be acquired by an investment group for $13.50 per share.[114] The investment group consisted of two private equity firms, General Atlantic LLC and Francisco Partners II, L.P.[115] Pursuant to the forty-day go-shop, on May 25, 2007, Aeroflex announced that it had entered into a merger agreement with another financial investment group, to be acquired for $14.50 per share in cash.[116] General Atlantic and Francisco Partners waived their matching rights under the initial merger agreement.[117] Finally, General Atlantic and Francisco Partners sued Aeroflex claiming that they should have been paid the termination fee rather than the go-shop termination fee because members of the second investment group were not excluded parties under the initial merger agreement.[118] This litigation is still being resolved in the Delaware courts. The Aeroflex merger does not fit with the predictions made by auction theory and cannot be explained from any publicly available information.

5. Catalina Marketing Corporation: Catalina is another situation where the jump bidder is a financial buyer, but the initial buyer in this case bought the company specifically in order to generate other bids. Initially, ValueAct Capital, Catalina's largest shareholder, signed a merger agreement to buy the company for $32.10 per share.[119] ValueAct is an activist fund, and before making its proposal to acquire Catalina, it sent a letter to Catalina's Board of Directors stating:

> ValueAct Capital makes this proposal to provide a high premium value to the Company's shareholders and at the same time further the sale process that the Company announced on December 8th *in the hope and expectation that the Company can obtain an even higher value*. The special committee of the board of directors terminated the sale process prematurely, before it had run its course in developing the best proposals possible.[120]

This letter indicates that ValueAct was trying to stimulate the sale process of Catalina and to get another bidder to bid more for the company. Also, this portion of the letter does not make it appear as though ValueAct had an intention of getting into a bidding war with another financial buyer or putting another financial buyer at a risk of suffering the winner's curse. As it happened, private equity firm Hellman Friedman offered $32.50 per share in cash (40 cents more than the ValueAct bid) and Catalina agreed to the offer.[121]

113. Aeroflex Inc., Current Report (Form 8-K) (Mar. 5, 2007).

114. *Id.*

115. *Id.*

116. Aeroflex Inc., Current Report (Form 8-K) (May 25, 2007).

117. *Id.* exh. 99.1.

118. Aeroflex Inc., Current Report (Form 8-K) (June 5, 2007).

119. Catalina Mktg. Corp., Current Report (Form 8-K), exh. 99.1 (Mar. 8, 2007).

120. Catalina Mktg. Corp., (Sched. 13D), exh. 2, at 15 (Feb. 21, 2007) (emphasis added).

121. Catalina Mktg. Corp., Current Report (Form 8-K), exh. 99.1 (Apr. 17, 2007).

However, the excerpt from the letter from ValueAct to the Catalina board shows that ValueAct was practically begging for another financial firm to make a bid.

6. Triad Hospitals, Inc.: Triad owns and operates hospitals and surgery centers around the country.[122] On February 5, 2007, an investor group led by CCMP Capital Advisors LLC and Goldman Sachs signed a deal to acquire Triad for $50.25 per share, giving Triad a forty-day go-shop period.[123] On March 19, Triad announced that it had agreed to be acquired by Community Health Systems, another hospital operator, for $54.00 per share.[124] The combined Community/Triad entity represents the largest publicly traded hospital chain.[125] Needless to say, Community is a strategic acquirer.

7. Maytag Corporation: Maytag makes home and commercial appliances.[126] On May 19, 2005, Maytag announced that it had entered into a merger agreement with an investor group to buy all of Maytag's stock for $14 per share and take the company private.[127] On August 22, Maytag announced that appliance maker Whirlpool Corporation had offered $21 per share for Maytag, and that Maytag had entered into an agreement with Whirlpool.[128] This combination of the two appliance makers is a strategic acquisition for Whirlpool. Additionally, it is not clear that the go-shop played any role in getting Whirlpool to bid. Whirlpool's bid for Maytag came *after* the expiration of the go-shop period, when the agreement called for Maytag to be in "no shop" mode.

8. Chalone Wine Group, Ltd.: On November 1, 2004, Chalone, a wine manufacturer, agreed to be acquired by fellow-wine maker Domaines Barons de Rothschild (Lafite) SCA (DBR) for $11.75 per share.[129] Pursuant to the go-shop with DBR, on December 20, 2004, Chalone announced that it had signed an agreement to merge with Diageo, an international beer, wine, and liquor producer, for $14.25 per share plus a $1.00 per share wine credit for all Chalone stockholders.[130] This is a different situation, since there is no financial buyer involved. As such, auction theory predicts that each party will bid up to its own private value and that potential second bidders will not be discouraged from bidding.

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122. Theo Francis, *Community Health to Acquire Rival Triad*, WALL ST. J., Mar. 20, 2007, at A3.

123. *Id.*

124. *Id.*

125. *Id.*

126. Maytag Corp., Current Report (Form 8-K), exh. 99.1 (May 19, 2005).

127. *Id.*

128. Maytag Corp., Current Report (Form 8-K), exh. 99.1 (Aug. 22, 2005).

129. Chalone Wine Group Ltd., Current Report (Form 8-K), exh 99.1 (Nov. 1, 2004).

130. Chalone Wine Group Ltd., Current Report (Form 8-K), exh 99.1 (Dec. 20, 2004).