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No-shop vs. Go-shop: New Trends in Mergers & Acquisitions

{By Blair Horn}

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A new trend is emerging on the mergers and acquisitions landscape. While M&A deals frequently include no-shop clauses that prevent boards from soliciting higher offers, some companies are now negotiating provisions that allow for the opposite result. These provisions are aptly named go-shop clauses.

No-shop clauses have been commonly used in merger and support agreements in both the U.S. and Canada for some time now. The no-shop clause prohibits the target company from soliciting bids from other buyers. However, in order to ensure the board of directors of the target company is not in breach of its fiduciary duties, no-shop clauses generally allow the board to respond to superior unsolicited bids. In such cases, the target company usually gives the original buyer an opportunity to match the bid. If the original bidder does not match the superior bid, merger agreements generally provide for break fees to be paid to the original buyer.

The transactional motivations behind a no-shop clause are easy to appreciate. Due diligence on a potential purchase, combined with senior management resources diverted away from daily business operations to engage in M&A negotiations, is expensive and time-consuming. Buyers want to protect themselves from incurring significant expenses and coming up empty-handed. Where a target board has actively auctioned the company for the best buyer, a target board should be able to accept a customary no-shop clause without significant concern for claims that they may have failed to perform their fiduciary duties by agreeing to a no-shop. However, where a board has failed to shop a deal thoroughly, the company's shareholders may question whether the offer represents the best price for the company.

Go-shop clauses, while relatively unusual in Canada, are becoming more common in the U.S. One of the early high profile transactions in the U.S involved Maytag Corp. The board of directors of Maytag used a go-shop clause to shop Maytag after announcing its proposed sale to Ripplewood Holdings, LLC for $14.00 per share. Ultimately, a higher offer was obtained from Whirlpool Corp., which paid $21.00 per share, and Ripplewood walked away with $40 million in break fees. Airsource Power Fund I LP was the first to use a go-shop clause in Canada. The Support Agreement with Algonquin Power Income Fund allowed the Airsource Independent Liquidity Committee to solicit competing offers without providing matching rights or a break fee.

A go-shop clause allows the target board to actively shop for additional buyers that will pay a higher price after the board has agreed to a deal with an initial buyer. In concept, this provides the opportunity for the target company to obtain better value for its shareholders by using the initial bid as a floor price in the

market. Go-shop clauses developed, in part, from the scepticism shareholders have for management-led buyouts. They are meant to reassure shareholders that the target company's board of directors is fulfilling its fiduciary duties and getting the best deal possible. Go-shop clauses have the benefit of promoting greater transparency and openness by allowing the target board to actively seek offers, as opposed to restricting the company to only reacting to unsolicited competing offers.

Although go-shop clauses can be helpful to target company boards in ensuring proper exercise of fiduciary duties, they have seen their share of criticism. It has been suggested that go-shop clauses are a disingenuous device used by target boards to shield themselves from claims by shareholders after the deal closes. Though they offer boards the ability to solicit additional offers, go-shop clauses generally only provide for a 30-50 day solicitation period. This does not give a latecomer much time to conduct proper due diligence, make a reasoned acquisition decision and complete negotiations. Furthermore, go-shop clauses are costly. Significant break fees are generally demanded as the trade-off for the flexibility of shopping the deal after reaching an agreement with the initial buyer. The timing and risk involved in being a latecomer to a deal may minimize the number of potential buyers and consequently higher offers. The break fee ultimately inflates the purchase price that is paid by the new bidder but the fee goes to the initial buyer, not the shareholders. Finally, there is evidence to support a conclusion that go-shop clauses do not result in better offers. A recent U.S. study shows that of 14 deals involving go-shop provisions since 2004, only 3 resulted in higher offers.

Sophisticated investors recognize that go-shop clauses may not ensure the best deal possible. In February 2007, Evercore Asset Management, LLC announced that it would vote against a proposal from Carl Icahn's American Real Estate Partners L.P. to purchase Lear Corporation. The proposal included a 45-day go-shop clause, as well as an $85 million break fee and a $15 million expense reimbursement. EAM stated it felt the offering price was too low and that the go-shop clause effectively handicapped the process in favour of Mr. Icahn by imposing significant time restrictions on other parties' ability to assess the transaction. It remains to be seen what EAM will do if in fact no other purchasers surface through the go-shop process. [The 45-day period had not yet expired at the time of publishing.]

While still a new concept in Canada, participants in the Canadian M&A marketplace should anticipate increased usesuse of go-shop clauses, particularly where a target company has not had the opportunity to adequately canvass potential buyers or otherwise conduct an auction process. Each deal will need to be analyzed independently to determine whether the use of a go-shop clause is appropriate. However, where a company has conducted an unrestricted auction process or there is a premium on the purchase price that is sufficiently high, it is less likely that a purchaser will agree to a go-shop clause.

Courtesy of Blair Horn, Partner, with assistance from Katey Grist, Articled Student, of Fasken Martineau DuMoulin LLP, Vancouver. Visit www.fasken.com