GO-SHOPS REVISITED

Guhan Subramanian & Annie Zhao

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A go-shop process turns the traditional M&A deal process on its head: rather than a pre-signing market canvass followed by a post-signing "no shop" period, a go-shop deal involves a limited pre-signing market check, followed by a post-signing "go shop" process to find a higher bidder. A decade ago one of us published the first systematic empirical study of go-shop deals. Contrary to the conventional wisdom at the time, the study found that go-shops could yield a meaningful market check, with a higher bidder appearing 13% of the time during the go-shop period. In this Article, we compile a new sample of M&A deals announced between 2010 and 2019. We find that go-shops, in general, are no longer an effective tool for post-signing price discovery. We then document several reasons for this change: the proliferation of first-bidder match rights, the shortening of go-shop windows, CEO conflicts of interest, investment banker effects, and collateral terms that have the effect of tightening the go-shop window. We conclude that the story of the go-shop technology over the past ten years is one of innovation corrupted: transactional planners innovate; the Delaware courts signal qualified acceptance; and then a broader set of practitioners push the technology beyond its breaking point. In view of these developments in transactional practice, we provide recommendations for the Delaware courts and corporate boards of directors.

INTRODUCTION

Until approximately 2005, the traditional sale process for U.S. public companies involved a broad market canvass and a merger agreement with the winning bidder, followed by a "no shop" obligation for the seller between the signing and the closing of the merger. In the mid-2000s, however, the introduction of the "go-shop" technology turned this standard deal template on its head. In its purest form, a go-shop process involves an exclusive (or nearly exclusive) negotiation with a single buyer, followed by an extensive post-signing "go shop" process to see if a higher bidder can be found.

The first go-shop transaction appeared in Welsh, Carson, Anderson & Stowe's buyout of US Oncology in March 2004.[1] Go-shops proliferated quickly after that, particularly in private equity (PE) buyouts of public companies. Many commentators at the time were skeptical of

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[1] *See* Mark A. Morton & Roxanne L. Houtman, *Go-Shops: Market Check Magic or Mirage?* (Potter, Anderson & Corroon, LLP, Wilmington, Del.), Feb. 2008, app. at 43.

go-shops.[2] The conventional wisdom held that go-shops amounted to nothing more than a fig leaf to provide cover for management to seal the deal with its preferred bidder, while insulating the board against claims that it failed to satisfy its obligation to maximize value for the shareholders in the sale of the company.

A decade ago, one of us published the first systematic empirical assessment of go-shops (Original Study).[3] The sample included all PE buyouts announced between January 2006 and August 2007 (n=141), including forty-eight deals that involved go-shop processes.[4] In contrast to practitioner and academic commentary at the time that was generally skeptical of go-shops, the Original Study found that go-shops frequently identified higher bidders during the go-shop period, and that sellers extracted slightly higher prices from the original bidder in exchange for pre-signing exclusivity.[5] Subsequent studies have generally confirmed these empirical findings.

Today, go-shops are a common tool for PE buyouts of public companies. In view of the earlier empirical findings and the general view today that go-shops can be meaningful, the continued deployment of go-shops might be viewed as a positive development in the evolution of public-company mergers and acquisitions (M&A). However, in this Article we present new evidence suggesting that go-shops have become less effective as a tool for price discovery since the time frame of our earlier empirical analysis. The Original Study, which examined deals announced in 2006–2007, reported that a higher bid emerged during the go-shop period 12.5% of the time (6 instances out of 48 go-shop deals).[6] Using a new database of M&A transactions over the past ten years, we find that the jump rate in the 2010–2019 time frame was 6.1% (7 out of 114 go-shops), declining to 4.3% (2 out of 46) in the period from 2015–2019.[7]

This decline in jump rates cannot be explained by straightforward factors, such as uniformly shorter go-shop periods or an increase in go-shop termination fees. Delaware courts have emphasized the importance of these factors for structuring a meaningful go-shop process,[8] and practitioners, not surprisingly, have taken that guidance. As with other areas of transactional practice, the lawyers, bankers, and princi-

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[2] *See infra* note 16 and accompanying text.

[3] Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729 (2008) [hereinafter *Original Study*]; *see also* Jin Q Jeon & Cheolwoo Lee, *Effective Post-Signing Market Check or Window Dressing? The Role of Go-Shop Provisions in M&A Transactions*, 41 J. BUS. FIN. & ACCT. 210, 213 (2014) ("Subramanian (2008) is the first study that empirically examines the go-shop provision in takeover agreements.").

[4] *Original Study*, *supra* note 3, at 730, 742.

[5] *Id.* at 748–50, 753–55.

[6] *See id.* at 744 fig.1, 749 tbl.3.

[7] *See infra* pp. 1230–31.

[8] *See, e.g.*, *In re* Del Monte Foods Co. S'holders Litig. 25 A.3d 813, 818–19 (Del. Ch. 2011).

pals are far better than that at burying their handiwork. The real explanation requires deeper digging into structural and contextual factors involving go-shops.

Match rights, for example, which were just beginning to appear at the time of the Original Study, are now ubiquitous. Match rights give the initial buyer the right to match any new offer received during the go-shop period. Basic game theory indicates that match rights will deter prospective third-party bidders. In addition, go-shop windows are no longer as sensitive to deal size as they were in the Original Study. The result is shorter go-shop windows in larger deals, which amplifies information asymmetries and "winner's curse" concerns. Shorter go-shop windows also make consortium bids more difficult, which are particularly important for larger deals. These developments reduce the effectiveness of go-shops as a tool for price discovery.

Conflicts of interest for management also hinder the effectiveness of go-shop processes. CEOs often have a financial incentive to keep the deal price down, which means discouraging potential third-party bids during the go-shop process. And in some instances, CEOs have undisclosed qualitative reasons for discouraging third-party bids.

Conflicts of interest among the investment bankers can also reduce the effectiveness of go-shops. For example, in the incestuous world of PE, the sell-side banker's financial incentives to please the buyer (who does not want an overbid) may be larger than the banker's financial incentives to find a higher bidder during the go-shop period. Alternatively, or in addition, the buyer's bankers may discourage prospective buyers from meaningful participation in the go-shop process. This Article presents a taxonomy of these conflicts and provides examples of each. This Article also documents how boards fail to form special committees that might adequately cleanse these conflicts.

A final category of reasons that can reduce the effectiveness of the go-shop process involves the technical details of the go-shop itself. Some deals have tightened the "Excluded Party" definition, making it more difficult for prospective third parties to perceive a pathway to success. Through a complex interaction of deal terms, some buyers have achieved a "back-door" tightening of the Excluded Party definition. These seemingly technical adjustments to the legal terms of the go-shop can significantly reduce the effectiveness of the go-shop as a tool for price discovery.

At the highest level, the story of the go-shop technology over the past ten years is one of innovation corrupted: transactional planners innovate, the Delaware courts signal qualified acceptance, and then a broader set of practitioners push the technology beyond its breaking point. This trajectory has a venerable pedigree. Mortgage securitization unquestionably created enormous value for society in the 1970s and 1980s, but practitioners pushed this technology too far by the 2000s,

leading to the financial crisis of 2008–2009.[9] Likewise, the proliferation of derivatives unquestionably created enormous value in the 1980s and 1990s, but the distortion and eventual corruption of this new technology led to the Enron debacle of 2003.[10] In view of this (no doubt) eternal dance between practitioners and their regulators, this Article concludes with specific recommendations for the Delaware courts and transactional planners in the realm of go-shop processes.

At stake are general policy goals involving allocational efficiency in the M&A marketplace. Economists generally agree that social welfare is maximized when assets flow to their highest and best use; while lawyers, bankers, and principals on the buy side (and sometimes on the sell side) want to maximize deal certainty rather than allocational efficiency. Corporate law must therefore police the deal process to ensure that business objectives and professional interests do not crowd out desirable policy goals. Go-shops can facilitate allocational efficiency if (but only if) they are structured properly. This Article presents evidence that the go-shop deal technology has moved away from fulfilling its potential as a tool for allocational efficiency over the past ten years. It also proposes specific interventions for practitioners and courts to set things back on course.

I. BACKGROUND

A. The Development of Go-Shops

In 1985, the Delaware Supreme Court held in *Revlon v. MacAndrews & Forbes Holdings, Inc.*[11] that when a "sale" or "break-up" of the company becomes "inevitable," the directors' duties shift from "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[12] Virtually all PE buyouts of public companies are subject to examination under the *Revlon* standard because target shareholders are typically getting cashed out of the company. The traditional way in which sell-side boards fulfill this "*Revlon* duty" is by canvassing the market, then signing a merger agreement with the highest bidder.[13] Traditionally, public companies canvass the market in a pre-signing process, then announce the deal with the

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[9] *See* Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 44–51 (2009).

[10] Geoffrey Etherington & Brian P. Iaia, *Regulation of Derivatives in a Post-Enron World*, 18 ANDREWS CORP. OFFICERS & DIRECTORS LIABILITY LITIG. REP. 10 (2002).

[11] 506 A.2d 173 (Del. 1986).

[12] *Id.* at 182.

[13] For more detail on the traditional deal process, see Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621, 647–48 (2003).

winning bidder. Once the deal is announced, the merger agreement typically includes a "no shop" (sometimes called a "window shop") clause, in which the target agrees not to actively solicit other buyers during the three- to six-month window between the signing and closing. The target board will nevertheless insist on a "fiduciary out," which allows the board to negotiate with a third party who might be able to make a superior offer. If a higher bidder emerges during this post-signing period, the target will be required to pay the initial bidder a breakup fee (also known as a "termination fee"), typically amounting to two to four percent of the deal value.[14]

Enter the go-shop clause. In the purest form of a go-shop, a buyer approaches the target with an indication of interest. Rather than canvassing the marketplace at this point, the target will negotiate exclusively, in exchange for confidentiality and standstill agreements. If the parties reach agreement during this period, the deal is announced. The go-shop provision in the merger agreement allows the seller to affirmatively solicit other buyers for twenty to sixty calendar days, in sharp contrast to the traditional "no shop" deal. The merger agreement will usually include a "bifurcated" breakup fee: a lower amount, typically one to three percent of the deal equity value, if a higher offer emerges during the go-shop period; and a higher amount, typically two to four percent of the deal value, if a higher offer emerges after the go-shop period expires but before the initial deal closes.

If a higher offer emerges before the go-shop period expires, the target board will designate the new bidder an "Excluded Party" ("excluded" because it is exempt from paying the higher breakup fee if it reaches a deal to buy the target). If the initial buyer gets a "match right" (which, today, is almost always the case), the target board must then negotiate for three to five business days, "in good faith," with the initial bidder to see if the initial bidder can match the terms offered by the Excluded Party. The seller may go back and forth several more times, but each new bid by the Excluded Party will typically trigger a new three- to five-day match right for the initial bidder. If the Excluded Party ultimately wins the auction, the target board will pay the reduced breakup fee to the initial bidder. The length of the go-shop period and the size of the two breakup fees are heavily negotiated points between the original bidder and the target during the pre-signing phase.

At the highest level, in both the no-shop and go-shop processes, the target canvasses the market to see if there is a higher-value bidder. The critical difference lies in when this market check takes place: in the traditional no-shop route, the market check takes place before signing, while in the go-shop process, the market check takes place after the deal

[14] *See generally* John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307 (2000) (providing empirical evidence on the magnitude of breakup fees in a sample of public-company acquisitions announced between 1988 and 1998).

is signed and announced. The timing difference has important implications for price discovery. In the pre-signing process, all bidders are (at least theoretically) on a level playing field. In a post-signing go-shop process, the initial bidder has a favored position but (if the go-shop is structured well) serves as a "floor bid" (also known as a "stalking horse") for potential third-party bidders.[15] In exchange for providing a floor bid the first bidder will get a modest breakup fee (one to three percent) in the event the transaction is taken away by a higher bidder.

When go-shops first appeared, some commentators argued that go-shops were a manifestation of seller bargaining power in a world of frenzied buy-side competition.[16] Under this view, the go-shop clause was seller-friendly because it replaced the usual "no shop" with a "go-shop," which would only work to the seller's advantage. Others, however, claimed that go-shop clauses worked primarily to the buyer's advantage, because the addition of a go-shop clause gave the target board an excuse to curtail (or eliminate completely) shopping during the critical pre-signing phase, and the subsequent go-shop period was illusory.[17] These competing theories would be examined by the Delaware courts in their examination of go-shop processes.

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[15] *See, e.g.*, *Go-Shop Provisions: A New Trend?*, PRIV. EQUITY NEWSL. (Davis Polk & Wardell, New York, N.Y.), Dec. 2006, at 1 ("From a seller's standpoint, a go-shop provision is desirable for a number of reasons. The initial buyer serves as a stalking horse to potentially make the seller more attractive to other buyers, and its purchase price sets a floor for other potential buyers to top."); *see also In re* Lear Corp. S'holder Litig., 926 A.2d 94, 99, 112 (Del. Ch. 2007) (noting that Carl Icahn, the initial bidder, "was not willing to be an amateur stalking horse," *id.* at 112); Brian JM Quinn, Omnicare*: Coercion and the New* Unocal *Standard*, 38 J. CORP. L. 835, 844 (2013) (describing that in a go-shop process "the seller will treat the initial bidder as a stalking horse to generate an active post-signing auction").

[16] *See, e.g.*, *Original Study*, *supra* note 3, at 739 n.72 ("M&A lawyers say [go-shop clauses] are likely to remain popular as sellers seek to include this provision in more deals." (alteration in original) (quoting *Why More Sellers Are Using a "Go-Shop" Clause*, CAPITALEYES (May/June 2007))); *id.* ("The existing seller's market environment may help account for the recent popularity of the go-shop provision." (quoting Mark W. Peters et al., Commentary, *The Increasingly Popular "Go-Shop" Provision — Why Now?*, MERGERS & ACQUISITIONS, May 2007)); *A Review of Merger Agreement Provisions in Going Private Transactions*, MERGERMETRICS.COM (Mar. 23, 2007), https://www.mergermetrics.com/pub/rs_20070326.html [https://perma.cc/57WW-MM9P] (arguing that proliferation of go-shop clauses indicates "a strengthening of the target's negotiating position"); Steve Rosenbush, *Private Equity Slugfest*, BLOOMBERG (Feb. 13, 2007, 5:00 AM), https://www.bloomberg.com/news/articles/2007-02-13/private-equity-slugfestbusinessweek-business-news-stock-market-and-financial-advice [https://perma.cc/6SEH-FRRV] ("Target companies are figuring out ways to elicit more competition. One technique is the so-called 'go-shop' provision."). *See generally Shop Till You Drop: A Closer Look at Go-Shop Provisions in Going-Private Transactions*, DEBEVOISE & PLIMPTON PRIV. EQUITY REP., Fall 2006, 1, 1 ("The business press perceives go-shop provisions as another example of how the competitive M&A market is changing acquisition agreements in favor of targets.").

[17] *See, e.g.*, Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops: The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 530 (2008) (arguing that inclusion of go-shop provisions "has the same end result with respect to value maximization as the typical post-signing market

B. Delaware Case Law

When go-shops first emerged in the mid-2000s, two decisions in the Delaware Court of Chancery squarely addressed their effectiveness. In *In re Topps Co. Shareholders Litigation*,[18] then–Vice Chancellor Strine held that a forty-day go-shop period, despite the existence of a match right and a 4.3% breakup fee after the go-shop period expired, did not violate the target board's *Revlon* duties.[19] In contrast, in *In re Lear Corp. Shareholder Litigation*,[20] issued just one day later, Vice Chancellor Strine looked far more skeptically on the go-shop provision because the Lear go-shop required the board "to get the whole shebang done [that is, discovery of a Superior Proposal, expiration of the 10-day match right, termination of the initial agreement, and a signed-up agreement with the new bidder] within the 45-day window."[21] In both *Topps* and *Lear*, the court refused to grant a preliminary injunction against the deal on the *Revlon* claims, but granted the plaintiffs' request for a preliminary injunction until certain disclosure problems were cured.[22] Taken together, *Topps* and *Lear* signaled qualified acceptance of go-shops as a means for target boards to satisfy their *Revlon* duties.

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check"); *Original Study*, *supra* note 3, at 740 n.74 ("[I]t's usually the case that a 'go shop' doesn't amount to much anyway." (alteration in original) (quoting Tom Taulli, *ACS Buyout: A Second Bite at the Apple?*, BLOGGINGBUYOUTS (June 12, 2007) (website unavailable)); Andrew Ross Sorkin, *Looking for More Money, After Reaching a Deal*, N.Y. TIMES (Mar. 26, 2006), https://nyti.ms/2uShvGa [https://perma.cc/JS6L-Z35H] ("The question, though, is why a company wouldn't hold an open auction to begin with? . . . More often than not, it would seem that an open auction is the best way to go. . . . [T]he biggest problem with a go-shop provision is that by default, other potential bidders start at a huge disadvantage."); Steven M. Davidoff, *Harman's Shopping Spree*, M & A L. PROF BLOG (Apr. 26, 2007), http://lawprofessors.typepad.com/mergers/2007/04/harmans_shoppin.html [https://perma.cc/DZ8D-R7SP] ("[I]nvestors have increasingly come to see 'go-shop' provisions as cover for unduly large break-up fees and the significant advantage and head-start provided by management participation."); *cf.* Morton & Houtman, *supra* note 1, at 1 ("[O]ur practical experience suggests that while go-shops may be beneficial in some circumstances, they may serve as mere window dressing in other cases."); *id.* at 11 ("[W]hy should one assume that a go-shop will serve to effectively canvass the market . . . if that effort so rarely produces a competing bid?"). *See generally* M. Lipton, T.N. Mirvis & P.K. Rowe, *Private Equity and the Board of Directors* (Wachtell, Lipton, Rosen & Katz, New York, N.Y.), May 17, 2007, at 4 ("[S]ome skepticism has been expressed about the effectiveness of go-shops given a perception that private equity buyers may be reluctant to compete against signed-up deals . . . .").

[18] 926 A.2d 58 (Del. Ch. 2007).

[19] *See id.* at 86 ("For 40 days, the Topps board could shop like Paris Hilton.").

[20] 926 A.2d 94 (Del. Ch. 2007).

[21] *Id.* at 120; *see id.* at 119–20. Vice Chancellor Strine continued in his usual entertaining way:

> It is conceivable, I suppose, that this could occur if a ravenous bidder had simply been waiting for an explicit invitation to swallow up Lear. But if that sort of Kobayashi-like buyer existed, it might have reasonably been expected to emerge before the Merger Agreement with Icahn was signed based on Lear's lack of a rights plan and the publicity given to Icahn's prior investments in the company.

Id. at 120.

[22] *See id.* at 123; *Topps*, 926 A.2d at 63.

The endorsement by the Delaware courts made go-shops a permanent feature in practitioners' deal toolkit. Go-shops appear disproportionately in PE deals, because PE buyers, with their portfolio of deals, are more likely to be willing to take the "option" on the deal that comes from giving the seller the right to go shop.[23] The Original Study reported that 34% of PE deals (48 out of 141) included a go-shop.[24] A search of the Thomson Platinum M&A database from January 2010 to June 2019 finds that 22% of PE deals (102 out of 470) included a go-shop.[25] Go-shop incidence has generally fluctuated annually between twenty to thirty-five percent, with no consistent trends over time.[26]

C. *Literature Review*

Professor Guhan Subramanian presented the first systematic empirical examination of go-shops in the Original Study (Subramanian (2008)).[27] The sample included all PE buyouts announced between January 2006 and August 2007 (n=141), including forty-eight deals that involved go-shop processes.[28] In contrast to practitioner and academic commentary at the time that was generally skeptical of go-shops,[29] the Original Study found that go-shops frequently led to higher bidders during the go-shop period, and that sellers extracted slightly higher prices from the original bidder in exchange for pre-signing exclusivity.[30]

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[23] *See Original Study*, *supra* note 3, at 742 (finding that go-shops are disproportionately used in PE deals); *see also* Sridhar Gogineni & John Puthenpurackal, *The Impact of Go-Shop Provisions in Merger Agreements*, FIN. MGMT., Spring 2017, at 275, 285 (same).

[24] *See Original Study*, *supra* note 3, at 742.

[25] We examined deals over $50 million in value, excluding deals with controlling shareholders (with control defined as a thirty-five percent threshold).

[26] The relevant data are available from the authors upon request.

[27] *Original Study*, *supra* note 3. This article was selected by academics as one of the "top ten" articles published in corporate and securities law for 2008, *see* CORP. PRACTICE COMMENTATOR, TOP 10 CORPORATE AND SECURITIES ARTICLES OF 2008 (2008), and was reprinted in a volume of "seminal" articles from the past forty-five years, *see* 2 LAW AND ECONOMICS OF MERGERS AND ACQUISITIONS (Steven M. Davidoff & Claire A. Hill eds., 2013). The article has also been cited regularly by the Delaware courts. *See, e.g.*, Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *23 n.263 (Del. Ch. July 27, 2018); *In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *36 n.35 (Del. Ch. May 31, 2016); *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 840 n.5 (Del. Ch. 2011).

[28] *Original Study*, *supra* note 3, at 730.

[29] For practitioner commentary, see sources cited *supra* note 17. For academic commentary, see, for example, Sautter, *supra* note 17, at 530 (arguing that these effects make go-shops no more effective than a passive market check achieved through a no-shop with a fiduciary out); and J. Russel Denton, Note, *Stacked Deck: Go-Shops and Auction Theory*, 60 STAN. L. REV. 1529, 1548 (2008) ("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.").

[30] *See Original Study*, *supra* note 3, at 741–55.

