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No-Shop Provisions: Drafting Guidance From the Litigator's Perspective

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Contractual counterparties often plant the seeds of litigation during negotiations over a preliminary framework for a complex corporate transaction—well before parties commit to the ultimate deal. Preliminary agreements, often styled as letters of intent (LOIs), can impose significant obligations on their signatories, even if a deal never ultimately closes. And where a deal falls apart because of a competing offer at the 11th hour, no-shop provisions can become a critical battleground for any ensuing litigation.


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A "no-shop" or "exclusivity" provision in an LOI temporarily restricts one or both parties to an M&A negotiation from discussing competing transactions with third parties. No-shops offer a powerful tool for incentivizing parties to negotiate in good faith. Corporate parties (typically potential acquirors) often employ no-shops to protect themselves from investing resources into negotiating with a counterparty who intends to use the negotiations as a stalking horse for other transactions.

If a deal breaks down before closing and litigation ensues, simple drafting choices in a no-shop provision could mean huge differences in the outcome. Under certain circumstances, a litigated outcome could produce a massive damages award or prevent a third-party deal—or it could leave a jilted suitor empty-handed.

This article provides insight, from a litigator's perspective, into how four key no-shop drafting decisions can impact the outcome of a litigation: duration, scope, choice of law and remedy.

Duration

A no-shop provision should specify an expiration date, since courts will not interpret contracts to create indefinite obligations. *See M & G Polymers*

USA v. Tackett, 574 U.S. 427, 441 (2015). When choosing an expiration date, drafters should consider whether the exclusivity period provides enough time for negotiators to realistically complete diligence, obtain third-party approvals and consummate a final agreement.

For parties motivated to consummate the transaction (typically potential acquirors), an unrealistically brief exclusivity period risks counterparties using them as a stalking horse, safe in the knowledge that accountability for post-expiration talks with a third party will be difficult to obtain. On the other hand, parties more interested in playing the field (typically merger targets) may prefer a shorter exclusivity period so they can negotiate with others sooner.

In *Garda U.S. v. Sun Capital Partners*, 194 A.D.3d 545 (N.Y. App. Div. 2021), the parties agreed to a 28-day exclusivity period, but negotiations stretched on for over two months, after which the target sold itself to a third party. The jilted acquiror had limited ability to recover against the target, since the target was permitted to negotiate with third parties after 28 days passed without a definitive agreement in place.

Scope

No-shop provisions can prohibit or require a broad range of conduct. Their scope can have a major impact on their enforceability in court and their practical effect on a party's behavior.

As an example of a broad scope, Twitter agreed while negotiating the final terms of its sale to Elon Musk not to "solicit, initiate, knowingly encourage or knowingly facilitate any substantive discussion, offer or request that constitutes or would reasonably be expected to lead to a competing acquisition proposal" (*see* Merger Agreement between Twitter and X Holdings, April 25, 2022).

But an overly restrictive no-shop risks enforceability challenges. No-shop provisions that clearly inhibit a board's freedom to exercise its fiduciary duties are unlikely to be enforced. *See Paramount Communications v. QVC Network*, 637 A.2d 34, 51 (Del. 1994).

Importantly, target boards often have a fiduciary duty to entertain unsolicited third-party offers. A Delaware court thus declined to enforce a provision placing onerous conditions on *any* discussions with potential acquirors, even if unsolicited. *ACE v. Capital Re*, 747 A.2d 95, 104–107 (Del. Ch. 1999).

In New York, an overly broad no-shop provision will likely be interpreted to prohibit only affirmative outreach to third parties. *See BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 395 (1999). Enforcing such a narrow restriction creates evidentiary challenges because it requires the litigant to prove both the content of discussions with third parties and that those discussions were the result of prohibited affirmative outreach—not an easy task.

A no-shop provision can better protect a buyer if it requires the recipient of third-party offers to notify their counterparty. Such provisions are often enforceable. *See NACCO Industries v. Applica*, 997 A.2d 1, 15 (Del. Ch. 2009). Breaches of notification provisions are more obvious, with a clear evidentiary record accessible to the wronged party, increasing the likelihood of relief.

Choice of Law

Choice of law can make an enormous difference to the recoverable damages for breach of a no-shop provision. While governing law will bear on many aspects of an LOI, drafters should heed the implications that a choice-of-law provision may have on potential remedies for breach of a no-shop.

Currently, the majority rule limits the default damages to a party's reliance damages, *i.e.*, its out-of-pocket costs in carrying out the negotiations. This rule governs in major jurisdictions such as New York and California.

But a growing number of jurisdictions, including Delaware, have opened the door for recovery of expectation damages when a counterparty breaches a no-shop provision. *See NACCO*, 997 A.2d at 19 (Delaware law); *Venture Associates v. Zenith Data Systems*, 96 F.3d 275, 278 (7th Cir. 1996) (Illinois law); *United House of Prayer for All People v. Therrien Waddell,* 112 A.3d 330, 345 (D.C. 2015) (D.C. law).

Expectation damages give the aggrieved party the full benefit of their bargain, which can far exceed a party's reliance costs if a jury is convinced that good-faith negotiations would have led to a final deal. Thus, in certain jurisdictions, a jilted acquiror could invoke the breach of a no