In the context of "pure" go-shops (which were defined as deals "in which the target negotiated exclusively with a single bidder, then conducted a market canvass during a post-announcement 'go-shop' period"[31]), the Original Study reported that sell-side bankers on average contacted 39.6 potential buyers during the go-shop phase, and 3.2 of these signed confidentiality agreements.[32] With "add-on" go-shops (which were defined as deals "in which the target conducted a market canvass pre-announcement but also engaged in a post-announcement market canvass pursuant to a go-shop clause"[33]), the Original Study reported that the sell-side bankers contacted 33.0 potential buyers on average, and 1.5 of these signed confidentiality agreements.[34] The Original Study further reported that "the go-shop successfully generates another offer 5% of the time in an add-on go-shop and 17% of the time in a pure go-shop, consistent with the intuition that the go-shop should yield a higher-value buyer more often when there has been no pre-signing shopping."[35] The Original Study concluded from these findings that "a pure go-shop can be a valuable tool for extracting the highest possible price in the sale of the company."[36]

The intuition for these findings is that the initial buyer serves as a "bird in hand" so that the seller can safely see if a higher-value "bird in the bush" can be found. That is, a go-shop process can mitigate the seller's risk of a busted sale process while simultaneously permitting the sell-side board to execute a meaningful market canvass. And on the buy side, PE buyers at the time might have been willing to pay a premium for pre-signing exclusivity in order to deploy their massive pools of committed but unallocated capital (also known as "dry gunpowder"). The Original Study concluded:

> The narrow (doctrinal) implication of these findings is that go-shop provisions, appropriately structured, can satisfy a target board's *Revlon* duties [to maximize value in the sale of the company]. The broader (transactional) implication is that go-shop provisions can be a "better mousetrap" in deal structuring — a 'win-win' for both buyer and seller.[37]

However, the Original Study cautioned that this sanguine view held only if the go-shop process was structured properly, so that the post-signing market canvass was conducted on a level playing field.[38] For example, the Original Study recommended that Delaware courts should

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[31] *Id.* at 745 tbl.2.
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.* at 747.
[36] *Id.* at 755.
[37] *Id.* at 731.
[38] *See id.* at 755–60.

look for "a longer (fifty to sixty day) window to shop"[39] and "information rights . . . rather than the increasingly commonplace match right."[40] The concern for a level playing field was particularly acute in management buyouts (MBOs) because management would have informational and other structural advantages over other potential bidders.[41]

Subsequent empirical studies of go-shops have generally confirmed the positive view provided in the Original Study. Professors Jin Jeon and Cheolwoo Lee (Jeon & Lee (2014)) examined 1706 transactions from 2004 through 2010, of which 140 deals were go-shops.[42] Using multiple regression analysis and instrumental variables to control for go-shop endogeneity, this study confirmed that go-shops increased initial deal premiums,[43] increased the probability of a jump bid,[44] and decreased the likelihood of deal completion.[45] Professors Sridhar Gogineni and John Puthenpurackal (Gogineni & Puthenpurackal (2017)) examined a sample of 2996 mergers announced between 2003 and 2012, including 145 go-shop deals.[46] This study similarly found that go-shops were positively associated with measures of sell-side shareholder interests. Specifically, this study found a statistically significant positive association between go-shops and the probability of a competing bid, the likelihood and magnitude of an upward revision of the initial offer, and the final offer premium.[47] The authors concluded that "the inclusion of go-shop provisions in merger agreements has been beneficial for target shareholders, on average."[48]

Professors Adonis Antoniades, Charles Calomiris, and Donna Hitscherich (Antoniades, Calomiris & Hitscherich (2016)) examined 306 cash transactions with a public U.S. target and a financial acquirer announced between 2004 and 2011.[49] Noting the tension between their study, on one hand, and the Original Study and Jeon & Lee (2014), on the other, they reported that a go-shop resulted in a statistically significant reduction in the initial offer premium.[50] Jump bids during the go-

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[39] *Id.* at 757.
[40] *Id.* at 758.
[41] *Id.* at 756–57.
[42] Jeon & Lee, *supra* note 3, at 214.
[43] *Id.* at 228.
[44] *Id.* at 230.
[45] *Id.* at 232.
[46] Gogineni & Puthenpurackal, *supra* note 23, at 279–80.
[47] *See id.* at 289–305, 311.
[48] *Id.* at 311.
[49] Adonis Antoniades, Charles W. Calomiris & Donna M. Hitscherich, *No Free Shop: Why Target Companies Sometimes Choose Not to Buy 'Go-Shop' Options*, 88 J. ECON. & BUS. 36, 37, 41–42 (2016).
[50] *Id.* at 39 ("In contrast to previous studies — Subramanian, 2008; Jeon and Lee, 2014 — we find that the inclusion of a go-shop provision results in a statistically significant reduction in the

shop process did not make up for this difference because the incidence of deal jumpers was so low that "they would need to generate unrealistically high increases in premia to offset the large decrease in the initial offer premium."[51]

The following table summarizes the prior academic literature on go-shops:

Study	Sample time frame	Go-shop sample size	Go-shop generally improves target shareholder value?
Subramanian (2008)	2006–2007	48	Yes
Jeon & Lee (2014)	2004–2010	140	Yes
Antoniades, Calomiris & Hitscherich (2016)	2004–2011	85	No
Gogineni & Puthenpurackal (2017)	2003–2012	145	Yes

The table highlights the mixed empirical results: while the general weight of the empirical evidence is in favor of the idea that go-shops increase target shareholder value, a potential inflection point in this assessment arises from the fact that one out of three of the most recent studies found that go-shops do not create value. The table also shows that no study has examined go-shops since 2012. In view of the potential inflection point suggested by the prior literature, this omission is surprising. The next section seeks to fill the empirical gap.

D. New Empirical Evidence

We assembled a new database of PE deals to assess the development of go-shops, and deal processes more generally, since the time frame examined in the Original Study and other prior literature. We used the Thomson Platinum M&A database, supplemented by data from the MergerMetrics database, to identify all public company deals[52] larger than $50 million in value (in order to focus on economically meaningful

initial offer premium — defined as the percentage difference of the offer price from a reference pre-offer price.").

[51] *Id.*

[52] Private company deals were omitted because there is typically no period of vulnerability between signing and closing in private company deals.

transactions), involving a financial buyer[53] and with a go-shop provision, announced between January 2010 and June 2019.[54] We excluded deals in which the acquirer was a controlling shareholder (with control defined as a 35% threshold) because such transactions are subject to a different doctrinal regime.[55] The resulting sample includes 114 transactions (the New Sample).

For each deal in the New Sample, we examined the Background of the Merger section of the proxy statement (or Schedule 14D-9 for deals executed pursuant to a tender offer) to code certain aspects of the pre-signing and post-signing processes. We supplemented our review of SEC filings with news reports. We then tabulated key features of the deal process and compared these features to the findings from the Original Study. Summary statistics from the Original Study are reported in Table 1; summary statistics from the New Sample are reported in Table 2.

Table 1: Summary Statistics from Original Study (2006–2007)[56]

Mean (median)	**No-shop (*n*=93)**	**Add-on go-shop (*n*=19)**	**Pure go-shop (*n*=29)**	**All deals (*n*=141)**
Deal characteristics:				
Deal size ($MM)	$2,914 ($910)	$5,835 ($3,609)	$4,208 ($1,480)	$3,574 ($1,193)
Buyout group includes management	12.9%	15.8%	24.1%	15.6%
Initiated by buy side	53.3%	68.4%	93.1%	63.8%

[53] Some strategic buyers are highly acquisitive, making them resemble financial buyers in pertinent ways. *See infra* section II.D.2, pp. 1256–58 (discussing Fortune Brands' acquisition of Norcraft). However, they still differ from financial buyers in certain key respects. In particular, strategic buyers tend to be willing to pay a premium to acquire a company, expecting synergies to decrease costs and increase cash flows. Accordingly, we would expect higher prices and lower jump rates with strategic buyers. Since we do not consider this reflective of defective deal processes, we exclude deals in which the initial bidder is a strategic buyer from our sample. However, bidders that emerge during the go-shop period may be either financial or strategic buyers.

[54] The combined Thomson Platinum and MergerMetrics database included two deals incorrectly coded as having a financial buyer. Shuanghui International, which acquired Smithfield Foods, Inc., in 2013, and Hudson's Bay Company, which acquired Saks Inc. in 2013, were strategic acquirers. We excluded these deals from the New Sample.

[55] For a summary, see Fernán Restrepo & Guhan Subramanian, *Freezeouts: Doctrine and Perspectives*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 285, 285–90 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

[56] *Original Study*, *supra* note 3, at 745 tbl.2.

Mean (median)	No-shop (*n*=93)	Add-on go-shop (*n*=19)	Pure go-shop (*n*=29)	All deals (*n*=141)
Pre-signing solicitation process:				
# of potential buyers contacted	31.6 (15)	15.9 (5.5)	1.0 (1)	22.4 (7)
# signing confidentiality agreements	16.1 (8.5)	7.8 (4)	1.0 (1)	11.7 (5)
# making bids	3.9 (3)	2.7 (2)	1.0 (1)	3.1 (2)
Post-signing solicitation process:				
# of potential buyers contacted	0.0 (0)	33.0 (27)	39.6 (40)	12.3 (0)
# signing confidentiality agreements	0.07 (0)	1.5 (0)	3.2 (2)	0.9 (0)
# making bids	0.08 (0)	0.05 (0)	0.17 (0)	0.10 (0)
Go-shop structuring:				
Bifurcated termination fee		84.2%	88.9%	87.0%
Breakup fee during go-shop period (% of equity value)		1.65% (1.54%)	1.45% (1.41%)	1.53% (1.41%)
Breakup fee after go-shop period (% of equity value)		2.82% (2.91%)	2.62% (3.02%)	2.70% (3.01%)
Right to match third-party bidder		78.9%	59.3%	67.4%
Length of go-shop period (days)		33.7 (30)	41.2 (45)	38.4 (40)

Table 2: Summary Statistics from the New Sample (2010–2019)

Mean (median)	Add-on go-shop (*n*=87)	Pure go-shop (*n*=27)	All go-shops (*n*=114)
Deal characteristics:			
Deal size ($MM)	$2,430.2 ($802.1)	$1,277.4 ($455.1)	$2,157.2 ($692.5)
Buyout group includes management	11.5%	11.1%	11.4%
Initiated by buy side	77.0%	88.9%	79.8%
Pre-signing solicitation process:			
# of potential buyers contacted	13.5 (8)	1.0 (1)	10.5 (5)
# signing confidentiality agreements	6.5 (4)	1.0 (1)	5.2 (3)
# making bids	3.1 (2)	1.0 (1)	2.6 (2)
Post-signing solicitation process:			
# of potential buyers contacted	49.6 (42)	56.4 (43)	51.2 (43)
# signing confidentiality agreements	4.1 (2)	6.6 (3)	4.6 (3)
# making bids	0.08 (0)	0.12 (0)	0.09 (0)
Go-shop structuring:			
Bifurcated termination fee	88.5%	96.3%	90.4%
Breakup fee during go-shop period (% of equity value)	2.00% (1.72%)	1.91% (1.55%)	1.98% (1.69%)
Breakup fee after go-shop period (% of equity value)	3.61% (3.36%)	3.53% (3.15%)	3.59% (3.30%)
Right to match third-party bidder	100.0%	100.0%	100.0%
Length of go-shop period (days)	35.4 (35)	40.1 (40)	36.6 (37.5)

Table 2 shows that conditional on using a go-shop, the pre-signing phase is virtually unchanged since the Original Study: sell-side advisors contact roughly the same number of potential buyers; approximately the same number of bidders sign confidentiality agreements; and approximately the same number make offers for the target company. During the post-signing phase, Table 2 indicates that sell-side bankers contact significantly more potential buyers than reported in the Original Study. For example, in an add-on go-shop, sell-side bankers contacted 49.6 potential buyers on average, compared to 33.0 potential buyers on average that were contacted in the Original Study. Similarly, for a pure go-shop, sell-side bankers contacted 56.4 potential buyers on average, compared to 39.6 potential buyers on average, as reported in the Original Study. These differences are statistically significant at the 5% level.[57] Not surprisingly, in view of the broader market canvass, Table 2 also reports that a larger number of potential buyers signed confidentiality agreements, on average, in order to gain access to due diligence on the target company.

Table 2 shows a slight increase in average termination fees since the Original Study, but this difference can be explained entirely by the slightly smaller average deal size in the New Sample. This (non)finding is consistent with an earlier work by one of us, indicating an end to "termination fee creep" since approximately 2010.[58] However, it represents a shift from earlier deal protection work, which emphasized the growing size of termination fees as a key factor in predicting bidder deterrence.[59]

Despite the broader market canvass and no increase in termination fees, the jump rate has declined. The Original Study reported that a higher bidder emerged during the go-shop period 12.5% of the time (6 instances out of 48 go-shop deals).[60] This has dropped to what initially appears to be a 7.0% jump rate (8 out of 114 go-shop deals) in the New Sample.[61] Bifurcating the New Sample reveals a starker difference: a 7.4% jump rate (5 out of 68) during the period 2010–2014, and what

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[57] We ran Welch two-sample t-tests in R. Comparing add-on go-shops to the Original Study, we found a p-value of 0.008004. Comparing pure go-shops to the Original Study, we found a p-value of 0.02063.

[58] Fernán Restrepo & Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. 1013, 1023 (2017); *see id.* at 1030.

[59] *See, e.g.*, Coates & Subramanian, *supra* note 14.

[60] *Original Study*, *supra* note 3, at 745 tbl.2, 749 tbl.3.

[61] Note that this is lower than the average number of bidders in the post-signing solicitation process shown in Table 2 because in two of these successful go-shops, there were two higher bidders. Paulson and Samick emerged as higher bidders than Kohlberg in the acquisition of Steinway Musical Instruments, Inc., with Paulson ultimately winning the deal. II-VI Inc. and "Party B" emerged as higher bidders than GaAs Labs in the acquisition of ANADIGICS, Inc., with II-VI ultimately winning the deal.

initially appears to be a 6.5% jump rate (3 out of 46) during the period 2015–2019.

The last successful go-shop in the New Sample occurred in August 2018, when Siris Capital matched a Superior Proposal from an undisclosed third party for $28.00 per share for Web.com Group, Inc., up from the original agreement of $25.00 per share.[62] Prior to that, the last time a higher bidder emerged was in June 2016, when Skullcandy, the headphone manufacturer, had initially accepted an offer from Incipio for $5.75 per share.[63] During the go-shop period, Mill Road Capital made a bid for Skullcandy, and after a multi-round bidding contest with Incipio, Mill Road Capital ultimately won Skullcandy for a price of $6.35 per share.[64] However, Mill Road already held a 9.8% stake in Skullcandy at the time the initial deal with Incipio was announced and had offered to buy Skullcandy for $6.05 per share (higher than Incipio's announced deal at $5.75 per share) during the pre-signing phase.[65] Rather than providing an example of a successful go-shop, the Skullcandy case study seems to be an example of a flawed and/or conflicted pre-signing sale process.

Putting aside Skullcandy, then, the jump rate in the 2010–2019 time frame was 6.1% (7 out of 114 go-shops), declining to 4.3% (2 out of 46) in the latter part of the New Sample (2015–2019). The decline in jump rates from the Original Study to both the full New Sample and the last five years is statistically significant at the 10% level.[66]

With no discernible change in the pre-signing deal process, and a significant increase in the number of bidders contacted during the post-signing phase, the absence of successful competing bids against PE deals presents something of a puzzle. The pre-signing market canvass in go-shop transactions is *unchanged*, and the post-signing market canvass is significantly *up*, yet jump rates have dropped by two-thirds.

We believe the explanation can be found in the Original Study's cautious endorsement of go-shop processes. Go-shops could be effective, the Original Study concluded, but only if they were "appropriately structured."[67] The next Part offers structural and contextual features indicating that go-shops are no longer appropriately structured. The result

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[62] Michael Dabaie, *Siris Capital Boosts Deal to Buy Web.com to $28 a Share*, WSJ PRO: PRIV. EQUITY (Aug. 6, 2018, 7:06 PM), https://www.wsj.com/articles/siris-capital-boosts-deal-to-buy-web-com-to-28-a-share-1533596774 [https://perma.cc/2SU2-6YN2].

[63] Laura Berman, *Mill Road Capital Victorious in Skullcandy Bidding War*, THESTREET (Aug. 24, 2016, 4:31 PM), https://www.thestreet.com/story/13684595/1/mill-road-capital-victorious-in-skullcandy-bidding-war.html [https://perma.cc/4P6F-YJFS].

[64] *Id.*

[65] *Id.*

[66] We ran a one-sided two-sample test for equality of proportions (without continuity correction) in R. Comparing the Original Study to the 2010–2019 period, we found a p-value of 0.0896. Comparing the Original Study to the 2015–2019 period, we found a p-value of 0.0784.

[67] *Original Study*, *supra* note 3, at 731.

has made go-shops less meaningful as a mechanism for price discovery since the time frame of the Original Study.

II. Explaining the Decline of Go-Shop Effectiveness

The most straightforward potential explanation for the decline in go-shop jump rates would be higher prices from first bidders. Law and economics theory would predict that first bidders, understanding (implicitly or explicitly) the high jump rates documented in the Original Study, would simply pay more in their initial bid to avoid being jumped. However, we do not find evidence to support this hypothesis in our data. After controlling for deal size, we find no difference in deal premiums or shareholder returns between the Original Study and the New Sample.[68]

Soft factors regarding PE attitudes toward deal jumping are another potential explanation. The Original Study quoted Robert Friedman, then–Chief Legal Officer of the Blackstone Group, as follows:

> Go-shops are totally meaningful. . . . Both the strategic universe and the private equity universe would be reticent to come in during a classic no-shop process [after a signed deal is announced]. We just wouldn't do it. But when you put a 'For Sale' sign on the door [through a go-shop], and say come get me, then people drop everything and look because they are being invited in.[69]

Over the ensuing decade since the Original Study was published, some PE practitioners have expressed to us an opposing point of view — that PE buyers are generally reluctant to participate in go-shop processes — because jumping a PE deal signals to the market (and, more importantly, to the PE firm's limited partners) that the firm is unable to "source" its own deals. This signaling explanation might partially explain the decline in jump rates since the Original Study. To the extent it is correct, it would support the conclusion that go-shops used to be a meaningful mechanism for price discovery but are less meaningful today.

However, the signaling explanation cannot be a complete one, because our data indicate that strategic buyers are deterred as well, once

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[68] Specifically, we assembled a sample of the largest go-shop deals in the New Sample from 2000 to June 2018 that collectively had an average value of $5.7 billion, which was the average size in the Original Study. We ran both two-sided and one-sided Welch two-sample t-tests comparing cumulative abnormal returns from thirty days before the announcement of the deal to thirty days after the announcement. None of the premium differences between this subset of the New Sample and the Original Study (for add-on go-shops, pure go-shops, or all go-shops) were statistically significant.

[69] *Original Study*, *supra* note 3, at 750 (first alteration in original) (quoting Robert L. Friedman, Chief Legal Officer, Blackstone Grp., Remarks at Panel Discussion on Private Equity Buyouts, Harvard Law School Forum on Corporate Governance & Financial Regulation (Nov. 13, 2007)).

a PE deal has been announced. The absence of strategic buyers is particularly puzzling because strategic buyers, unlike PE buyers, bring synergies to the deal.[70] The conventional wisdom among practitioners is that synergies should generally beat financial engineering.[71] The remainder of this Part offers structural and contextual explanations that, we believe, provide a more complete explanation for the decline of go-shop effectiveness over the past decade.

A. Match Rights

The first and most straightforward explanation for the decline of go-shop effectiveness is the proliferation of match rights. A match right requires the target to negotiate "in good faith" with the first bidder, typically for three to five business days, to see if the first bidder can match the third-party bid.[72] In the Original Study, match rights appeared in approximately two-thirds of the sample.[73] Over the past decade, however, match rights have become ubiquitous in PE deals, and M&A deals more generally.[74] Nearly all of these are "unlimited" match rights, meaning that the initial bidder gets an additional three to five days each time the third party makes an overbid. In contrast, the far less common one-time matching rights only permit a single match by the initial bidder, though nothing would prevent the initial bidder from negotiating for an additional match right each time it matched.

Without a match right, a third-party bidder may make a bid with a "short fuse" that cannot be shopped back to the first bidder.[75] But with a match right there is no obvious pathway to success in making an overbid — either the first bidder will match (in which case the third party has nothing to show for its efforts) or the first bidder will not match (in which case, absent bidder-specific synergies, the third party has likely overpaid).[76] First bidders generally know more about the target than

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[70] Jan Vild & Claudia Zeisberger, *Strategic Buyers vs. Private Equity Buyers in an Investment Process* 2 (INSEAD, Working Paper No. 2014/39/DSC/EFE, 2014), http://ssrn.com/abstract=2439589 [https://perma.cc/ME75-ZUYS].

[71] *See, e.g.*, Leonce L. Bargeron et al., *Why Do Private Acquirers Pay So Little Compared to Public Acquirers?*, 89 J. FIN. ECON. 375, 380 (2008) (finding that lack of synergies may explain lower announcement returns for acquisitions by PE firms compared to those by public firms and private operating firms).

[72] *Original Study*, *supra* note 3, at 735.

[73] *Id.* at 745 tbl.2.

[74] *See* Restrepo & Subramanian, *supra* note 58, at 1032 fig.2, Panel A (documenting increased incidence of match rights from approximately 60% in 2003 to nearly 100% by 2015); *supra* tbl.2. All of the deals in the New Sample include match rights.

[75] Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 614 (2016).

[76] *See, e.g.*, *In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *39 (Del. Ch. May 31, 2016) ("[I]n this chess game of M & A, most of these parties being very sophisticated, don't just think incrementally one step ahead. They're thinking two, three, four, five moves ahead. Any third

prospective go-shop bidders because the pre-signing phase, with no "ticking clock," will invariably be longer than the go-shop period.[77] The match right therefore fuels the winner's curse problem: in any scenario where a third party bids and wins, it would know that a better-informed party (namely, the initial bidder) thought that the price was too high.[78] Looking forward and reasoning back, a third party would be unlikely to bid.

When the first bidder has an unlimited match right, a third party will bid only if it believes it can beat the first bidder in a bidding contest.[79] In other words, the third party must believe it can beat the first bidder's full willingness to pay, not just the current bid on the table.[80]

Risk aversion amplifies the deterrence of an unlimited match right because the bid on the table is a known quantity while the first bidder's full willingness to pay is not.[81] Even seemingly innocuous announcements of synergies and fit can signal to potential third-party bidders a very high willingness to pay.[82] When a first bidder has a match right

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party looking at this would say, 'What is my pathway to success?' So even if you value this thing at a very high number, you might reasonably say there's no pathway to success and, therefore, I'm not going to start on this process because there's no finish line." (alteration in original) (quoting Testimony of Guhan Subramanian, Transcript of Record at 811)).

[77] *See* Subramanian, *supra* note 75, at 629.

[78] *See* GUHAN SUBRAMANIAN, DEALMAKING: THE NEW STRATEGY OF NEGOTIAUCTIONS 172–73 (2011) (analyzing the Toys "R" Us LBO, which included a 4% termination fee and a three-day match right, as follows: "What have you learned if you make a bid in this situation, three days pass, and you win? You've learned, three days too late, that some really smart people at KKR, Bain Capital, and Vornado didn't want to match your offer. The combination of the breakup fee and the so-called matching right meant that winner's curse concerns ran rampant for a third party considering whether to enter the deal. The potent combination of deal terms effectively shut down the negotiauction for Toys "R" Us.").

[79] Restrepo & Subramanian, *supra* note 58, at 1059.

[80] *Id.*; *see, e.g.*, Merion Capital L.P. v. Lender Processing Servs., Inc., C.A. No. 9320, 2016 WL 7324170, at *25 (Del. Ch. Dec. 16, 2016) ("[T]he existence of an incumbent trade bidder holding an unlimited match right was a sufficient deterrent to prevent other parties from perceiving a realistic path to success. Put differently, for another bidder to warrant intervening, the bidder would have had to both (i) value the Company more highly than [the current bid] *and* (ii) believe that it could outbid [all subsequent bids from the first bidder]." (footnote omitted)).

[81] Restrepo & Subramanian, *supra* note 58, at 1059.

[82] *See, e.g.*, Press Release, TeamHealth Holdings, Inc., TeamHealth to Be Acquired by Blackstone (Oct. 31, 2016) (quoting Bruce McEvoy, a senior managing director at Blackstone: "TeamHealth has built an industry leading physician services platform that is ideally positioned to enable its hospital partners and clinicians to navigate the evolving healthcare landscape while providing outstanding service to its patients. We are excited to help the Company continue its long track record of organic and acquisition driven growth."); Press Release, Apax Partners, Quality Distribution Agrees to Be Acquired by Funds Advised by Apax Partners for $16.00 per Share in All Cash (May 6, 2015) ("'Having followed Quality for several years, we have been impressed with the strategy and vision articulated by the Company's management team,' said Ashish Karandikar, a Partner on Apax's Services team. 'As the leading logistics platform in the bulk chemical transportation industry, Quality is well positioned to take advantage of both organic growth opportunities and strategic acquisitions while benefiting from the financial and operational flexibility of operating as a private company.'"); Press Release, J.Crew Grp., Inc., TPG Capital and Leonard Green

and the second bidder is risk averse, the mere possibility that the first bidder's willingness to pay will be large could deter bids.[83]

Our interactions with transactional lawyers over the past decade confirm this analysis: match rights are put in merger agreements not only to give the bidder a relatively leisurely look at any third-party bid (that is, ex post effects), but also to deter third-party bidders from emerging in the first place (ex ante effects). This conclusion is also supported by standard economic analysis and game theory. As described by one commentator: "[T]here are no two-handed economists when it comes to the incentives generated by matching rights. Matching rights work to deter subsequent bids when held by an initial bidder."[84] Buy-side practitioners regularly push for match rights in order to deter third-party bids;[85] when their investment bankers subsequently seek to dissuade prospective go-shop bidders,[86] those bankers will invariably point to the first bidder's match right as a good reason for third parties to stay away.[87]

To the extent that economic theory should be supplemented with empirical evidence, the horse race can no longer be run because match rights are ubiquitous in M&A deals; therefore, there is no longer any variation in the variable of interest. However, the Original Study was conducted in an era when match rights were not ubiquitous. That study reported six jump bids in a sample of forty-eight go-shop transactions.[88] Among these six jumped deals, three did not have match rights.[89] Therefore: the jump rate when the initial bidder did not have a match right was twenty percent (three out of fifteen), while the jump rate when the initial bidder did have a match right was nine percent (three out of

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& Partners to Acquire J.Crew Group, Inc. for $43.50 per Share in Cash (Nov. 23, 2010) (quoting Carrie Wheeler, a partner of TPG Capital: "We are proud of our 13-year history with J.Crew since our investment in the company in 1997 and the success it has achieved . . . . We are looking forward to working with Mickey [Drexler, J.Crew Chairman and CEO,] and his exceptional team and are excited by the prospect of continuing to expand the business.").

[83] Restrepo & Subramanian, *supra* note 58, at 1060.

[84] *See* Brian JM Quinn, *Normalizing Match Rights*, 1 HARV. BUS. L. REV. ONLINE 7, 9 (2010) (footnote omitted), https://www.hblr.org//wp-content/uploads/sites/18/2010/11/Quinn-Normalizing-Match-Rights.pdf [https://perma.cc/YXG9-6PXG].

[85] *See, e.g.*, Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *15 (Del. Ch. July 27, 2018) ("Fortune, on the other hand, knew full well what was at stake. Its Vice President of M & A, Robert Baab, pushed hard for an unlimited match right and for Fortune's right to launch Tahiti's tender offer during the Go-Shop Period, understanding that both measures would make it less likely that a topping bidder would emerge.").

[86] *See infra* section II.D.2, pp. 1256–58.

[87] *See Blueblade*, 2018 WL 3602940, at *15 n.158 (noting emails "explaining RBC [the buyer's investment banker] should emphasize to other potential buyers that Fortune has matching rights").

[88] *Original Study*, *supra* note 3, at 744, 748.

[89] *Id.*

thirty-three).[90] This would seem to be at least suggestive empirical evidence that match rights deter prospective go-shop bidders. It would also seem difficult to explain the rapid proliferation of match rights if they did not have a substantive effect on deal dynamics.[91]

Match rights can become even more potent if they require exclusive negotiations with the initial bidder during the matching period. For example, in May 2016, PE firm Accel KKR ("AKKR") acquired SciQuest, a provider of cloud-based software solutions for spend management.[92] The merger agreement provided for a twenty-five-day go-shop period and a five-business-day unlimited match right.[93] As a threshold issue, a five-business-day match right is particularly potent as a bid deterrent because it means that the match right period always extends through a weekend.[94] For this reason a five-business-day match right is more than just twenty-five percent more onerous than a four-business-day match right. More importantly, during those five business days, SciQuest was required to "negotiate . . . on an exclusive basis" with AKKR.[95] This exclusive negotiation requirement means that SciQuest would have to "go silent" with any potential third-party bidder while it negotiated exclusively with AKKR. This week-long period of silence would amplify information asymmetry concerns for a prospective third-party bidder. The information asymmetry would have been

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[90] *See id.* at 745 tbl.2.

[91] *See* Petitioner's Opening Post-trial Brief at 33, *Blueblade*, 2018 WL 3602940 (C.A. No. 11184) ("[T]he team at Fortune understood that unlimit[ed] matching rights would discourage potential bidders in a go-shop process." (second alteration in original) (quoting one buy-side deal team member)). Subramanian served as an expert witness on deal process for petitioners seeking an appraisal of their shares in this transaction.

[92] This deal is included in the New Sample.

[93] SciQuest, Inc., Current Report (Form 8-K) Ex. 2-1, at §§ 6.2(a), (e) (May 30, 2016) [hereinafter SciQuest Merger Agreement].

[94] Even if a bid were made at 9:00 a.m. on a Monday morning, the match right invariably requires the target to give the first bidder the right to match through 5:00 p.m. on the Monday following the offer. *See, e.g.*, American Dental Partners, Inc., Current Report (Form 8-K) Ex. 2-1, at § 1.3 (Nov. 4, 2011) ("For purposes of this Agreement, a 'Business Day' shall be any day on which the principal offices of the Securities and Exchange Commission (the 'SEC') in Washington, DC are open to accept filings, other than a day on which banking institutions located in New York, New York are permitted or required by applicable Law to remain closed."); *id.* at § 6.1(d) ("[T]he Company Board may make an Adverse Recommendation Change if (i) it determines in good faith (after consultation with its financial advisors and outside legal counsel) that, in light of such change in circumstances, failure to take such action would reasonably be expected to result in a breach of the fiduciary duties of the Company Board to the stockholders of the Company under applicable Law, (ii) the Company Board notifies the Buyer in writing of its intention to make such Adverse Recommendation Change at least five Business Days prior to doing so, which notice shall contain a reasonably detailed description of the change in circumstances, (iii) for the five Business Days following delivery of the notice described in clause (ii), the Company shall, and shall cause its Representatives to, negotiate with the Buyer (to the extent the Buyer desires to negotiate) in good faith . . . .").

[95] SciQuest Merger Agreement, *supra* note 93, at § 6.2(e).

particularly salient because AKKR had followed SciQuest for years[96] and had participated in private discussions with SciQuest management for almost two years prior to its May 2016 offer.[97]

During the go-shop period, SciQuest's investment bankers at Stifel contacted twenty potential strategic bidders and twenty-three potential financial bidders to see if they could beat AKKR's offer of $17.75 per share.[98] While some of these bidders signed confidentiality agreements to gain access to due diligence on SciQuest, no bidders ultimately bid.[99] This outcome is not surprising when the initial bidder (AKKR) has a significant informational advantage, the go-shop period is (an extremely tight) twenty-five days, and any bid would trigger a seven-calendar-day exclusive negotiation period with AKKR. Without a pathway to success, prospective bidders will decline to bid.

The Delaware Court of Chancery has endorsed the idea that match rights deter bids. Vice Chancellor Laster has expressed the view that "an unlimited match right . . . is a powerful disincentive,"[100] and Vice Chancellor Slights found in a recent deal that "[the] Board apparently did not understand what an unlimited match right was much less how that deal protection might work to hinder the go-shop."[101] Vice Chancellor Slights even quoted (with apparent approval) trial testimony from one of us that "[e]verybody agrees that match rights deter bids. It [is] not even a debated question."[102]

While the Delaware Supreme Court has not explicitly rejected the (straightforward) idea that match rights deter bids, the court has expressed the view that prospective third-party bidders are only deterred when the deal is already fully priced: "If a deal price is at a level where the next upward move by a topping bidder has a material risk of being a self-destructive curse, that suggests the price is already at a level that is fair."[103] Under this view, the only time the winner's curse applies is

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[96] *See* SciQuest, Inc., Definitive Proxy Statement (Schedule 14A), at 31 (June 24, 2016) [hereinafter SciQuest Proxy Statement] ("AKKR has had contact with the Company over the years in the course of their normal business.").

[97] *Id.*

[98] *Id.* at 35, 38.

[99] *Id.* at 38.

[100] *In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *41 (Del. Ch. May 31, 2016); *see also* Merion Capital L.P. v. Lender Processing Servs., Inc., C.A. No. 9320, 2016 WL 7324170, at *25 (Del. Ch. Dec. 16, 2016) ("[A]n unlimited match right was a sufficient deterrent to prevent other parties from perceiving a realistic path to success.").

[101] Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *22 (Del. Ch. July 27, 2018).

[102] *Id.* (alterations in original) (quoting Testimony of Guhan Subramanian, Trial Transcript at 254:4–7).

[103] Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 33 (Del. 2017); *see also* Transcript of Oral Argument at 15–16, *Dell*, 177 A.3d 1 (No. 565, 2016) (reporting Chief Justice Strine's statement: "[I]f you think the next move in a deal dynamic is that the next person who makes the price move will hurt themselves, is what you're saying that [sic] means you're already

when the seller has already extracted full value from the first bidder. Therefore, according to the Delaware Supreme Court, winner's curse concerns are in fact desirable because they deter prospective third parties from overpaying for the target.

In fact, this characterization of the winner's curse is not correct. When an initial bidder has an unlimited match right (which is typical), a potential third-party bidder will not know how many bids it will take to win. This means that a third party might not bid even if the immediate offer on the table is below fair value. It is simply incorrect that the winner's curse deters bidders only when the deal price already represents fair value. Sophisticated bidders "look forward and reason back" to identify a pathway to success before bidding in the first place. The Delaware Supreme Court's apparent tolerance of match rights is inconsistent with basic game theory, conventional wisdom among M&A practitioners, and chancery court pronouncements on the same question.

And so we are in the unusual situation in which the chancery court is on stronger theoretical and empirical ground, yet the supreme court's view must necessarily prevail. Future case law will hopefully unmuddy the waters on the deterrent effect of match rights. We return to this point in section III.B below. For present purposes, the more basic point is that the proliferation of match rights since the time frame of the Original Study might provide some of the explanation for the decline in the effectiveness of go-shops.

B. Shorter Go-Shop Windows

Tables 1 and 2 show that the average length of go-shop periods has decreased only slightly over the past decade: from 38.4 calendar days, on average, in 2006–2007, down to 36.6 days, on average, in 2010–2019. While some might consider this to be a meaningful decline, particularly given the proliferation of match rights that trigger exclusive negotiating periods, we do not put great weight on this difference in explaining the decline of go-shop effectiveness. Go-shop bidders have always understood that post-signing due diligence is a sprint, not a leisurely stroll. A two-day difference does not change the nature of the sprint in any meaningful way.

Peeling the onion reveals a slightly larger relative decline in go-shop windows for larger deals. In the Original Study, the average length of the go-shop period for deals larger than $1 billion was 39.2 days, compared to 36.3 days for smaller deals. In the 2010–2019 sample, however, this already modest sensitivity to deal size decreased: the average go-shop window for deals larger than $1 billion was 38.0 days, compared

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at fair value?" *Id.* at 15. To which appellants' counsel Greg Williams responded: "It certainly is . . . ." *Id.* at 16.).

to 35.5 days for smaller deals. Simple regression analysis confirms that the length of the go-shop window was 13% more sensitive to deal size in the Original Study than in the New Sample.[104] And in the second half of the New Sample period (2015–2019), the average go-shop window was 36.1 days for deals larger than $1 billion and 37.9 days for deals smaller than $1 billion, which makes go-shop lengths now an average of 1.8 days *shorter* for larger deals.

When go-shops first appeared, practitioners correctly understood that larger deals would require longer go-shop windows in order to have a meaningful post-signing market canvass. This is true for at least two reasons. First, larger companies are more complicated, and require more due diligence. Second, and less obviously, larger deals are more likely to require a consortium bid[105] — either due to diversification requirements for prospective bidders, financing constraints, or the benefits of sharing the risk of such a massive investment. Consortium bids are time-consuming. The internal negotiation among the consortium members regarding financing, governance, and exit rights can take weeks or even months, putting aside the time it would take for due diligence on the actual target company.

Practitioners understood these points in the early days of go-shops. A thirty-day go-shop window in a $500 million deal might no longer be appropriate in a $5 billion deal. But with time, the data shows that practitioners were less likely to adjust the length of the go-shop window to reflect the complexity of the target company and/or the likelihood of requiring a consortium bid.

In our experience, this is a common development in transactional practice: initial deal technology innovations are built from scratch, with little precedent, and therefore are typically tailored to the relevant structural and contextual factors. But over time, these benchmarks provide guideposts, and practitioners who have less experience with the technology will use these guideposts without fully understanding the structural and contextual factors that motivated the innovations in the first place.[106] We have observed banker presentations that present "typical" go-shop periods in "benchmark" transactions, with little or no reference to deal size in those allegedly comparable transactions;[107] we have also

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[104] When length of go-shop window is regressed on the natural log of deal value (in $ millions), the coefficient for the Original Study is 1.830 while the coefficient for the New Sample is 1.585.

[105] *Cf., e.g.*, Jason Singer & Carrick Mollenkamp, *M&A Milestone: $101 Billion Deal for ABN Amro*, WALL ST. J. (Oct. 5, 2007, 12:01 AM), https://www.wsj.com/articles/SB119154087347749578 [https://perma.cc/3SSZ-M4QN].

[106] *See, e.g.*, *Blueblade*, 2018 WL 3602940, at *15 (noting that the Citigroup banker who ran Norcraft's unsuccessful go-shop had never run a go-shop before).

[107] For a publicly available example, see SCHULTE ROTH & ZABEL, PRIVATE EQUITY BUYER/PUBLIC TARGET M&A DEAL STUDY: 2015–17 REVIEW AND COMPARATIVE ANALYSIS 7 & n.3 (2018), https://www.srz.com/images/content/1/5/v4/159733/PE-M-A-DealStudy-2017-

observed director testimony relying on such presentations in determining that their particular go-shop was structured appropriately.

Of course, banker ignorance of deal size can be convenient: by presenting benchmark transactions with no reference to deal size, the average length of go-shop periods for larger transactions will naturally move downward, consistent with what we find in our data. Shorter go-shop periods in larger deals mean that bankers can deliver a truncated process, and therefore greater deal certainty, to their buy-side clients. This can be useful even for sell-side bankers, who may have significant buy-side interests.[108]

Delaware courts have sporadically commented on deal size as a relevant factor in determining the appropriate length of a go-shop window. In the Dell management buyout, for example, Vice Chancellor Laster noted that a forty-five-day go-shop period was an average length, but insufficient for a $26 billion deal.[109] However, our data indicate that these occasional hints from the Delaware courts have not been sufficient to overcome the one-size-fits-all approach in transactional practice that has emerged over the past decade with respect to the length of go-shop windows. While we do not consider it a major factor, the slight shortening of go-shop windows in larger deals may have contributed at least in part to the overall decline in effectiveness of go-shops over the past decade.

C. CEO Incentives to Discourage Third-Party Bids

The CEO of any public company, of course, has a fiduciary duty to the corporation that he or she runs. In a sale of the company for cash, this means that the CEO must maximize the value that shareholders receive.[110] But in any transaction, the personal incentives of the CEO can distort or outweigh the CEO's legal obligations. Delaware Supreme

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FINAL-web.pdf [https://perma.cc/8GYS-8VUF] (presenting bar chart of go-shop durations but noting in a footnote only that "[t]he duration of the go-shop periods in the 2015–17 Large-Market Transactions had a mean of 36 days and median of 40 days . . . . The duration of such periods in the 2015–17 Middle-Market Transactions had a mean of 38 days and median of 33 days," *id.* at 7 n.3). The fact that the mean go-shop period was longer in the "Middle-Market" sample than in the "Large-Market" sample reflects practitioners' indiscriminate application of "typical" go-shop periods.

[108] *See infra* section II.D.2, pp. 1256–58.

[109] *In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *40–42 (Del. Ch. May 31, 2016) ("The main structural problem that Subramanian identified did not result from the terms of the go-shop in the abstract, but rather stemmed from the size and complexity of the Company. The Merger was *twenty-five times larger* than any transaction in Subramanian's sample of 'jumped' deals, meaning that a successful topping bid literally would have been unprecedented." *Id.* at *42.). Subramanian served as an expert witness on deal process for petitioners seeking an appraisal of their shares in this transaction.

[110] *Cf.* Revlon, Inc. v. MacAndrews & Forbes, Holdings, 506 A.2d 173, 182 (Del. 1986).

Court Chief Justice Strine approvingly quoted one "M&A specialist" as follows:

> I do not think there has been enough focus on the fact that management has "conflicts" in every M&A deal that happens or doesn't happen. The "conflict" relates to what the "motivation" is of the CEO. Is the CEO selling the company because he or she is approaching retirement and does not want to hand over the reigns to a successor (or wants a payout on change of control)? Or is the CEO resisting a hostile bid because he or she wants to keep running a public company? Or is a friendly stock deal with huge synergies not happening because of the "social issues" — e.g., the CEO will not be running the combined company? So many deals happen or don't happen because of the ego or motivation of the CEO.[111]

Our experience is consistent with this observation. Specifically, in the context of go-shops, we believe that the CEO's incentives to discourage third-party bids may be the single most important explanation for the overall decline in go-shop effectiveness over the past decade. In this section, we document two kinds of distortions: the CEO as net buyer and the CEO's incentives induced by buy-side compensation.

Not only can these distortions exist exogenously, independent of the deal, but they can also be created endogenously as well: that is, PE firms will create financial interests for the CEO as part of the deal, precisely in order to dampen competition during a go-shop process. One PE investor told one of us that his firm tries to "corrupt" (his word) management whenever possible, to favor his firm over other firms in a sale-of-the-company transaction. While this comment is anecdotal, it squares with our observation of the PE industry and competitive strategy in general. With PE firms running roughly the same financial models and hiring their associates from the same business schools, how would it be possible to create consistent "alpha" (abnormal returns) for PE limited partners if every deal were subject to full and fair competition from all possible buyers? Professor Michael Porter of the Harvard Business School famously identified the five forces of competition, and observed that "competitive advantage" (which yields sustainable profitability) comes from creating imperfections in the marketplace that dampen one or more of these five forces from working effectively.[112] The same holds true in PE deals. We document the various methods of creating competitive advantage in the remainder of this section.

1. CEO as Net Buyer. — A CEO can be both a seller and a buyer in a PE deal. As the first, a CEO will always hold at least some sell-

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[111] Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 BUS. LAW. 679, 685 n.9 (2015) (quoting an unnamed M&A specialist).

[112] MICHAEL E. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE *passim* (1985). *See generally* MICHAEL E. PORTER, COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS (1980).

side equity. This factor is well understood, and courts and commentators often point to the CEO's "skin in the game" as evidence that the CEO's interests are aligned with shareholders.[113] In addition, however, the CEO can have buy-side equity, either by rolling over sell-side equity and/or receiving equity from the PE partner as part of the deal. This factor can diminish or even outweigh the CEO's alignment with his own shareholders.

When deal prices increase, the CEO's sell-side shares increase in value, but the CEO has to pay more for them as a buyer. Thus, the CEO's overall financial incentive depends on whether the CEO is a net seller or a net buyer of the CEO's company's stock in the deal.[114] Net sellers will generally want a higher price, all else equal, while net buyers will generally want a lower price. For example, a CEO who rolls over his entire stake and then contributes additional equity capital on the buy side is a net buyer of shares in the transaction. This CEO would have an incentive to keep the price down because he is a net buyer.

This analysis has implications for the CEO's receptivity to engaging with potential third-party bidders during a go-shop process. If the CEO is a net buyer in the transaction, the CEO will have personal financial incentives to discourage overbids, which pushes the price up. A well-advised CEO would of course make representations of being willing to work with prospective go-shop bidders, but these representations will have limited credibility when the CEO is a net buyer.[115] And if the CEO is important to the ongoing value of the enterprise, no go-shop bidder would want to partner with a reluctant CEO.

For this reason, prospective go-shop participants are caught in a Catch-22: not partnering with the CEO means they will not realize the value that comes from such partnership, but partnering with a reluctant CEO may destroy the very value that prospective bidders are seeking

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[113] *See, e.g.*, Oliver Schutzmann, *Skin in the Game: Why Directors' Shareholdings Matter*, IRIDIUM ADVISORS (June 3, 2018), https://www.iridiumadvisors.com/insights/thought-leadership/skin-in-the-game-why-directors-shareholdings-matter [https://perma.cc/W8FD-XQMR] (noting that "investors care about directors' holdings" because they reinforce a "circle of trust" between investor, manager, and company).

[114] *See* Subramanian, *supra* note 75, at 624–29.

[115] Cooperation commitments with senior managers typically only require them to work with the board and/or special committee to facilitate due diligence, and to consider working with all potential buyers. *See, e.g.*, HCA Inc., Definitive Proxy Statement (Schedule 14A), at 26 (Oct. 17, 2006) ("As instructed by the special committee, the management discussions were conditioned on management's agreement that it would not commit to be exclusive to the sponsors, and accordingly would be available to enter into similar discussions and arrangements with any subsequent bidder for the Company."); J.Crew Grp., Inc., Definitive Proxy Statement (Schedule 14A), at 91 (Jan. 25, 2011) (requiring CEO Mickey Drexler's "[1] participation in meetings, presentations, due diligence sessions and other sessions with persons interested in making a takeover proposal; [2] assistance in the preparation of solicitation materials, offering documents and similar documents to be used in connection with such efforts; and [3] cooperation and assistance in obtaining any consents, waivers, approvals and authorizations for and in connection with any takeover proposal").

to achieve in the first place. Recognizing this problem, they will rationally be deterred from bidding. The magnitude of the deterrent effect will depend on the magnitude of the value that the CEO and management bring to the table, as well as the magnitude of the CEO's financial incentive on the buy side of the transaction.

Management buyouts (MBOs) can present the most extreme version of the net buyer problem, because management invariably will become a major shareholder on the buy side. For example, Michael Dell faced the net buyer problem in the MBO of Dell Inc. In that deal, "Mr. Dell rolled over his entire 16% equity stake into the new company"; in addition, he contributed $750 million of new equity on the buy side.[116] Therefore, Mr. Dell was a net buyer of shares, which meant he would have had a financial incentive to push the deal price down rather than up.

In earlier work, one of us highlighted the magnitude of the net buyer problem:

> If an overbid increased the debt and equity in proportion with the deal price, keeping all else equal, each dollar increase in the deal price would cost Michael Dell an additional $263 million. If instead an overbid were funded entirely with equity . . . , each dollar increase in the deal price would cost Michael Dell an additional $1.1 billion. If instead Michael Dell kept his equity commitment the same and the PE firm contributed the additional equity, he would lose voting control at any deal price above $15.73. For example, at a $20 per share deal price, he would own 28% of the post-MBO company. These examples illustrate that regardless of what lever was pulled, any overbid structured similarly to the Dell–Silver Lake Offer (that is, with Michael Dell as a net buyer of shares) could only cost him more. Foreseeing all of this, third-party bidders considering an overbid would understand that Michael Dell would be a reluctant partner in their bid.[117]

Not surprisingly, no higher bids emerged during the forty-five-day go-shop period.

Sometimes the net buyer aspect of the deal is not even disclosed to shareholders. In the buyout of Fresh Market by Apollo Global Management, for example, the company did not disclose that founder Ray Berry had an agreement to roll over all of his shares into an Apollo-sponsored transaction as early as October 2015, a full six months before the deal was announced in March 2016.[118] Instead, the Schedule 14D-9 stated only that Berry "would consider" such a rollover.[119] The Schedule 14D-9 also did not disclose the degree to which Berry was disinclined to work with other potential PE buyers. Putting these points together: Berry preferred a deal with Apollo, was indifferent to the price

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[116] *In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *43 (Del. Ch. May 31, 2016).

[117] Subramanian, *supra* note 75, at 627.

[118] *See* Morrison v. Berry, 191 A.3d 268, 276–78 (Del. 2018).

[119] The Fresh Market Inc., Solicitation/Recommendation Statement (Schedule 14D-9), at 17 (Mar. 25, 2016).

Apollo paid (because of his 100% rollover), and did not want to work with other buyers. Not surprisingly (like Dell), no other buyers for Fresh Market emerged during the twenty-one-day go-shop period.[120]

Fresh Market shareholders brought suit challenging the transaction for inadequate disclosures, but the Delaware Court of Chancery (surprisingly, in our opinion) granted the defendants' motion to dismiss.[121] In June 2018, the Delaware Supreme Court reversed the Court of Chancery's dismissal, agreeing with the plaintiffs that Berry's buy-side financial interests were material and not adequately disclosed.[122] The case is currently pending in the Delaware Court of Chancery.

While Fresh Market's inadequate disclosures were pursued by dogged plaintiffs' attorneys, one wonders how many CEOs have softer undisclosed commitments that give them significant post-closing buy-side interests. In prior work, one of us finds that management were net buyers or neutral in ten out of forty-one (24%) MBO transactions announced between 2006 and 2015.[123] The Fresh Market example suggests that this 24% figure might underestimate the degree to which CEOs have buy-side interests that outweigh their sell-side interests. These interests, of course, would make the go-shop period less meaningful as a mechanism for price discovery, because management would have financial incentives to *not* find a higher bidder.

2. CEO Incentives Induced by Buy-Side Compensation. — The prior section focused on the subset of PE deals in which management rolls over or contributes so much equity as to become a net buyer in the transaction. The Fresh Market transaction suggests that observable "net buyer" situations may underestimate the number of PE deals where this happens, but the analysis in the prior section still applies to only a subset of all PE deals. In this section, we focus on a factor that we believe is far more pervasive, namely, the CEO's incentives induced by buy-side compensation.

In most PE deals, the PE firm will want to retain management, at least initially. The "disciplinary" takeovers of the 1980s, which were motivated by the idea of removing underperforming management, are not common today.[124] In fact, many PE firms advertise (publicly or

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[120] The Fresh Market Inc., Amendment No. 2 to Solicitation/Recommendation Statement (Schedule 14D-9) (Apr. 4, 2016).

[121] Morrison v. Berry, C.A. No. 12808, 2017 WL 4317252, at *4 (Del. Ch. Sept. 28, 2017).

[122] *Morrison*, 191 A.3d at 275.

[123] Subramanian, *supra* note 75, at 628. This prior work also reports that when management are net buyers the prices paid to target shareholders are significantly lower than when management are net sellers. *See id.* at 627–29.

[124] Wayne H. Mikkelson & M. Megan Partch, *The Decline of Takeovers and Disciplinary Managerial Turnover*, 44 J. FIN. ECON. 205, 207, 225 (1997); Peter Lattman & Dana Cimilluca, *Court Faults Buyouts*, WALL ST. J. (July 12, 2007), https://www.wsj.com/articles/SB118420528127564278 [https://perma.cc/PBJ9-5D77] ("The issues raised by [then–Vice Chancellor] Strine differ from the

privately) their general practice of retaining management, presumably as a way of inducing management to come to the table in the first place.[125] The PE firm cannot formally negotiate employment agreements with management until the major terms for the shareholders are worked out.[126] But the PE firm will invariably give guidance early in the process as to what its typical compensation package for the CEO and senior management looks like.[127]

Management, in turn, will often investigate a PE firm's track record for management compensation soon after initiating conversations about selling the company. What they will discover will generally please them. Academic research shows that PE buyouts, on average, double management's equity stake in the company.[128] This means that a successful PE

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legal concerns that emerged with the buyout boom of the 1980s. That era was marked by so-called corporate raiders. They offered shareholders rich premiums for their companies and vowed to remove existing management and boards. In those deals, Delaware courts examined shareholder allegations that company management and boards had rejected rich, hostile bids to keep their jobs. In the current buyout craze, many buyout firms retain the management by offering rich pay packages and a stake in the newly private entity.").

[125] *See, e.g.*, *About*, VECTOR CAP., https://www.vectorcapital.com/about#investment-solutions [https://perma.cc/Q47C-U6ZX] ("We partner with management teams and align incentives to transform businesses and create value."); *Approach*, ACCEL-KKR, https://www.accel-kkr.com/approach [https://perma.cc/8VNC-WRB9] ("Accel-KKR partners with management teams to accelerate organic growth and take advantage of targeted M&A opportunities."); BAIN CAP. PRIV. EQUITY, https://www.baincapitalprivateequity.com [https://perma.cc/BE9E-6K3T] ("Our globally integrated teams leverage deep vertical expertise and partner with management teams around the world to accelerate growth."); LEONARD GREEN & PARTNERS, http://www.leonardgreen.com [https://perma.cc/TW7C-WMJ9] ("Our firm partners with experienced management teams and often with founders to invest in market-leading companies.").

[126] *See Original Study*, *supra* note 3, at 757.

[127] *See, e.g.*, ExamWorks, Definitive Proxy Statement (Schedule 14A), at 42 (June 23, 2016) [hereinafter ExamWorks Proxy Statement] (noting that the PE buyer, Leonard Green Partners, raised with certain ExamWorks officers the "typical structure of rollover arrangements in LGP's transactions, particularly as related to certain members of management" on April 5, 2016, four weeks after LGP's initial indication of interest and three weeks before the deal was finalized and announced); Press Release, Leonard Green & Partners, ExamWorks Enters into Definitive Agreement to be Acquired by Leonard Green & Partners, L.P. for $35.05 per Share in Cash (Apr. 27, 2016) ("We are excited to partner with ExamWorks' management team and organization." (quoting John Baumer of Leonard Green & Partners)).

[128] *See, e.g.*, Steven Kaplan, *The Effects of Management Buyouts on Operating Performance and Value*, 24 J. FIN. ECON. 217, 220 (1989) (finding that "[t]he equity holdings of the management team increase from a median of 5.88% to 22.63%"); Chris J. Muscarella & Michael B. Vetsuypens, *Efficiency and Organizational Structure: A Study of Reverse LBOs*, 45 J. FIN. 1389, 1395 (1990) (finding that for companies that go public again, "officers and directors of these firms had a mean (median) ownership of 62.3% (58.0%), nearly double the pre-buyout level"); Phillip Leslie & Paul Oyer, *Managerial Incentives and Value Creation: Evidence from Private Equity* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14331, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1341889 [https://perma.cc/YJ2R-HBRL]; *see also* PWC, GREATER SHARING — EVEN GREATER EXPECTATIONS: PWC'S 2016 PRIVATE EQUITY PORTFOLIO COMPANY MANAGEMENT COMPENSATION SURVEY 2 (2016), https://www.pwc.com/us/en/hr-management/publications/assets/pwc_private_equity_stock_compensation_survey_2016_pwc.pdf [https://perma.cc/US7Q-PAZ5] [hereinafter PWC 2016 COMPENSATION SURVEY] (reporting that median

buyout can create "generational wealth" — in contrast to just everyday wealth — for the CEO and top management team. In our observation, management will quickly understand this, or an initial PE buyer will make it known, very early in the conversation.

The structure of this compensation is critically important. PE buyers will invariably tie management's post-buyout compensation to their own financial return.[129] Before the financial crisis of 2008–2009, the most common metric was Internal Rate of Return (IRR).[130] IRR implicitly pushes the performance bar higher every year.[131] For example, if the PE firm requires a 15% IRR in order for management to receive significant performance-based pay,[132] and if management has a 0% return in Year 1, it must achieve a 32.3% return in Year 2 to "catch up" to a 15% IRR across the two years.[133] For this reason, IRR is a demanding metric.[134] If the company underperforms for the first few years after the buyout, management's financial incentives based on IRR might become impossible to achieve. This is exactly what happened during the financial crisis: management incentives based on IRR went significantly underwater,[135] to the point where achieving the IRR hurdles became virtually impossible. This is of course not a good outcome for managers; but it also does not serve PE firms' long-term interests because managers no longer have significant financial incentives to perform well.

Perhaps in response to this experience, the most common metric for management compensation in the aftermath of the financial crisis shifted from IRR to Multiple of Invested Capital (MOIC),[136] which

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pool size for managers in PE-backed companies had increased from 10% to 12%, between 2005 and 2016, in addition to time-based and performance-based compensation).

[129] *See, e.g.*, PWC 2016 COMPENSATION SURVEY, *supra* note 128, at 4 (reporting that 83% of PE-backed companies in their sample tied a portion of management compensation to the company's performance). Among these companies, "some 70% used exit-based performance metrics such as" the multiple on invested capital (MOIC) or internal rate of return (IRR). *Id.* at 5.

[130] *See* SUMMIT EXEC. RES., PRIVATE EQUITY IN TRANSITION: COMPENSATION, COMPLIANCE, AND TALENT CREATION 16 (2019), https://summitexecutiveresources.com/wp-content/uploads/2019/05/ser-privateequity-guide.pdf [https://perma.cc/A2CC-PDXL].

[131] *See* Elisabeth de Fontenay, *Private Equity's Governance Advantage: A Requiem*, 99 B.U. L. REV. 1095, 1120 (2019) (noting that IRR "decreases the longer . . . capital has been invested before the payoff occur[s]").

[132] *See* PWC 2016 COMPENSATION SURVEY, *supra* note 128, at 5 ("[C]ompanies with IRR performance metrics generally allow for partial vesting at 15% and maximum vesting only when a return of 25% is achieved.").

[133] Calculated as: $1.15 \times 1.15 - 1$.

[134] *See* PWC 2016 COMPENSATION SURVEY, *supra* note 128, at 5 (describing "the time pressure to show results and deliver a quick exit necessary to achieve a high IRR").

[135] *See* Gianfranco Gianfrate & Simone Loewenthal, *Private Equity Throughout the Financial Crisis*, J. PRIV. EQUITY, Winter 2015, at 14, 18 exhibit 1 (showing that, during the financial crisis, IRRs at 75% of PE funds were at or below 15%).

[136] *See* SUMMIT EXEC. RES., *supra* note 130, at 16 ("Choosing the right performance metric is essential to aligning the incentives of C Suite leadership and Operating Partners. Prior to 2008, PE

measures the ratio of an investment's value to the amount of capital invested, without any time discounting.[137] MOIC is a much more forgiving metric than IRR, because it represents a fixed hurdle, rather than a bar that goes up every year.[138] For example, if the PE firm requires a 2.0x MOIC in order for management to receive significant performance-based pay,[139] management could have two to three bad years and still have some chance of delivering a 2.0x MOIC on exit. The main question for management is not *if* the MOIC multiple will be achieved, but *when*.

This difference between IRR and MOIC has implications for management's incentives in the deal. While management might reasonably view IRR-based compensation as speculative, they are far more likely to factor MOIC-based compensation into their decisionmaking at the buyout stage. This means that managers in PE-backed companies can have a financial incentive to keep the deal price *low*, because a lower deal price increases the MOIC on exit.[140]

Consider a typical compensation structure in a PE deal, in which management buy-side equity vests one-third each at MOIC multiples of 2.0, 2.5, and 3.0x.[141] If the deal price goes up through the go-shop process, management would face two competing financial effects: (1) they would receive more on the shares they sold into the deal; but (2) the increase in the sale price would cause the PE firm's MOIC on exit to go down (because the sale price is the "IC" of MOIC, that is, it represents the denominator of MOIC). This second effect would reduce the likelihood that management would achieve the requisite MOIC thresholds. In particular, by pushing the deal price up, the expected MOIC would go down, which means that management would have a lower likelihood of achieving the MOIC thresholds that trigger the vesting of their equity.

Figure 1 presents the expected return to management as the deal price (hypothetically) went up in one deal in the New Sample.[142]

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firms were more likely to use internal rate of return (IRR) metrics. Following the financial crisis which result[ed] in longer holding periods and lower IRR, there was a shift to us[ing] a Multiple of Invested Capital (MOIC) metric as the primary return measure.").

[137] Simon Tang, *How to Measure Private Equity Returns*, CEPRES, https://www.cepres.com/private-equity-returns-measure [https://perma.cc/5NZJ-M32R].

[138] *See* PWC 2016 COMPENSATION SURVEY, *supra* note 128, at 5.

[139] *See id.* ("[F]or companies with MOIC plans, vesting may begin with a MOIC of 2.0x, but maximum vesting does not occur unless a MOIC of 3.0x is achieved.").

[140] The incentive to keep the deal price low also exists where compensation is tied to IRR, but it is less pronounced for the reasons discussed in the prior paragraph.

[141] These vesting values are fairly typical. *See* PWC 2016 COMPENSATION SURVEY, *supra* note 128, at 5.

[142] This analysis cannot be run across the full sample because it requires a level of detail on the management compensation (and specifically, the MOIC triggers) that is not generally available through public filings.

Figure 1: Management Financial Incentives to Discourage Overbids

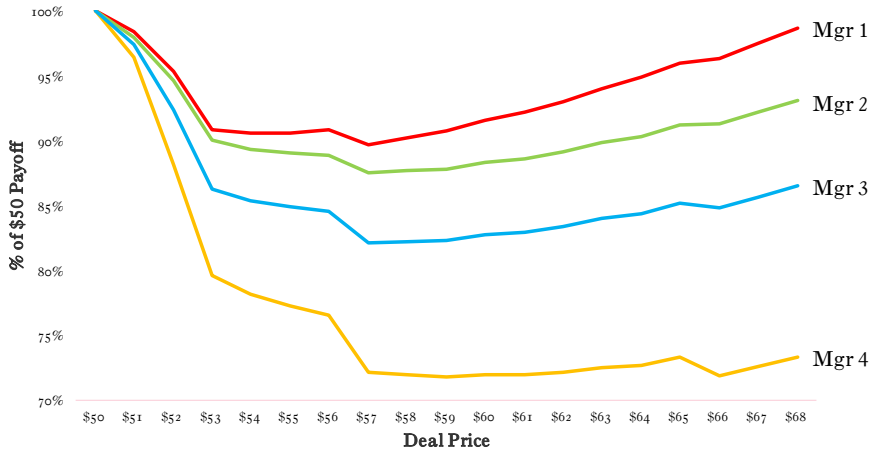

Figure 1 shows that the top four managers in the company would personally receive less in expected value if the bidding went up from the $50 deal price (indicated by their payout percentages dropping below 100% on the y-axis as the deal price increases above $50 per share on the x-axis). Figure 1 shows a particular decline around a $52 per share deal price, which is where the equity vesting that was triggered at a 2.5x exit MOIC would no longer vest. Even at a deal price of $68 per share, which would amount to a blockbuster 36% improvement over the $50 deal price, all four managers would receive less than they would receive at the $50 deal price. This is because the buy-side incentives to keep the deal price *down* (which drives the MOIC at exit *up*) dominated the sell-side incentives to maximize value for the exiting shareholders. Management's economic interest, then, directly conflicted with the interests of their shareholders.

This effect has gone unnoticed by prior commentators,[143] yet empirical evidence and practitioner anecdotes seem to indicate that it is commonplace if not ubiquitous in PE deals. The effect has obvious implications for management's receptivity to engagement with third-party

[143] In a prior work, one of us has observed the "net buyer" effect that can create perverse effects for management in MBOs. *See* Subramanian, *supra* note 75, at 624–29. The analysis here expands this prior work by indicating how the perverse effect is not limited to net-buyer situations and is not limited to MBOs. In general, economists tend to focus on whether management had a larger aggregate equity interest on the sell side or the buy side. But the correct question, for purposes of determining management's financial incentives in the deal, is this: Would management benefit or lose from increasing the deal price? That is, economists focus on the stock of assets held on the sell side and the buy side (a static analysis), when the correct analysis would focus on the marginal impact on those assets from increases in the deal price (a dynamic analysis).

bidders. Management will have personal financial incentives to discourage overbids, which would push the purchase price up. The (hypothetical) overbidder might not offer management the same "generational wealth" financial incentives as the initial PE buyer; or the initial buyer might exercise its match right, which would drive the price up and the MOIC on exit down. Because senior managers are central to the due diligence process, they can easily deter prospective third parties in subtle (and not so subtle) ways.[144] In the example above, then, it is not surprising that no higher bids emerged during the thirty-five-day go-shop period. It is exactly what our analysis would predict.

Figure 1 shows that all four managers would suffer financially from incremental increases over the $50 per share deal price. Even Manager 1 would have to achieve approximately a $69 deal price — representing a blockbuster 38% price bump — in order to achieve the same expected financial return as he would achieve at the $50 deal price. Even if (for purposes of argument) Manager 1 thought that such a price were achievable, bidding in M&A contests tends to move incrementally. Therefore, Manager 1 would suffer significant downside as the bidding went up from $50 before he achieved upside at a price higher than $69. And of course, there is the risk that the bidding would end well before it hit his $69 breakeven. This analysis indicates that even Manager 1 had strong incentives to discourage overbids.

PE firms, in general, are sophisticated investors. As Delaware Chief Justice Strine would say, they did not just fall off "the proverbial turnip truck."[145] They are no doubt aware that their MOIC-based compensation structure helps them (in the words of the PE investor) "corrupt" management. While every deal is different, PE investors typically anticipate a 15–20% annualized return, which translates into a 2.3–3.0 MOIC on exit.[146] It is no coincidence that the typical vesting triggers for management compensation are right around the same levels.[147] In

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[144] *See id.* at 615–16, 631–32; *Original Study*, *supra* note 3, at 756–57.

[145] *E.g.*, Sodano v. Am. Stock Exch. LLC, C.A. No. 3418, 2008 WL 2738583, at *12 (Del. Ch. July 15, 2008) ("Sodano would have had to have fallen off the proverbial turnip truck to have given up his right to advancement from the [National Association of Securities Dealers, Inc. (NASD)] at that point. And doing so would have been a big deal to both Sodano and the NASD. The evidence does not support such a momentous event."); Milford Power Co. v. PDC Milford Power, LLC, 866 A.2d 738, 744 (Del. Super. Ct. 2004) ("PDC is alleging that Milford Power has an enterprise value of $430 million and therefore that El Paso had, in fact, fallen off the proverbial turnip truck before it decided to exit its investment in Milford Power.").

[146] Assuming typical PE exit after 6 years, 1.15^6 = 2.3; 1.20^6 = 3.0.

[147] *See* PWC 2016 COMPENSATION SURVEY, *supra* note 128, at 4–5 ("In the 2016 study, 83% of companies tied a portion of awards to performance . . . . At the median, companies with performance-based vesting conditions are tying approximately 60% of award value to such conditions. The most common split among participants is to provide either 25% or 33% of award value with time-based vesting conditions and attach performance vesting conditions to the remainder of

effect, PE firms position their equity package at the edge of a cliff (in the form of MOIC thresholds), knowing that if management raised the deal price even slightly through an overbid, they would materially impair the expected value of their incentive packages.

In an article in *Buyouts* magazine titled *Slicing Up the Pie: The Role of Incentive Equity in Winning Deals*, the PE practice leaders at Goodwin Procter LLP recommend that PE firms structure their management equity incentive plans to "help . . . convince a CEO or founder to choose its proposal over competing bids."[148] Although they do not get to the level of detail presented in this Article, the authors offer specific examples of how PE firms can structure management compensation to appeal to managers.[149] Notably absent from Goodwin Procter's analysis is any reference to what the exiting shareholders receive in the deal.

We close this section with a general observation. The Original Study stated:

> While the data suggests a positive overall assessment of go-shops from the perspective of target shareholders, there is cause for concern in the subset of go-shops in which current management is part of the buyout group. The fact that no higher bidder has emerged in an MBO go-shop to date . . . suggests that third parties may be wary of entering a bidding contest, or that bankers might not conduct as thorough and energetic a search, when management has already picked its preferred buyout partner.[150]

The analysis presented in this section indicates that the "cause for concern" is not limited to MBOs, where management holds significant buy-side equity. It can also include situations where PE firms structure management compensation to achieve the same result. In the time frame of the Original Study, the primary compensation metric was IRR.

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awards. However, a fair number of respondents divide grants equally between time- and performance- based vesting (50%/50%). Time-based awards most commonly vest over five years. . . . Of the companies with performance-based vesting criteria, some 70% used exit-based performance metrics such as a MOIC or IRR, or a combination of both. . . . While the pool size of incentive plans has increased, the equity growth performance goals required to achieve full vesting have become more aggressive. Based on the aggregated data we collected, companies with IRR performance metrics generally allow for partial vesting at 15% and maximum vesting only when a return of 25% is achieved. Similarly, for companies with MOIC plans, vesting may begin with a MOIC of 2.0x, but maximum vesting does not occur unless a MOIC of 3.0x is achieved.").

[148] John LeClaire, Mike Kendall & Chris Nugent, *Slicing Up the Pie: The Role of Incentive Equity in Winning Deals*, BUYOUTS, Mar. 10, 2014.

[149] *Id.* ("[A]ssume that two sponsors are bidding to acquire a company, which we'll call 'Hotco.' Sponsor A offers a basic, time-vesting incentive plan that entitles the management team to 8 percent of any increase in the equity value of Hotco over Sponsor A's investment amount. Sponsor B offers an incentive plan that entitles the management team to 6 percent of increases in equity value under time-based vesting, plus an additional 3.5 percent, 3.0 percent and 2.5 percent if and when the sponsor realizes cash-on-cash returns of 2x, 3x and 4x, respectively. . . . If you were Hotco's CEO, which would you favor?").

[150] *Original Study*, *supra* note 3, at 756–57.

IRR was an unforgiving metric, so management might reasonably have viewed IRR-based compensation as potential "upside" in the deal, but not something that should drive decisionmaking. In the New Sample, however, the primary metric has shifted from the unforgiving IRR to the much more tolerant MOIC. Our analysis indicates that this form of compensation can swamp management's sell-side interests. To use the economics terminology, the "high-powered incentives" of MOIC-based buy-side compensation can dominate the "low-powered incentives" of sell-side equity.[151]

The result is that management is, in effect, nearly always a de facto net buyer. The concern expressed in the Original Study regarding MBOs is far more pervasive today. Management in PE deals no longer wants overbids because they hurt them financially. The "For Sale" sign that Friedman from Blackstone described in 2008[152] has turned into a "Go Away" sign due to management's financial incentives. Chief Justice Strine's observation quoted at the beginning of this section rings even more true once the mask is pulled back on management compensation in PE deals.[153] We believe that this phenomenon presents an important explanation for the significant decline in go-shop jump rates in our time frame of analysis.[154]

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[151] *See* Edward P. Lazear, *The Power of Incentives*, 90 AM. ECON. REV. 410, 410 (2000) (describing "high-powered" and "low-powered" incentives). While this section has focused on the top managers' financial interests, qualitative CEO interests can diminish the effectiveness of a go-shop as well. For example, in the 2015 sale of Norcraft, Inc., the buyer (Fortune Brands) gave assurances to the seller's CEO (Mark Buller) that they would negotiate the sale of the Canadian division of the company (called Urban Effects) back to him post-closing. *See* Petitioner's Opening Post-trial Brief, *supra* note 91, at 22 ("On March 25, Reilly e-mailed Buller that '[Klein] is going to offer to provide you some meaningful comfort around canada [sic].' On March 27, Buller e-mailed that he '[g]ot good comfort on [Norcraft Canada].' That same day, Reilly e-mailed that Buller 'will live with a trust me I will sell Canada to you.'" (alterations in original) (citations omitted)); *see also* Guhan Subramanian, Professor of Law & Bus. at Harvard Law Sch., Presentation: Blueblade Capital Opportunities LLC, et al. v. Norcraft Companies, Inc. 30 (2015) [hereinafter Subramanian Norcraft Trial Demonstratives] (on file with the Harvard Law School Library) ("Buller had a call with Chris Klein . . . Klein reiterated Canada and it was a good call." (omission in original) (quoting E-mail from Mr. Reilly to Norcraft's Advisors (Mar. 27, 2015))). Clearly, Buller would not be interested in selling to a go-shop bidder, even if it could offer significantly more, because that bidder might not provide the same assurances regarding the sale of the Canadian division back to him. Not surprisingly, no bidders emerged during the thirty-five-day go-shop period. The Delaware Court of Chancery determined that the overall deal process was "shambolic," Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *24 (Del. Ch. July 27, 2018), and that the thirty-five-day go-shop process was ineffective for price discovery, in part because of Buller's undisclosed interest to acquire Norcraft Canada, *see id.* at *25–27. Subramanian served as an expert witness on deal process for petitioners seeking an appraisal of their shares in this transaction.

[152] *Original Study*, *supra* note 3, at 750.

[153] *See supra* pp. 1240–41.

[154] *See* Ann Lipton, *Guhan Subramanian & Annie Zhao on Go-Shops*, BUS. L. PROF BLOG (Feb. 23, 2019), https://lawprofessors.typepad.com/business_law/2019/02/guhan-subramanian-annie-zhao-on-go-shops.html [https://perma.cc/S85B-WN6S] ("There are a lot of interesting observations in the new paper, with the basic point being that deal attorneys — aware that Delaware courts focus a lot

3. Absence of Special Committees. — In corporate law, it is well understood that special committees can cleanse conflicts of interest.[155] In the context of a sale of control, the board can appoint a special committee, typically consisting of two to four independent directors, to negotiate and recommend (or not) the terms of the deal to the full board. In our New Sample, the board formed a special committee in 58% of deals. In the remaining 42%, the CEO typically would lead the negotiation with potential buyers. The logic, presumably, is that the CEO does not have a conflict of interest as long as the CEO is not rolling over shares or receiving buy-side equity. To the contrary, the CEO is thought to be highly motivated to get the highest possible price, because he or she will have sell-side equity that goes up in value as the deal price goes up.

Our analysis indicates that this logic is flawed. Even if CEOs are not getting buy-side equity, CEOs are generally conflicted because of their MOIC-based buy-side compensation. This conflict is generally known from the outset, because the PE firm will typically announce its intention to retain management in its initial approach to the company. Our analysis indicates that when the board receives such an indication of interest, the board should form a special committee to cleanse the perverse interests created by MOIC-based compensation.[156] Yet our data indicate that approximately 40% of boards do not.[157]

To the extent that the prospective buyer needs access to management in order to conduct due diligence, such meetings should be chaperoned, typically by outside counsel.[158] And even in chaperoned meetings, the board should prohibit management from discussing their own employ-

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on things like the size of termination fees — instead manipulate aspects of the go-shop that tend to escape judicial notice, and that collectively function to make go-shops less effective. One particular point that stood out: The authors note that PE firms have changed how they compensate CEOs who remain with the company after the buyout. Today, they pay based on whether the firm achieves certain multiples of invested capital, a metric that CEOs might view as functionally guaranteeing them a healthy payout, and one that incentivizes them to keep the deal price as low as possible.").

[155] *See* Subramanian, *supra* note 75, at 631–34.

[156] It does not matter whether management actually receives MOIC-based compensation. What is relevant is what top managers expect to receive, either through their discussions with the PE buyers or their general awareness of the structure of PE compensation, when they are negotiating the deal.

[157] Even in the approximately 60% of cases in which the board forms a special committee, it is sometimes done well after the conflict has already infected the deal process. For example, one deal from the New Sample is formally coded as having formed a special committee. In that deal, the PE buyer indicated its interest in retaining management, and having them roll over their shares, in its initial offer letter. On the same day, the lead attorney for the seller flagged the conflict of interest for management (and therefore the need for a special committee) in an internal email. Yet this was not done until ten weeks later, well after the deal process was underway.

[158] Subramanian, *supra* note 75, at 641.

ment arrangements until the special committee has reached an agreement in principle on behalf of shareholders. These procedural safeguards are intended to cleanse the taint of conflict in the deal, in order to ensure that shareholders receive the benefit of an arm's-length negotiation and a fair price.

By failing to cleanse management's conflict of interest, boards permit managers to pursue their own interests. In particular, management will often have incentives to discourage third-party bidders, who might not assure them of employment, might not have given them large compensation packages post-closing, or might cause the deal price to go up, which (if the initial PE buyer matches) would cause the MOIC at exit to go down.

Such managerial conflicts of interest arise with no-shops as well.[159] Yet they may have an outsized impact in go-shops. When the company conducts a pre-signing auction, discussions with management can more readily exclude management's own employment arrangements until an agreement in principle has been reached on behalf of shareholders.[160] In those discussions, management may find its interests best served, probabilistically, by maximizing the value of its own "skin in the game" — namely, its sell-side shares. But if, at the onset of a go-shop process, management *knows* that it will tend to benefit from the price being lowest, its incentives become clearly misaligned from those of the other shareholders. Furthermore, without a "bird in the hand," management may be less willing to interfere with the sale process, for fear of losing all potential buyers. Increased awareness of the improved potential to "corrupt" management under the go-shop model may be driving the decline in jump rates.

D. Banker Effects

Investment bankers regularly have conflicts of interest. Rob Kindler, Global Head of Mergers & Acquisitions and Vice Chairman of Morgan Stanley, once famously acknowledged: "We are all totally conflicted — get used to it."[161] Senior practitioners sometimes observe an inflection

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[159] *See id.* at 635.

[160] *See id.* at 640 & n.271.

[161] Andrew Ross Sorkin, *Conflicted, and Often Getting a Pass*, N.Y. TIMES: DEALBOOK (Mar. 12, 2012, 8:12 PM), https://nyti.ms/33pnrZa [https://perma.cc/Z2JA-9YST]. *But cf.* Charles W. Calomiris & Donna M. Hitscherich, *Banker Fees and Acquisition Premia for Targets in Cash Tender Offers: Challenges to the Popular Wisdom on Banker Conflicts*, 4 J. EMPIRICAL LEGAL STUD. 909, 937 (2007) ("Contrary to the jaundiced view of fairness opinions, greater fixity of fees paid by targets generally is not associated with higher acquisition premia and there is no evidence that targets' investment banks are suborned by acquirors with whom they have had a prior banking relationship."). However, the authors acknowledge that "the precision of the[ir] estimates is low, owing to small sample size," and they "do not claim to be able to reject" the cynical view based on their

point in investment banker behavior in the mid-1990s, when many of the larger investment banks went public.[162] Before, some claim, bankers perceived that they had a professional obligation to render unbiased advice to their client, similar to (in theory, at least) doctors, lawyers, and other professionals. But after banks went public, the profit-seeking motive supplanted professional obligations.

Investment bankers particularly value their PE firm clients, because PE firms are repeat players in the deal marketplace, and therefore generate enormous fees. Even a large and acquisitive public company might do one or two significant deals a year. A PE firm, between acquisitions and divestitures, might do five. The implication is that while investment bankers regularly have conflicts of interest (as Kindler admitted), these conflicts can be particularly pronounced in PE deals.

In the context of go-shops, investment banker conflicts can manifest themselves in at least two ways, one on each side of the table. *First*, the sell-side investment banker, whose job is to run the go-shop process, might have incentives to *not* find a higher bidder, in order to please their "real" client, the PE buyer. *Second*, the buy-side investment banker, trying particularly hard to please their (real) PE buyer client, might discourage prospective go-shop bidders from participating in the go-shop process. The remainder of this section describes each of these in turn. The net effect, consistent with the overall empirical evidence presented in this Article, is that go-shops will be less meaningful as a mechanism for price discovery.

1. Conflicts with Buy-Side Clients. — Sell-side investment bankers typically receive a 1–2% fee for their work, with the percentage fee generally going down as the deal size goes up.[163] The fee is calculated as a percentage of deal value, so if the deal price goes up, the bankers' fee goes up. In theory, this pay arrangement aligns the bankers with the goal of maximizing shareholder value. In practice, however, the upside from finding a higher go-shop bidder is trivially small: for example, a 10% overbid (which is typical) during a go-shop process would yield a 0.15% higher fee for the investment bank.[164] In a billion-dollar deal, this standard overbid during the go-shop process would add $1.5 million to the bankers' fee.

Compared to this small amount of upside opportunity on the sell side, investment bankers would no doubt consider their future potential relationship with their PE firm buyer. This buy-side interest can easily

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regressions. *Id.* at 935. The study is also based on all-cash deals over $100 million, not just go-shops, announced between 1994 and 2002. *Id.* at 918.

[162] *See* Alan D. Morrison & William J. Wilhelm, Jr., *The Demise of Investment Banking Partnerships: Theory and Evidence*, 63 J. FIN. 311, 311 (2008).

[163] M&A FEE GUIDE 2017, FIRMEX & DIVESTOPEDIA 14 (2017).

[164] Using a typical banker fee of 1.5% of deal value, 1.5% * 10% = 0.15%.

swamp any interest that the bank might have on the sell side. Consider, for example, the 2016 buyout of ExamWorks by Leonard Green Partners (LGP), a well-known PE firm.[165] Goldman Sachs, the banker for the seller, had received $53 million in fees from LGP in the prior two years.[166] Goldman received four times less — $13 million — for its sell-side work on ExamWorks.[167] It would be reasonable for Goldman to believe that it would continue to receive fees from LGP if it did a "good job" on the ExamWorks deal, in which a "good job" would mean not finding a higher bidder during the go-shop period.

The ExamWorks Proxy Statement acknowledged Goldman's conflict of interest but dismissed it because Evercore, another investment bank, was also involved as an advisor to the company.[168] But this reliance on Evercore to cleanse the Goldman Sachs conflict was also unwarranted because of Evercore's own conflict of interest. William Shutzer was a director of ExamWorks and a Senior Managing Director at Evercore at the time of the deal.[169] In the final deal, Shutzer contributed $11 million of his own money on the buy side.[170] Shutzer also continued on the board as a director of ExamWorks post-closing, for which he would naturally receive board fees.[171] While running the go-shop, therefore, the Evercore bankers would have known that: (a) Shutzer, their Senior Managing Director, was making an $11 million investment on the buy side, alongside LGP; (b) Shutzer might not have the opportunity to make the same investment if Evercore found a higher bidder during the go-shop period; and (c) Evercore stood to receive a $13 million fee in part because Shutzer's $11 million investment helped finance the deal. To the extent that the Evercore bankers were trying to please (or thank) their Senior Managing Director, they too would want the LGP deal to close, which would mean *not* finding a higher bidder. These incentives

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[165] Subramanian served as an expert witness on deal process for petitioners seeking an appraisal of their shares in this transaction.

[166] ExamWorks Proxy Statement, *supra* note 127, at 68 (disclosing fees "for financial advisory and/or underwriting services provided to Leonard Green and its affiliates and portfolio companies of approximately $53.2 million in the aggregate").

[167] *Id.* (disclosing fees "for its services in connection with the proposed merger an aggregate fee [then] estimated to be approximately $13,080,000").

[168] *Id.* at 41 ("The Board also determined that while Goldman Sachs had been involved in transactions with LGP or its affiliates in the last two years, those engagements should not impact a Company transaction with LGP and even were that not the case, any potential conflict would be mitigated by, among other things, Evercore's involvement in the transaction.").

[169] *Id.* at 8.

[170] *Id.* at G-24 (disclosing rollover investors).

[171] *Id.* at 8 (noting "the expectation that Mr. Shutzer [would] serve as a director of the surviving company").

were in direct conflict with the interests of the ExamWorks shareholders. Consistent with this analysis, no higher bidder emerged during the thirty-five-day go-shop period.[172]

As the ExamWorks example illustrates, sell-side investment banker conflicts of interest can be subtle and complex. But in our experience observing numerous deals, they are commonplace if not ubiquitous — we concur with Kindler's candid statement that investment bankers "are all totally conflicted." Even in situations where sell-side advisors do not have ongoing relationships with the PE firm buyer, as Goldman did in the case of LGP, sell-side advisors will certainly be aware of the possibility of future business. Bankers regularly keep lists of "possible," "likely," and "highly likely" prospective future clients. PE firms are generally very high on their list.[173] Therefore, even though their formal obligation is to the sell side, as a practical matter the sell-side bankers may have strong allegiances to the buy side. An important manifestation of this effect would be reduced effectiveness of go-shop processes.

2. Interference with Go-Shop Process. — Investment bankers can also distort go-shop processes from the buy side by interfering with prospective go-shop bidders. Zealous investment bankers, trying to please their high-rolling PE clients, would have strong incentives to deter prospective third-party bidders as much as possible. In the Fortune Brands acquisition of Norcraft, for example, Royal Bank of Canada (RBC) advised Fortune. Although Fortune Brands was a strategic buyer, not a PE firm (and therefore the deal is not included in the New Sample), Fortune was highly acquisitive,[174] which means the same repeat-buyer dynamic was at play.

Robert Biggart, the Fortune Brands General Counsel, testified at trial that his CEO, Christopher Klein, did not like the fact that the merger agreement provided Norcraft a thirty-five-day go-shop:

> [Chris Klein] really didn't like the go-shop provision. . . . [H]e wanted to buy the company. And he didn't see how [the go-shop] was in his interest. . . . I spent a lot of time explaining to him that we needed to do the go-shop on this thing. Not because it was helping Fortune Brands, but it . . . allowed the Norcraft board to satisfy their fiduciary duties . . . .

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[172] ExamWorks Definitive Additional Materials (Schedule 14A), at 3 (June 23, 2017) ("All of the 46 parties ultimately indicated that they were unable to provide value equal to or greater than $35.05 per share.").

[173] Manasa Reddy Gummi, Restricted Investment in Private Equity: The Volcker Rule's Incursion into Banking? (2013) (unpublished LL.M. Graduate Research Paper, Cornell Law School) http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1062&context=lps_LLMGRP [https://perma.cc/X629-RPK5] ("Private equity firms are important clients for banks, since the frequency and scale of their transactions are larger than those of traditional borrowers.").

[174] *See Mergers & Acquisitions History*, FORTUNE BRANDS (Oct. 2017), https://www.fbhs.com/getattachment/about-us/Fortune-Brands-M-A-Timeline-Oct2017-(1).pdf [https://perma.cc/SQ8J-VBBY] (providing a timeline of Fortune Brands' M&A transactions).

> . . . I spent a lot of time convincing Mr. Klein. He didn't like the idea. He didn't want to be embarrassed, because once you announce the deal — he's the CEO. He didn't like the idea that he could have potentially been embarrassed and somebody else could have bought it out from under him.[175]

RBC, no doubt, understood that its client did not like the go-shop. It therefore set up calls with potential go-shop participants. Such calls are typically within the purview of the sell side, under the (intuitive) theory that the seller will pitch the bidder in the interest of obtaining an overbid. Instead of pitching Norcraft, however, the purpose of these calls was to highlight Norcraft's particular strategic value to Fortune, so as to diminish the value it might represent to another potential acquirer:

> *RBC to Mr. Klein*: "We've [already] spoken to several private equity firms (Onex, AEA, American Securities)."
>
> *Mr. Klein to RBC*: "The trick . . . is not to make Norcraft sound very interesting for [prospective bidders]," and to "shut[] the door on them and their willingness to look at it."
>
> *RBC to Mr. Klein*: "We are on the same page. . . ."[176]

Biggart later testified that "[T]here's no way a banker should be doing this. . . . Chris [Klein] had a lapse in judgment."[177] Fortune's CFO Lee Wyatt agreed: "[M]y view was I wouldn't do this for multiple reasons, one of which is it's probably not appropriate."[178] In reviewing the overall "shambolic" process in the sale of Norcraft, the Delaware Court of Chancery described it as well:

> In an effort to ensure that Fortune would reap the benefits of its hard-fought bargain, RBC and Klein devised a strategy to dissuade potentially interested parties from engaging with Norcraft [during the go-shop period]. . . .
>
> When Fortune's general counsel, Biggart, learned of this correspondence, he nearly had "a heart attack in [his] office."[179]

Notwithstanding the after-the-fact hand-wringing, it is not clear what law (or even norm) Fortune Brands violated by interfering with Norcraft's go-shop process. Absent any prohibition, overzealous bankers, trying to please their high-roller PE clients, might readily engage in such behavior. We have no systematic evidence on how pervasive the phenomenon of buy-side banker interference is. But we do know that it exists, that there are no obvious impediments to its proliferation, and

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[175] Trial Transcript — Volume I at 135–36, Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940 (Del. Ch. July 27, 2018).

[176] Subramanian Norcraft Trial Demonstratives, *supra* note 151, at 21 (alterations and omissions in original).

[177] *Id.* (alterations and omission in original).

[178] *Id.* (alteration in original).

[179] *Blueblade*, 2018 WL 3602940, at *40–41 (alteration in original) (quoting Testimony of Robert Biggart, Trial Transcript at 144:3–4).

that it would be difficult to detect in the absence of litigation. This phenomenon would again diminish the effectiveness of go-shops as a mechanism for price discovery.

E. Collateral Terms

Finally, we observe that the structure of the go-shop can sometimes reduce its effectiveness as a mechanism for price discovery. We present three such examples in this section. In all three, it is the interaction of the various terms, rather than any particular term on its own, that reduces the effectiveness of the go-shop.[180] This is not surprising: if lawyers made the go-shop ineffective through straightforward means (for example, shrinking the go-shop window to five days, or increasing the go-shop termination fee to six percent), the Delaware courts would readily invalidate these deal features. Lawyers, particularly in the high-stakes world of corporate M&A, are more skilled than that and have better methods for burying their handiwork.

1. Requiring a Full-Blown Superior Proposal. — Most go-shop provisions define an Excluded Party as a prospective bidder whose bid "constitutes or is reasonably expected to result in a Superior Proposal."[181] Recall that an Excluded Party gets the benefit of the go-shop termination fee, which tends to be half as large as the standard termination fee.[182] This means that a third-party bidder typically does not have to get to a full-blown Superior Proposal by the end of the go-shop period. Delaware courts have looked favorably on this "reasonably expected" language, finding that a go-shop process is more meaningful

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[180] *Cf.* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887, 925 (2002) (documenting how the interaction among takeover defenses, rather than any particular defense on its own, determines the overall vulnerability of a target company).

[181] *E.g.*, CKE Restaurants, Inc., Annual Report (Form 8-K) Ex. 2.1, at § 5.2(j) (Feb. 26, 2010) ("'Excluded Party' shall mean any Person . . . from whom the Company or any of its Representatives has received a Takeover Proposal after the execution of this Agreement and prior to the No-Shop Period Start Date that . . . the Board of Directors of the Company determines in good faith . . . constitutes or is reasonably expected to lead to a Superior Proposal . . . ." (emphasis omitted)). Most merger agreements achieve this result directly, by requiring only a reasonable likelihood of a Superior Proposal in order to achieve Excluded Party status. *See, e.g.*, *id.* Some merger agreements achieve this result indirectly, by requiring only an Acquisition Proposal to achieve Excluded Party status, and defining an Acquisition Proposal to include an "inquiry" regarding a merger or other business combination. *See, e.g.*, BWAY Holding Co., Definitive Proxy Statement (Schedule 14A) Annex A, at § 8.12(a) (Mar. 29, 2010) ("Exempted Person means any Person, group of Persons or group of Persons that includes a Person from whom the Company has received a written Acquisition Proposal after the execution of this Agreement and prior to the No-Shop Period Start Date." (emphasis omitted)); *id.* ("'Acquisition Proposal' means (i) any inquiry, proposal or offer relating to a merger, joint venture, partnership, consolidation, dissolution, liquidation, tender offer, recapitalization, reorganization, share exchange, business combination or similar transaction involving more than 20% of the total voting power of the capital stock . . . .").

[182] *See supra* section I.A, pp. 1219–21.

when a prospective third-party bidder does not have to "get the whole shebang done" during the go-shop window.[183] Courts and practitioners understand that a lower bar to qualify for Excluded Party status will encourage prospective bidders to participate in the go-shop process in the first place.

However, some recent deals have ignored the Delaware courts' not-so-subtle hints on how a go-shop should be structured. Rather than requiring that a bidder be "reasonably likely" to make a Superior Proposal in order to qualify for Excluded Party status, these deals have required prospective go-shop bidders to get "the whole shebang" done during the go-shop period in order to qualify for the (lower) go-shop termination fee. Three examples illustrate the point.

In January 2018, Silver Lake Partners announced the acquisition of Blackhawk Network Holdings, Inc. for $2.6 billion.[184] The deal included a twenty-five-day go-shop and a five-day unlimited match right,[185] already a remarkably tight go-shop structure for a deal of this size. Plaintiffs pointed out in their complaint that a go-shop bidder would have to bid just nine days into the go-shop period if Silver Lake matched just twice in order to have a pathway to success under this structure (and of course, a go-shop bidder would not know how many times Silver Lake would match when it first bid).[186] Perhaps to ensure the complete ineffectiveness of the go-shop process, the merger agreement further provided that the reduced go-shop termination fee of $81.7 million (amounting to 3.0% of deal equity value) was payable only if the Blackhawk board accepted a third-party offer and terminated the merger agreement with Silver Lake during the go-shop period — a virtually impossible task in view of the already tight twenty-five days and the

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[183] *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 120 (Del. Ch. 2007); *see id.* at 119–20 ("This was not a [go-shop] provision that gave a lower break fee to a bidder who entered the process in some genuine way during the go-shop period — for example, by signing up a confidentiality stipulation and completing some of the key steps toward the achievement of a definitive merger agreement at a superior price. Rather, it was a provision that essentially required the bidder to get the whole shebang done within the 45-day window."); *see also In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *40 (Del. Ch. May 31, 2016) ("More flexible go-shops only require an acquirer to provide a non-binding indication of interest in a transaction that could lead to a Superior Proposal, and they define the concept of 'Superior Proposal' broadly. More restrictive go-shops demand more, such as a bona fide offer that qualifies as a Superior Proposal, a fully financed bid, or even a fully negotiated merger agreement. A nominally shorter go-shop that requires less to qualify as an Excluded Party may be more open as a practical matter than a nominally longer go-shop that imposes tougher criteria for Excluded Party status.").

[184] Imani Moise, *Silver Lake, P2 Capital to Take Blackhawk Network Private for $2.57 Billion*, WALL ST. J. (Jan. 16, 2018, 10:02 AM), https://www.wsj.com/articles/silver-lake-p2-capital-to-take-blackhawk-network-private-for-2-57-billion-1516110518 [https://perma.cc/68Q7-NLKH]. The $2.6 billion figure excludes the value of debt.

[185] Verified Class Action Complaint at 44, 50, City of Warren Gen. Emps.' Ret. Sys. v. Roche, C.A. No. 2019-0740 (Del. Ch. Sept. 18, 2019).

[186] *Id.* at 51–52.

five-day match right.[187] Not surprisingly, no bidders appeared during the go-shop period, and the deal closed in June 2018.[188]

In November 2018, Vista Equity Partners announced the acquisition of Apptio Inc. for $1.6 billion.[189] The deal included a thirty-day go-shop period, a two-day unlimited match right, a $29 million go-shop termination fee (amounting to 1.9% of deal equity value), and a $58 million termination fee after the go-shop period expired (amounting to 3.7% of deal equity value).[190] However, like Blackhawk, a third party would pay the go-shop termination fee only if the Apptio board accepted its offer during the go-shop period.[191] This meant that in order to qualify for the reduced go-shop termination fee, a third party would have had to make a Superior Proposal and trigger Vista's two-day match right; then the Apptio board would have had to determine that the third-party bid was superior, terminate the merger agreement with Vista, and enter into a new merger agreement with the third-party bidder — all within the thirty-day go-shop period. Running this gauntlet would be virtually impossible for a third-party bidder. No bidders appeared during the go-shop period, and the deal closed in January 2019.[192]

In December 2018, Vista Equity Partners (again) announced the acquisition of MindBody, Inc. for $1.9 billion.[193] The deal was structured

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[187] *See* Blackhawk Network Holdings, Inc., Definitive Proxy Statement (Schedule 14A) Annex A, at § 9.5(b)(iii) (Mar. 2, 2018) ("[T]he Termination Fee shall mean a fee of $81,700,000 instead of $109,000,000 in the event that this Agreement is terminated pursuant to Section 9.3(a) and the fee is paid on or prior to the No-Shop Period Start Date.").

[188] Press Release, Blackhawk Network Holdings, Inc., Acquisition of Blackhawk by Silver Lake and P2 Capital Partners Complete (June 15, 2018), https://blackhawknetwork.com/acquisition-of-blackhawk-by-silver-lake-and-p2-capital-partners-complete [https://perma.cc/4JKX-5Y82].

[189] Press Release, Apptio, Inc., Apptio Enters into Definitive Agreement to be Acquired by Vista Equity Partners for $1.94 Billion (Nov. 11, 2018), https://www.apptio.com/company/news/press-releases/apptio-enters-into-definitive-agreement-to-be-acquired-by-vista-equity-partners-for-$1.94-billion [https://perma.cc/LFF9-RWTZ].

[190] *See* Apptio, Inc., Preliminary Proxy Statement (Schedule 14A) Annex A, at § 8.3(b)(iii) (Nov. 21, 2018) [hereinafter Apptio Merger Agreement] ("If this Agreement is validly terminated pursuant to Section 8.1(h) [so that Apptio can accept a Superior Proposal], then the Company must prior to or concurrently with such termination pay to Parent the Company Termination Fee [= $58 million]; provided, that if (A) such termination occurs prior to the No-Shop Period Start Date and (B) the Company has entered into a definitive Alternative Acquisition Agreement to consummate an Acquisition Transaction at the time of such termination, then the 'Company Termination Fee' shall mean an amount equal to $29,070,000." (emphasis omitted)).

[191] *See* Apptio, Inc., Definitive Proxy Statement (Schedule 14A) at 71 (Dec. 10, 2018) ("If Apptio terminates the Merger Agreement for the purpose of entering into an agreement in respect of a Superior Proposal prior to the No Shop Period Start Date, Apptio must pay a termination fee of $29.07 million to Parent.").

[192] Press Release, Apptio, Inc., Vista Equity Partners Completes Acquisition of Apptio (Jan. 10, 2019, 9:29 AM), https://www.prnewswire.com/news-releases/vista-equity-partners-completes-acquisition-of-apptio-300776260.html [https://perma.cc/BMA5-EJSK].

[193] Press Release, MINDBODY, Inc., MINDBODY Enters into Definitive Agreement to Be Acquired by Vista Equity Partners for $1.9 Billion (Dec. 24, 2018), https://company.

virtually identically to Apptio: a thirty-day go-shop period, a two-day unlimited match right, a $29 million go-shop termination fee (amounting to 1.7% of deal equity value), and a $57 million termination fee after the go-shop period expired (amounting to 3.4% of deal equity value).[194] Yet again, a prospective third party would have had to run the gauntlet: make a Superior Proposal, wait two days for Vista's match period to expire, and (assuming that Vista did not match), have MindBody terminate its merger with Vista and enter into a merger agreement with the third party, all within thirty days, in order to qualify for the go-shop termination fee.[195] Needless to say, no bidders appeared during the go-shop period, and the deal closed in February 2019.[196]

As a transactional practice point, it is not surprising that the go-shops in Apptio and MindBody were structured virtually identically. Vista was the buyer in both deals; they were announced only a few weeks apart; and (perhaps most importantly) Kirkland & Ellis (K&E), a well-known corporate law firm with PE expertise, advised Vista on both of these transactions. In fact, the same three attorneys, all from K&E's San Francisco office, are listed as Vista's counsel in both of the merger agreements.[197] Most likely, these attorneys used the Apptio merger agreement as the template for MindBody.

The more surprising fact is that the other side in each of these three deals agreed to go-shops that were highly unusual and that significantly reduced their effectiveness. It is also surprising that the parties, collectively, would ignore the Delaware courts' warnings against requiring a third-party bidder to get the "whole shebang" done during the go-shop

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mindbodyonline.com/press/mindbody-enters-into-definitive-agreement-to-be-acquired-by-vista-equity-partners-for-19 [https://perma.cc/S4ZG-Y3RG].

[194] *See* MINDBODY, Inc., Definitive Proxy Statement (Schedule 14A) Annex A, at § 8.3(b)(iii) (Jan. 23, 2019) [hereinafter MINDBODY, Inc. Merger Agreement] ("If this Agreement is validly terminated pursuant to Section 8.1(h), then the Company must prior to or concurrently with such termination pay to Parent the Company Termination Fee [= $57 million]; provided, that if (A) such termination occurs prior to the No-Shop Period Start Date and (B) the Company has entered into a definitive Alternative Acquisition Agreement to consummate an Acquisition Transaction at the time of such termination, then the 'Company Termination Fee' shall mean an amount equal to $28,584,000." (emphasis omitted)).

[195] S*ee id.* at 73–75 ("If MINDBODY had terminated the Merger Agreement for the purpose of entering into an agreement in respect of a Superior Proposal prior to the No Shop Period Start Date, MINDBODY would have been required to pay a termination fee of $28.584 million to Parent. . . . If MINDBODY terminates the Merger Agreement after the No Shop Period Start Date but prior to the adoption of the Merger Agreement by MINDBODY stockholders for the purpose of entering into an agreement in respect of a Superior Proposal, MINDBODY must pay a $57.168 million termination fee to Parent.").

[196] Press Release, MINDBODY, Inc., Vista Equity Partners Completes Acquisition of MINDBODY, Inc. (Feb. 15, 2019), https://company.mindbodyonline.com/press/vista-equity-partners-completes-acquisition-of-mindbody-inc [https://perma.cc/DW83-J2XY].

[197] *See* Apptio Merger Agreement, *supra* note 190, § 9.2(a) (requiring notices and other communications to Vista to be sent to Stuart E. Casillas, Joshua M. Zachariah, and Joseph K. Halloum of K&E San Francisco); MINDBODY, Inc. Merger Agreement, *supra* note 194, § 9.2(a) (same).

window.[198] Go-shops that are structured in this way are virtually meaningless as a mechanism for price discovery. Blackhawk and MindBody are currently in litigation in the Delaware Court of Chancery, in part over the highly unusual go-shop structure.

2. Tightening the Go-Shop Window. — The Blackhawk, Apptio, and MindBody transactions represent a relatively simple way to make the go-shop less meaningful, but things can get a lot more complicated. The 2016 sale of SciQuest to PE firm Accel-KKR (AKKR) illustrates the way in which experienced practitioners can make a go-shop even less effective, if not totally useless, through a complex interaction of deal terms. The starting point is the twenty-five-day go-shop window — already at the shorter end of go-shop windows.[199] Layer on top of that the SciQuest Excluded Party definition, which required "a *bona fide* written Acquisition Proposal . . . prior to the No-Shop Period Start Date . . . , which such written Acquisition Proposal the Board of Directors of the Company . . . has determined in good faith . . . constitutes a Superior Proposal . . . ."[200] This is in stark contrast to the normal "reasonably likely" language, but functionally equivalent to the Blackhawk, Apptio, and MindBody go-shops. As discussed in section II.D.1 above, it is far more difficult — and takes considerably more time — to make a bona fide Acquisition Proposal and have the board declare it to be a Superior Proposal than it takes to make a proposal that has a reasonable likelihood of resulting in a Superior Proposal. This tightening of the Excluded Party definition makes the Go-Shop Period even shorter than the nominal twenty-five days.

In case this were not enough, the consequences of not achieving Excluded Party status prior to the end of the SciQuest go-shop period were severe. The merger agreement provided that, as of the end of the twenty-five days, SciQuest was required to (i) "immediately cease any discussions or negotiations" with any go-shop participant that had not made a full-blown Superior Proposal and reached Excluded Party status and (ii) request that such go-shop participant "return or destroy all con-

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[198] *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 120 (Del. 2007). However, anecdotal experiences suggest that the plaintiffs' bar does not fully police the Excluded Party definition in go-shop deals. For example, in one recent deal, Sirius XM's acquisition of Pandora Media, the plaintiffs' attorneys entirely missed the point that the Excluded Party definition required a prospective third-party bidder to get the "whole shebang" done during the go-shop period. *See* Verified Class Action Complaint at 48–49, Tornetta et al. v. Sirius XM Holdings, Inc., C.A. No. 2019-0649 (Del. Ch. Aug. 20, 2019) (noting numerous flaws in the go-shop but not the Excluded Party definition). Transactional attorneys will continue to take up the invitation to tighten Excluded Party definitions unless the plaintiffs' bar adequately polices the deal.

[199] *See supra* p. 1229 tbl.2.

[200] SciQuest Merger Agreement, *supra* note 93, § 1.1 (defining "Excluded Party"). An Acquisition Proposal is defined, in relevant part, as "any proposal or offer . . . representing more than 20% of all outstanding equity securities of the Company." *Id.* (defining "Acquisition Proposal").

fidential information" provided by SciQuest to such go-shop participant.[201] Therefore, at the end of the twenty-five-day go-shop period, unless a prospective go-shop bidder got to a full-blown Superior Proposal, it would be cut off from further discussions and access to information.

Even if a go-shop participant managed to make a full-blown Superior Proposal and reach Excluded Party status during the go-shop period, such Excluded Party would still face an impending deadline for discussions with SciQuest. The merger agreement specified that even an Excluded Party, having made a Superior Proposal, had only an additional fifteen days (until July 9, 2016, termed the "Excluded Party Deadline") before SciQuest was required to (i) "immediately cease any discussions or negotiations" with the Excluded Party and (ii) request that the Excluded Party "return or destroy all confidential information" provided by SciQuest.[202] This meant that a go-shop bidder might run the gauntlet of the SciQuest go-shop provisions and still get kicked out of the process due to the Excluded Party Deadline. And, of course, prospective bidders would be deterred not just by actually hitting the Excluded Party Deadline, but by the possibility that they might.

In addition to having a deterrent effect on its own, AKKR's five-business-day unlimited match right also interacted with the Excluded Party provision. Consider the situation where a potential third-party bidder could bid more than AKKR's current bid, but the third party believed there was some chance that AKKR would match. The third party could not wait until the end of the go-shop period to make a Superior Proposal, because if AKKR matched, the third-party bid would no longer be a Superior Proposal, the third party would not be considered an Excluded Party, and the third party would be cut off from access to information and management from the company.

As a specific example, assume that a third party made a Superior Proposal on June 17, 2016, which would have been the nineteenth day of the go-shop period. AKKR would then have five business days to match, which would last through the end of the go-shop period on June 24. If AKKR decided to match, AKKR would rationally take the full five business days and match at the end of the go-shop period, so that the third party could not qualify as an Excluded Party, which means that the third party would be cut off from further discussions with SciQuest. Looking forward and reasoning back, a prospective third party would not have a "pathway to success" even if it made a Superior Proposal on the nineteenth day of the go-shop period. Of course, if the third party envisioned that AKKR might match more than once, then it would have to make an Acquisition Proposal even earlier — moving

[201] *Id.* § 6.2(b).
[202] *Id.*

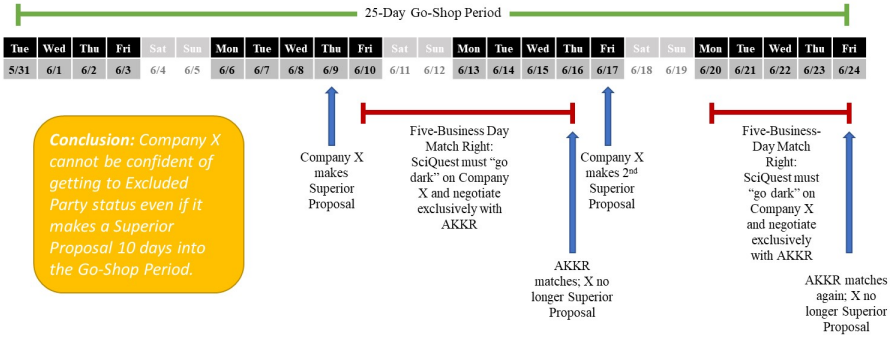
forward by *seven* calendar days (that is, five business days) for each additional match assumed.

Moreover, as discussed in section II.A above, during any five-business-day (seven-calendar-day) period that AKKR had to match, SciQuest was required to "negotiate . . . on an exclusive basis" with AKKR.[203] This exclusive negotiation requirement meant that SciQuest would have to go silent with any potential third-party bidder while it negotiated exclusively with AKKR. Just by itself, this week-long period of silence would amplify information asymmetry concerns and disrupt any third-party bidder attempting to top AKKR's offer.

Finally, the merger agreement specified that Excluded Party status would automatically terminate on the Excluded Party Deadline (July 9).[204] This meant that AKKR could slow dance to the finish line by matching bids until July 9, which would then permanently kick the third party out of Excluded Party status and cut off the third party's further access to SciQuest. And because of the five-business-day unlimited match right, AKKR would not have to match very often to be able to get to July 9.

Putting it all together, a third party (Company X) could make a full-blown Superior Proposal ten days after the go-shop period began and still not be guaranteed to get to Excluded Party status if AKKR matched just twice. And without a clear pathway to success, Company X would be deterred from participating in the first place. Figure 2 illustrates the point:

Figure 2: Interaction Among Deal Terms in SciQuest Go-Shop



No surprise, then, that one prospective bidder in the SciQuest go-shop process responded to the seller's bankers that it "could not move

[203] *Id.* § 6.2(e).

[204] *Id.* § 1.1 (defining "Excluded Party" and providing that "a Person shall cease to be an 'Excluded Party' from and after 11:59 p.m. (Eastern Time) on July 9, 2016").

fast enough to develop an opinion on value."[205] Another prospective bidder emailed back: "We've discussed this at length and have decided not to proceed [in the go-shop process] which was a difficult decision for us. While we are very interested in the company . . . , the deal dynamic is not one we are comfortable with given the tight time frame."[206] And a third bidder responded: "Given the timeframe we'll not try to pursue it."[207]

The architects for this remarkable set of go-shop terms were AKKR's attorneys at — you guessed it — Kirkland & Ellis.[208] K&E is highly experienced in M&A and (with their PE focus) go-shop deals in particular. K&E attorneys would know the importance of things like the Excluded Party definition, the Superior Proposal definition, and the duration and nature of the match rights. Rather than stopping with a go-shop that "only" required a Superior Proposal during the go-shop period, as they did in Apptio and MindBody, K&E went further to insert highly unusual provisions, which, taken together, effectively eviscerated the SciQuest go-shop.

SciQuest was represented by Smith Anderson, a North Carolina law firm. Smith Anderson has significantly less experience than K&E in both public company M&A and go-shop processes in particular. In a search of the MergerMetrics database from 2010 to 2017, we find that Smith Anderson had approximately twenty times less experience with public-company M&A relative to K&E.[209] And the lead banker at Stifel, who was tasked with actually running the go-shop process, had never run a go-shop before.[210] The SciQuest board did not recall having any discussions about the details of the go-shop, other than its duration.[211] And SciQuest management might well have preferred an eviscerated go-

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[205] Petitioners' Pretrial Brief at 16, Blueblade Capital Opportunities LLC v. SciQuest, Inc., C.A. No. 12831, 2019 WL 2009634 (Del. Ch. dismissed May 13, 2019).

[206] *Id.* at 17 (alteration in original) (emphasis omitted).

[207] *Id.*

[208] SciQuest Proxy Statement, *supra* note 96, at 33.

[209] We use the MergerMetrics database for this analysis, rather than Thomson SDC Platinum, because MergerMetrics generally has more comprehensive reporting on the law firms advising on the transaction. Smith Anderson is identified as sell-side counsel in a public company deal four times (including SciQuest), compared to fifty-two times for K&E. Only one of Smith Anderson's representations (other than SciQuest) involved a go-shop deal, compared to eleven for K&E. On the buy side, Smith Anderson is also identified four times, compared to 114 times for K&E. In sum, Smith Anderson is identified eight times, compared to 166 times for K&E.

[210] *See* Petitioners' Pretrial Brief, *supra* note 205, at 29 ("Q: Prior to this transaction, had you negotiated a go-shop, the terms of the go-shop? A: No.") (quoting deposition testimony from Stifel banker).

[211] *See id.* at 31 ("Q: Do you remember any Stifel discussion of the definition of either an excluded party or a superior proposal in the merger agreement? [A]: No. Q: Are you aware that there are different formulations of an excluded party definition in merger agreements? [A]: No.") (quoting testimony from SciQuest director).

shop because AKKR made clear that it would keep management on board after the deal closed.[212]

In general, when there is a noticeable expertise asymmetry between negotiators and/or when one negotiator does not pay attention to certain issues, it is not surprising when that party gets a bad deal on those issues. Key negotiators for SciQuest did not seem to understand the significance of the Superior Proposal definition, the Excluded Party definition, the match right, and how they all interacted. The case study illustrates how go-shops need to be structured properly in order to be meaningful. This structuring includes not only the readily observable features, such as the length of the go-shop period and the magnitude of the go-shop termination fee, but also the interaction among all the features of the go-shop taken as a whole. When a go-shop is not structured properly, it will no longer be an effective mechanism for price discovery.

3. Back-Door Tightening Through a Concurrent Tender Offer. — If Blackhawk, Apptio, and MindBody would be taught to aspiring transactional attorneys in "Go-Shops 101" and SciQuest would be taught in "Go-Shops 201," a back-door tightening of the go-shop through a concurrent tender offer would no doubt be taught in a "Go-Shops 301" course. In a nutshell, buy-side practitioners can achieve a "back-door" tightening of the go-shop period if a control stake is required to be tendered before — or around the same time as — the go-shop period expires, such that the acquirer can close its tender offer and gain voting control before the target can exit the merger agreement.

An example illustrates the point. In Fortune Brands' acquisition of Norcraft, also discussed in section II.D.2 above, the merger included Support Agreements from Buller (the CEO), his family, and other large shareholders (collectively, the Covered Shares).[213] The Covered Shares constituted approximately 54% of the Norcraft shares outstanding.[214]

The go-shop period ran thirty-five days, beginning on March 30 and ending on May 4, 2015.[215] By the end of the go-shop period, the Norcraft board would have the right to identify any Excluded Party, defined as a prospective bidder whose bid "constitutes or is reasonably

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[212] *See id.* at 32 ("[T]he retention of management is an important consideration for us in this process, and we want to ensure that we have the appropriate incentives in place to continue building a world-class company." (alteration in original) (quoting AKKR's initial indication to SciQuest)); *see also supra* section II.C.2, pp. 1244–51.

[213] *See, e.g.*, Norcraft Companies, Inc., Solicitation/Recommendation Statement (Schedule 14D-9) (Apr. 14, 2015) Ex. (e)(2), at § 3(a) [hereinafter Buller Family Tender and Support Agreement]. The other Support Agreements were substantively identical.

[214] *See* Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *26 (Del. Ch. July 27, 2018).

[215] Norcraft Companies, Inc., Solicitation/Recommendation Statement (Schedule 14D-9) (Apr. 14, 2015) Ex. (e)(1), at § 5.4 [hereinafter Norcraft Merger Agreement].

likely to result in a Superior Proposal."[216] This meant that a third-party bidder did not have to get to a full-blown Superior Proposal by the end of the go-shop period (unlike SciQuest). So far, so good.

However, the interaction of the Support Agreements with the go-shop period served as a "back-door" shortening of the go-shop period and tightening of the Superior Proposal language. The tender offer period began on April 14, in the middle of the go-shop period, and it expired exactly twenty business days later, on Monday, May 11.[217] The Support Agreements specified that the Covered Shares had to be tendered "promptly following" the initiation of the tender offer, "and in any event no later than two . . . Business Days prior to the initial expiration date of the Offer."[218] This meant that the Covered Shares had to be tendered no later than May 7 (May 9 and 10 were a Saturday and Sunday in 2015), which was just three days after the go-shop period expired.

Once the Covered Shares had been tendered, they could not be withdrawn from the offer "unless and until . . . the Offer shall have been terminated in accordance with the terms of the Merger Agreement."[219] But the Norcraft Board could terminate the merger agreement only to accept a Superior Proposal, not just the likelihood of a Superior Proposal.[220] In addition, the Norcraft board could terminate the merger agreement only after giving Fortune Brands its four-day match right.[221] Putting it all together, a prospective third-party bidder would have to make a full-blown Superior Proposal (not just get to a reasonable likelihood of making a Superior Proposal) well before the go-shop period expired.

To see why, imagine that the Norcraft Board determined that Bidder X was an Excluded Party at the end of the go-shop period (May 4), because Bidder X was "reasonably likely" to make a Superior Proposal. One day later, on May 5, Bidder X in fact made a Superior Proposal. Fortune Brands would now have four business days to match Bidder X's offer before Norcraft could terminate the Merger Agreement. This would give Fortune Brands through May 11 to "negotiate . . . in good

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[216] *Id.* § 8.2 (defining "Excluded Party").

[217] *Id.* § 1.1(a).

[218] Buller Family Tender and Support Agreement, *supra* note 213, § 3(a).

[219] *Id.* § 3(b). Section 3(b) further provides that the Covered Shares could be withdrawn if the Termination Date had occurred. *Id.* The Termination Date was defined as: the termination of the merger agreement; the closing of the Merger; any change to the terms of the Offer; or mutual written consent. *See id.* § 10(a); Norcraft Merger Agreement, *supra* note 215, § 1.4 (defining "Effective Time" as the closing date and time of the Merger).

[220] Norcraft Merger Agreement, *supra* note 215, § 7.1(c)(ii) (permitting Norcraft to terminate the merger agreement in order to "enter into a definitive agreement with respect to a Superior Proposal").

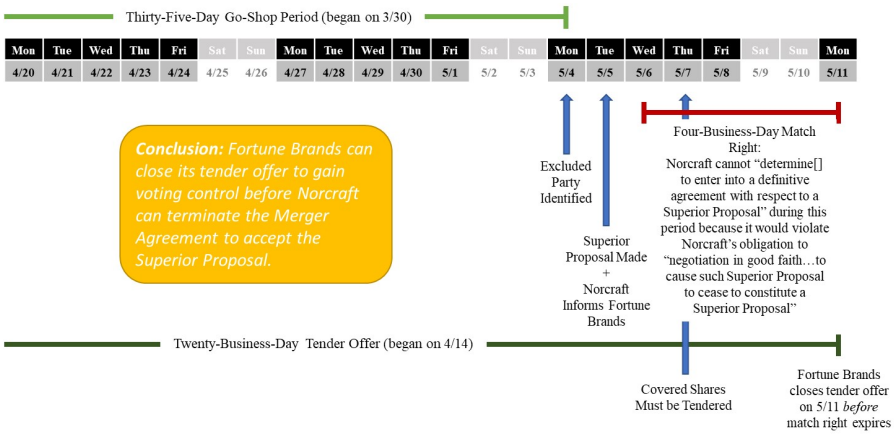
[221] *Id.* § 5.4(g).

faith . . . to make such adjustments in the terms and conditions of this [Merger] Agreement intended to cause such Superior Proposal to cease to constitute a Superior Proposal."[222]

But the Support Agreements (which could not be terminated at this point because the merger agreement was not yet terminated) required that the Covered Shares must be tendered to Fortune Brands no later than May 7. On May 11, Fortune Brands would close its tender offer for the Covered Shares,[223] and would decline to match Bidder X's Superior Proposal. Norcraft would terminate the merger agreement immediately, but at this point it would be too late: Fortune Brands would own 54% of the Norcraft shares pursuant to the Support Agreements. As a controlling shareholder, Fortune could at that point freeze out the remaining (nontendering) shareholders at the same deal price.[224]

Figure 3 summarizes the point in visual form[225]:

Figure 3: Interaction Among Deal Terms in Norcraft Go-Shop



Looking forward and reasoning back, the only way that a prospective third-party bidder could avoid this sequence of events would be to make a full-blown Superior Proposal no later than Thursday, April

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[222] *Id.*

[223] Norcraft did not have a poison pill, and the merger agreement specified that Norcraft would not put in any poison pill or "similar stockholder rights plan" while the merger agreement was in effect. *Id.* § 5.1(a). Norcraft also made a representation in the merger agreement that it had waived section 203 of the Delaware General Corporation Law. *Id.* § 3.24.

[224] *See* Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 5 n.1 (2005). Entire fairness would not apply, provided that Fortune paid the same $25.50 deal price in the freezeout, because the freezeout price had been negotiated at arm's length, before Fortune became a controlling shareholder. *See id.* at 59.

[225] This figure is adapted from Subramanian Norcraft Trial Demonstratives, *supra* note 151, at 17.

30 — which was five days before the go-shop period actually expired and only thirty days after the go-shop period began.[226]

This scenario assumes that Fortune Brands did not exercise its unlimited match right. Each time Fortune Brands exercised its match right, the third-party bidder would have to make its original Superior Proposal two business days earlier than the April 30 date calculated above. For example, if Fortune Brands exercised its match right just once, a prospective third party would have to make a Superior Proposal no later than Tuesday, April 28 — just twenty-eight days after the go-shop period began.

Of course, the number of times that Fortune Brands would exercise its match right would be unknown at the time when the third party made its initial bid. This meant that a third party could make a full-blown Superior Proposal as early as (say) Friday, April 24 — just twenty-four days after the go-shop period began — and still not be assured of winning the inevitable bidding contest (even if the bidder knew that it was the high bidder) if Fortune Brands exercised its match right twice and then closed its tender offer for the Covered Shares before the third party could bid again.[227]

To summarize: the interaction between the Support Agreements, Fortune Brands' match right, and the go-shop period had two effects. *First*, it shortened the go-shop period from thirty-five days to thirty days or even shorter (depending on a third party's expectation about Fortune Brands' willingness and ability to match). *Second*, it tightened the Excluded Party definition, requiring a third party to make a full-blown Superior Proposal (not just demonstrate a reasonable likelihood of a Superior Proposal) within this thirty-day period (or less).

The Delaware Court of Chancery agreed with this assessment in reaching its overall conclusion that the Norcraft go-shop period was not

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[226] If a proposal were made on Thursday, April 30, 2015, the Norcraft board would have two business days (through Monday, May 4) to convene and determine that it was a Superior Proposal. *See* Norcraft Merger Agreement, *supra* note 215, § 5.4(c). Fortune Brands would then have four days to determine whether it wanted to match (May 5–May 8). Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *26 (Del. Ch. July 27, 2018). The Covered Shares would have to be tendered on May 7, but Fortune could not close the tender offer until Monday, May 11. *Id.* at *16. On Friday, May 8, Fortune would decline to match (by assumption), which means that Norcraft could terminate the merger agreement and the Covered Shares could be withdrawn from the tender offer on May 11, before Fortune could close its tender offer at the end of that business day. *See id.* at *22 ("[A]ny potential bidder contemplating whether to participate in the go-shop could wait no longer than April 30 — what Subramanian terms the 'last clear chance' date — to make its superior proposal . . . .").

[227] The conflicts of interest described in section II.C.3 of this Article interact with this analysis. For example, if Buller wished to thwart a third-party bidder who made a Superior Proposal on April 28, he could wait two business days before officially informing Fortune Brands of the Superior Proposal. The four-day match right window would start to tick only on May 4, and the Covered Shares would have to be tendered on May 7, on the last day of Fortune Brands' match right.

effective for price discovery.[228] The court further found that the Fortune team knew exactly what it was doing by insisting on this exceedingly buyer-friendly structure for the go-shop, while the Norcraft side did not.[229] Klein, the Fortune Brands CEO, "touted Fortune's match right as a factor that would discourage other bidders and . . . demanded that the tender offer launch soon after the go-shop began."[230] Jason Baab, head of Fortune's M&A team, "testified that Fortune understood that its unlimited match right and ability to start its own tender offer during Norcraft's go-shop period made it less likely that Norcraft would have a successful go-shop process."[231] In contrast, the Norcraft team demonstrated limited awareness of even the more basic features of the go-shop process.[232] The court quoted (with apparent approval) testimony from one of us that "it seems like . . . the Fortune side was playing chess and the Norcraft side was playing checkers."[233]

Fortune Brands was not the first buyer to use a tender offer to effectively shorten and tighten the go-shop period. In the New Sample, described in section I.D. above, twenty-five deals were executed pursuant to a tender offer, and several of these tender offers expired around the end of the go-shop window. For example, in Ares Management's acquisition of Global Defense Technology & Systems in March 2011, approximately 41% of the Global Defense shares had to be tendered pursuant to support agreements ten business days after the commencement of the tender offer.[234] The go-shop period and the tender offer both ended on April 1, 2011, and Ares had a four-day match right. Therefore, a Superior Proposal would have had to emerge at least four business days before the end of the go-shop period in order for Global Defense to give Ares its four-day match right and then exit the merger agreement.

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[228] *Blueblade*, 2018 WL 3602940, at *25–27.

[229] *Id.* at *22.

[230] Subramanian Norcraft Trial Demonstratives, *supra* note 151, at 9.

[231] *Id.*

[232] *See id.* ("Q: What is your understanding of Fortune's rights during the go-shop period? A: I don't recall." (quoting Mr. Buller, CEO of Norcraft)).

[233] *Blueblade*, 2018 WL 3602940, at *22 (quoting Testimony of Guhan Subramanian, Transcript of Trial at 269:8–:11).

[234] *See* Glob. Def. Tech. & Sys., Inc., Current Report (Form 8-K) Ex. 99.1, at § 3 (Mar. 2, 2011), ("In connection with the Merger Agreement, Contego Systems LLC ('Contego'), which holds approximately 41% of the outstanding Common Stock, entered into a Tender and Voting Agreement (the 'Tender and Voting Agreement'), dated as of March 2, 2011, with the Parent. Under the Tender and Voting Agreement, Contego agreed to tender to the Purchaser all of its shares of Common Stock within 10 business days of the commencement of the Offer and, in the event a vote of the Company's stockholders is called for, to vote any shares of Common Stock it holds (i) in favor of the Merger, the Merger Agreement and the transactions contemplated by the Merger Agreement and (ii) against any competing proposal to acquire the Company, any action that would reasonably be expected to result in the breach of any representation, warranty, agreement or obligation of the Company, any action that would reasonably be expected to impede or adversely affect the timely consummation of the Offer or the Merger or any change in the voting rights of any class of shares of the Company.").

Similarly, in TransDigm Group's acquisition of Breeze-Eastern in November 2015, 54.7% of the Breeze-Eastern shares had to be tendered pursuant to Support Agreements no later than ten business days after the tender offer began.[235] The go-shop period ended on December 28, 2015, and the tender offer expired on December 31, 2015.[236] If a Superior Proposal were submitted on December 28, at the end of the go-shop period, TransDigm had a three-day match right. In theory, Breeze-Eastern could identify a Superior Proposal at the end of the go-shop period (on December 28), give TransDigm three days to match, and terminate the merger agreement on December 31, before the tender offer expired. But if the prospective third party thought that TransDigm would match even once, it would shorten and tighten the go-shop period in the same way as described above.

III. IMPLICATIONS

This Article began by identifying an empirical puzzle: relative to the Original Study, the pre-signing market canvass in go-shop transactions announced between 2010 and 2019 is *unchanged*, and the post-signing market canvass is significantly *up*, yet jump rates have dropped to effectively zero.[237] This Article then presented several explanations for this change: the proliferation of matching rights, the shortening of go-shop windows in larger deals, CEO conflicts of interest, investment banker effects, and collateral terms that have the effect of shortening and tightening the go-shop window. We now turn to implications of these developments for corporate boards and the Delaware courts.

A. For Boards

In this Article, we affirm the core conclusion from the Original Study that a go-shop can be an effective tool for conducting a meaningful market canvass and achieving price discovery, if — but only if — it is "appropriately structured."[238] When go-shops were first invented, they were indeed structured appropriately. But with time, it is perhaps not surprising that practitioners have pushed the limits of the technology, and go-shop structuring has correspondingly deteriorated. Our updated evidence suggests that corporate boards should be more skeptical today of using go-shops to fulfill their obligation to maximize value in the sale of their companies.

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[235] *See* Breeze-Eastern Corp., Current Report (Form 8-K) Ex. 10.1, at § 1 (Nov. 19, 2015).
[236] *Id.* Ex. 2.1, at § 6.2(c)(1).
[237] *See supra* section I.D, pp. 1226–32.
[238] *Original Study*, *supra* note 3, at 731.

More specifically, boards should not allow a post-signing go-shop to crowd out a pre-signing market canvass. If the board is going to truncate pre-signing competition, the board should make sure that it gets something in exchange — ideally, a price bump. The Original Study documented several examples where the seller extracted a price bump in exchange for pre-signing exclusivity.[239] We find fewer instances of this kind of quid pro quo in the New Sample. Indeed, the reverse seems to be more often true, in that more buyers are conditioning their bids on exclusivity.[240] Rather than conceding a go-shop as "market" or "standard practice," boards should go back to the old-time religion that go-

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[239] *See, e.g.*, *id.* at 754 n.108 (citing deals: Aeroflex Inc., Definitive Proxy Statement (Schedule 14A), at 24 (June 22, 2007) ("After discussion, the special committee asked TWP [its bankers] to communicate to the initial bidding group that . . . Aeroflex was likely to engage in a pre-signing 'market check' of the proposed transaction price but might be prepared to forgo this if the proposed per share price were to be revised to $16.50 or more." (alteration and omission in original)); Jameson Inns Inc., Definitive Proxy Statement (Schedule 14A), at 18 (June 29, 2006) ("JMP Securities [investment bankers for the seller] further indicated that there was a direct correlation between the purchase price the board of directors would be willing to accept and our opportunity to solicit or receive a competing offer superior to the terms of the merger agreement that may be agreed by the board and JER." (alteration in original)); HUB Int'l Ltd., Definitive Proxy Statement (Schedule 14A), at 10 (May 4, 2007) ("[R]epresentatives of Apax explained that they did not want to participate in an auction process. . . . At the end of the meetings, representatives of Apax advised Mr. Hughes that, subject to further due diligence, they were prepared to present Hub a proposal within ten business days. In addition, Apax requested that for the remainder of the week, Mr. Hughes not contact any other party regarding a potential transaction. Mr. Hughes agreed that he would not make any such solicitations with the view that this would improve Apax's proposal." (alteration and omission in original)); Nuveen Invs., Inc., Definitive Proxy Statement (Schedule 14A), at 29 (Aug. 14, 2007) ("[The special committee] informed Madison Dearborn that the special committee might be willing to consider an offer in the range of $62.00 to $65.00 per share subject to a concurrent market check, but if Madison Dearborn wished to negotiate a transaction on an exclusive basis for a limited period of time, Madison Dearborn would have to increase its proposed purchase price to at least $65.00 per share. [Two days later], Madison Dearborn delivered a revised indication of interest to the special committee that included a proposed purchase price of $65.00 per share." (alterations in original)); Spirit Fin. Corp., Definitive Proxy Statement (Schedule 14A), at 19 (June 1, 2007) ("[T]he Company advised Macquarie that the [$14.16] offer price would likely be viewed by its board of directors to be insufficient to grant Macquarie the requested exclusive negotiation period and other terms requested, and suggested that a price of $15.00 per share would be more likely to be acceptable to the Company's board of directors. [Three days later] Macquarie submitted a revised draft MOU indicating . . . a price of $14.50 per share." (alterations and omission in original))).

[240] *See, e.g.*, InVentiv Health Inc., Definitive Proxy Statement (Schedule 14A), at 23 (June 17, 2010) ("Bidder A submitted a letter indicating that Bidder A would not be willing to participate in a public or private auction of the Company. Bidder A requested that the Company negotiate a binding acquisition agreement with Bidder A providing for a post-signing market check."); HealthGrades Operating Co., Solicitation/Recommendation Statement (Schedule 14D-9), at 15 (Aug. 10, 2010) ("Mr. K. Hicks reported to the Board that Vestar had indicated that it would either withdraw its indication of interest or significantly reduce its price if the Company engaged in a process that involved other bidders, including a 'go shop' provision."); BlackHawk Network Holdings, Inc., Definitive Proxy Statement (Schedule 14A), at 31 (Mar. 2, 2018) ("The Blackhawk board of directors also discussed whether to solicit other proposals to acquire the Company and the benefits and risks inherent in undertaking an auction process, but ultimately determined not to do

shops are a second-best solution and should only be adopted in exchange for something else, ideally a price bump.

To the extent that boards agree to a go-shop, they should understand that the structure of the go-shop matters. This means that the details of the go-shop must be a board-level issue, and not one to be delegated to the bankers and lawyers. Boards should "stress test" the structure of the go-shop, making sure that they understand the specific design and implications of, for example, match rights, concurrent tender offers, and Excluded Party definitions. At the very least, such awareness would allow them to avoid embarrassing testimony if the adequacy of their price is challenged by dissenting shareholders.[241]

Finally, boards should be aware that management may be conflicted in virtually any PE deal, even if management holds significant sell-side equity, because the buy-side incentives (actual or anticipated) can swamp that sell-side equity. As a result, boards should be more inclined to establish a special committee even when management seems to be aligned as a result of having significant sell-side "skin in the game."

In general, boards should be aware that the modern playbook for PE deals seems to go as follows:

Step 1: The PE firm approaches a target company and threatens to walk away unless the target negotiates exclusively.

Step 2: The target board caves to this threat, assured by their bankers that they can always canvass the market and fulfill their fiduciary obligation through a post-signing go-shop.

Step 3: The PE firm implicitly or explicitly offers management significant buy-side incentives, such that senior managers have incentives to keep the deal price down and to discourage overbids.

Step 4: The board does not adequately cleanse this conflict of interest.

Step 5: The parties agree on a deal, and the sell-side bankers launch a go-shop process.

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so because of the risk of losing the Sponsors' proposal if the Company elected to solicit other proposals, the risk that the Sponsors might lower their proposal if the Company elected to solicit other proposals and little to no competitive bidding emerged, and the potential significant harm to the Company's business if it became known that the Company was seeking to be sold (without assurance that a financially superior proposal would be made or consummated).").

[241] *See, e.g.*, Subramanian Norcraft Trial Demonstratives, *supra* note 151, at 10 ("'Q: Do you recall reading any literature or studies or that type of information about how go-shop processes can and should be structured during your consideration of this go-shop structure? A: No.' 'Q: And what was the time [period for] this go-shop process? A: I can't recall.' 'Q: Did you personally ever consider what effect the tender and support agreements would have on the go-shop process? A: I can't recall.' 'Q: What are matching rights? A: I have no idea.'" (quoting testimony of a Norcraft Director)), *quoted in* Petitioner's Opening Post-trial Brief, *supra* note 91, at 20; *id.* at 9 ("Q: What is your understanding of Fortune's rights during the go-shop period? A: I don't recall." (quoting testimony of Norcraft CEO and Chairman)), *quoted in* Petitioner's Opening Post-trial Brief, *supra* note 91, at 19.

Step 6: Due to the various factors enumerated in this Article, the go-shop process turns up empty, and management closes its deal with its favored buyer.

If all of this sounds too simplistic, consider the fact that PE firms continue to achieve "alpha" (that is, positive abnormal returns) despite massive competition for PE deals.[242] This is only possible if there are structural defects in the way that companies are sold. This Article identifies several such defects. Forming a special committee, and making sure that it functions well, would be an important inoculation against defective sell-side processes.

B. For Courts

With the near death of post-closing damages actions under *Revlon* in the aftermath of *Corwin v. KKR Financial Holdings LLC*,[243] appraisal actions have been the primary venue in which go-shops have been assessed by the Delaware courts.[244] Appraisal entitles shareholders who dissent from a deal to obtain a judicially determined "fair value" for their shares.[245] In recent years, Delaware courts have held that fair value should be the deal price if the deal process is sufficiently good such that price discovery was achieved in the marketplace.[246] If instead the deal process is not good, deal price should receive limited or no weight, and courts should rely on other methods (such as discounted cash flows) to determine fair value.[247] Vice Chancellor Laster recently summarized the appropriate deference under Delaware law to deal price as follows:

> Band 1: A sale process is so well-constructed and well-executed that a trial court would err by not giving the deal price heavy, if not dispositive, weight.
>
> Band 2: A sale process is sufficiently good that the trial court would err by not treating the deal price as a reliable valuation indicator, but the trial

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[242] Frank Jian Fan, Grant Fleming & Geoffrey J. Warren, *The Alpha, Beta, and Consistency of Private Equity Reported Returns*, 16 J. PRIV. EQUITY 21, 21 (2013) ("Further, we estimate that Buyout generated significantly positive alpha of about 5.6% per annum, relative to passive investments.").

[243] 125 A.3d 304, 305–06 (Del. 2015).

[244] *See, e.g.*, David Marcus, *Grant's Last Stand*, CORP. CONTROL ALERT, Aug.–Sept. 2018, at 10, 12 ("The world has shifted. There are effectively no more breach of fiduciary duty cases in deal litigation because of [*Corwin*] and the other doctrines. Appraisal has become the new breach of fiduciary duty.").

[245] *See* 8 DEL. CODE ANN. tit. 8, § 262(h) (2019).

[246] *See, e.g.*, *In re* Appraisal of PetSmart, Inc., C.A. No. 10782, 2017 WL 2303599, at *31 (Del. Ch. May 26, 2017); Merion Capital L.P. v. Lender Processing Servs., Inc., C.A. No. 9320, 2016 WL 7324170, at *29–33 (Del. Ch. Dec. 16, 2016).

[247] *See, e.g.*, *In re* Appraisal of AOL Inc., C.A. No. 11204, 2018 WL 3913775, at *3 (Del. Ch. Aug. 15, 2018); Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *36–38 (Del. Ch. July 27, 2018).

> court would not commit error by failing to give the deal price heavy, if not dispositive, weight.
>
> Band 3: The sale process is sufficiently flawed that the trial court could determine without erring that the deal price was not a reliable valuation indicator.
>
> Band 4: The sale process is so flawed that the trial court would err by treating the deal price as a reliable valuation indicator.[248]

We agree with Vice Chancellor Laster's formulation of existing Delaware doctrine. As a matter of policy, we further believe that this is a sound formulation, because it encourages good deal processes. The key question, of course, is which deals should go in each band.

On that key question, we are not suggesting that go-shops are categorically bad — that is, their use should not automatically push the deal into Band 3 or Band 4. There may be good reasons for sellers to want to limit pre-signing competition (e.g., to avoid leaks, grab the "bird in hand," etc.). However, the key doctrinal takeaway from this Article is that the use of a go-shop in lieu of a traditional pre-signing market canvass (particularly a "pure" go-shop) should generally push the deal down on this spectrum, but this presumption of a downward nudge can be overcome by a properly structured go-shop.[249]

In determining whether a go-shop is properly structured, courts should of course continue to take note of straightforward metrics, such as the length of the go-shop window and the magnitude of the go-shop termination fee. In addition, this Article highlights other structural and practical impediments to a prospective third-party bid. Unless courts take note of these factors as well, practitioners will continue to exploit them to diminish the effectiveness of go-shops.

Specifically, the Delaware Supreme Court should squarely endorse what game theorists have known for a long time: match rights deter bids. Unless courts flag their bid deterrence effect and penalize the go-shop accordingly for determining what band to put it in, practitioners will continue to use match rights with impunity. The Delaware Supreme Court should also renounce the idea that there must be actual evidence

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[248] Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., C.A. No. 11448, 2018 WL 2315943, at *17–18 (Del. Ch. May 21, 2018) (emphasis omitted).

[249] In a recent blog post based on a client memo, Wachtell Lipton attorneys proposed a different kind of post-signing market canvass: "Post-deal market checks can be an attractive tool for maximizing value, providing the benefits of an 'auction with a floor.' A no-shop coupled with a two-tiered break fee (low for an initial period and then climbing to market) is sometimes a helpful compromise between go-shops and high-break-fee no-shops." Adam O. Emmerich & Robin Panovka, *REIT M&A in 2019*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 4, 2019), https://corpgov.law.harvard.edu/2019/01/04/reit-ma-in-2019 [https://perma.cc/DDC2-ZNDB]. In our opinion, this compromise approach can also be effective in satisfying a target board's fiduciary duties, if structured appropriately, but should be treated even more skeptically than a standard go-shop because of the inability to affirmatively solicit potential buyers during the post-signing phase.

of deterred bidders in order to conclude that a go-shop was not effective.[250] With some rare exceptions, deterred bidders are unobservable, because bidders will decline to participate in a go-shop process at the outset if they perceive no pathway to success.

We close this section with an observation on the comparative advantages of relying on deal price rather than a discounted cash flow (DCF) analysis. Although DCF is probably the most authoritative method used among valuation experts, commentators, including one of us, have observed that the methodology is highly sensitive to the inputs, in particular the weighted average cost of capital (often shortened to "WACC") and terminal value assumptions.[251] In view of the malleable nature of DCF, some have argued that the deal price should be given greater presumptive weight — that is, in choosing between a price that results from an imperfect deal process and a price that results from an imperfect valuation method, courts should rely more on the former.[252]

However, in our observation, DCF valuations in the Delaware Court of Chancery have been more imprecise than necessary. The starting point is the way that valuation experts seem to view their own role. In a recent appraisal decision, Vice Chancellor Slights observed in dicta that the valuation experts were simply advocates for their respective sides:

> It is accepted in Delaware appraisal litigation that paid valuation experts have assumed more of an advocacy role, and less of a traditional expert witness role (as illustrated by the wide deltas we regularly see in their valuation conclusions). Despite the repeated expressions of frustration by our courts, the practice continues. When a rushing river flows against a resisting rock, eventually the river wins out. Perhaps that is the hope among appraisal advocates and the valuation experts they engage to sponsor their positions.[253]

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[250] *See* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 34 (Del. 2017) (reversing the chancery court's determination that the deal price should receive no weight in the fair value determination, in part because "the [chancery] court did not identify any possible bidders that were actually deterred because of Mr. Dell's status").

[251] *See* Guhan Subramanian, *Appraisal After* Dell, *in* THE CORPORATE CONTRACT IN CHANGING TIMES 222, 225 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) (describing DCF as "notoriously imprecise"); *see also* William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Market Hypothesis*, 28 J. CORP. L. 551, 561 (2003) ("[T]he DCF method is . . . subject to manipulation and guesswork . . . .").

[252] *See, e.g.*, Corrected Brief of Law and Corporate Finance Professors as *Amici Curiae* in Support of Appellant and Reversal at 1–2, DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017) (No. 518, 2016) (arguing, from the perspective of "law professors . . . in the areas of corporation law, corporate finance, mergers and acquisitions, and valuation," *id.* at 1, that courts should defer more readily to observed transaction prices).

[253] Blueblade Capital Opportunities LLC v. Norcraft Cos., C.A. No. 11184, 2018 WL 3602940, at *16 n.179 (Del. Ch. July 7, 2018) (citations omitted).

But the wildly divergent testimony on valuation is not inherent in the DCF methodology. DCF is malleable, but not *that* malleable. Petitioners and respondents stake out radically different opinions on fair value for one simple reason: they believe that it works in the Delaware Court of Chancery. This conclusion is not inevitable. Delaware courts could signal in numerous ways that they want reasonable valuation testimony, not valuation experts who merely "advocate their side's position on fair value."[254]

For example, Delaware courts have the authority to retain their own valuation expert.[255] Judges might use this card in situations where the experts are too far apart on valuation — thereby creating ex ante incentives for the valuation experts to come in more reasonably so that they are not collectively rejected by the court.

Second, and not necessarily mutually exclusively, Delaware courts could engage in closer scrutiny of the valuation experts' expertise — not disqualifying experts for lack of expertise (which would be radical), but making clear that not all valuation experts are equally qualified. In every case that we are aware of, courts have not differentiated between the valuation experts' qualifications to opine on value, nor have they declared the experts on both sides to be anything less than eminently qualified.[256]

Professional courtesy has many virtues, of course, particularly in the small world of Delaware corporate law practice. However, by not differentiating among different degrees of valuation expertise, Delaware judges implicitly declare valuation expertise to be a commodity, which then causes potential valuation experts to "compete" (in the form of more extreme valuation outcomes) in order to be retained in a particular matter.

Rather than declaring bewilderment by the wide disparity in the valuations, Delaware judges should realize that it is a natural (and perhaps

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[254] *Id.*

[255] *See, e.g.*, *In re* Appraisal of Shell Oil Co., 607 A.2d 1213, 1222 (Del. 1992) (recommending that the chancery court should consider appointing its own valuation expert in appraisal proceedings). In fact, the original appraisal statute, promulgated in 1899, provided for a three-member panel of experts to determine the fair value of the shares. *See* Fernán Restrepo, Appraising Appraisers: An Empirical Analysis of Expert Valuations in Appraisal Proceedings (2017) (unpublished manuscript) (on file with the Harvard Law School Library). In 1943 the statute shifted to a single court-appointed expert, and in 1976 the statute shifted again to our current system of opposing valuation experts. *See id.*

[256] *See, e.g.*, *Blueblade*, 2018 WL 3602940, at *16 n.179 ("By any measure, both experts are well qualified."); *In re* Appraisal of SWS Grp., Inc., C.A. No. 10554, 2017 WL 2334852, at *8 (Del. Ch. May 30, 2017) (noting that petitioners' expert was "a well-seasoned valuation expert" and the respondents' expert was a "Corporate Finance Professor with substantial experience in expert testimony"); *In re* Appraisal of Dell Inc., C.A. No. 9322, 2016 WL 3186538, at *45 (Del. Ch. May 31, 2016) (noting that the opposing valuation experts were "[t]wo highly distinguished scholars of valuation science").

inevitable) consequence of declaring that valuation expertise is undifferentiated. But extreme valuation opinions do not have to be a "rushing river flow[ing] against a resisting rock," in which "eventually the river wins out."[257] Scrutinizing and differentiating among the expertise of the valuation experts would allow valuation experts to develop differentiated reputations on qualifications and credibility, which would create less divergence in valuation opinions and would allow the Delaware judges (who, after all, are generally untrained in finance) to rely more heavily on the valuation experts' opinions.[258]

Finally, Delaware courts have the ability to mandate baseball-style appraisals, in which each side offers a valuation and the court must pick one or the other.[259] Basic game theory indicates that this will cause both sides to behave far more reasonably, in order to maximize the odds that the court would accept their valuation.[260] With this one small adjustment to appraisal, DCF valuations that look so malleable today would magically appear in a much tighter band. Courts would have better guidance from their valuation experts, which would allow them more comfort in relying on DCF when the deal process is not sufficiently good to warrant reliance on the deal price. In turn, deal processes would become more buttoned up, because they would be competing for the court's attention with a more reliable DCF methodology. We predict that go-shop structuring would improve, with the elimination of many of the phenomena that we document in this Article.

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[257] *Blueblade*, 2018 WL 3602940, at *16 n.179.

[258] In the Dell appraisal, Vice Chancellor Laster recently ordered the expert reports from both sides to be filed publicly. *See In re* Appraisal of Dell Inc., C.A. No. 9322 (Del. Ch. 2018) (order regarding expert reports). Vice Chancellor Laster noted that "expert witnesses . . . [are] acting more as advocates rather than as advisors to the court," and directed that the expert reports should be made public in that case in support of "the broader goal of transparency." *Id.* We applaud the Vice Chancellor's approach, and observe that it seems to be proliferating within the Court of Chancery. *See* David Marcus, *Reigning in the Experts*, CORP. CONTROL ALERT, Dec. 2018, at 6 (noting that the court required expert reports to be filed publicly in cases involving Good Technology and Solera Holdings). However, in our opinion, it is unlikely to solve the underlying problem of experts acting as advocates. Rather than exposing, for example, different assumptions on discount rates and terminal values used by a particular expert, transparency would merely cause valuation experts to sort into solely defendant-side or plaintiff-side. That is, by staying on one side of the "v," experts would be able to maintain consistency among different valuation reports but still act as advocates.

[259] Motion of Law, Economics and Corporate Finance Professors to File Brief as *Amici Curiae* in Support of Petitioners-Appellees and Affirmance at 23, DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017) (No. 518, 2016) ("[T]he trial judge could employ approaches that incentivize greater moderation among competing experts (such as 'baseball arbitration' mechanisms), thereby narrowing the valuation gaps between their analyses.").

[260] *See, e.g.*, Christian J. Henrich, *Game Theory and* Gonsalves*: A Recommendation for Reforming Stockholder Appraisal Actions*, 56 BUS. LAW. 697, 716 (2001).

CONCLUSION

At the highest level, the story of go-shops over the past ten years is one of innovation corrupted. In the mid-2000s, transactional planners created a new deal technology that benefitted their buy-side and sell-side clients. As one of us concluded in the Original Study, "go-shop provisions can be a 'better mousetrap' in deal structuring — a 'win-win' for both buyer and seller."[261] However, over the ensuing decade, a broader set of transactional planners distorted the go-shop technology in ways that achieved their clients' objectives but no longer satisfy broader corporate law objectives of promoting allocational efficiency in the M&A marketplace.

This trajectory has a venerable pedigree. In the 1970s, for example, the invention of mortgage securitization unquestionably created enormous value for society. But by the 2000s, practitioners had pushed this technology too far, which led to the financial crisis of 2008–2009. Likewise, the proliferation of derivatives unquestionably created enormous value in the 1980s and 1990s. But the distortion and eventual corruption of this new technology led to the Enron debacle of 2003.[262]

The corruption of the go-shop technology does not rise to the same scale as the financial crisis or Enron. But the stakes are still large: allocational efficiency in the M&A marketplace, and the overall protection of capital markets, are critical goals of corporate law. Small investors put their money into the U.S. capital markets at levels far beyond their European and Asian counterparts, in part because corporate law assures them of value maximization if and when they exit their investment. Indeed, an influential stream of research, known as the "law and finance" literature, finds a connection between legal protections for minority owners and the development of capital markets around the world.[263] Our research shows that the evolution of the go-shop technology over the past ten years has worked against these desirable and important policy goals. Corporate boards and the Delaware courts have not yet caught up to the sophisticated practitioners who structure go-shops. We offer in this Article specific recommendations for corporate boards and the Delaware courts to counteract this trend.

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[261] *Original Study*, *supra* note 3, at 731.

[262] *See generally* MALCOM S. SALTER, INNOVATION CORRUPTED: THE ORIGINS AND LEGACY OF ENRON'S COLLAPSE (2008).

[263] *See, e.g.*, Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998).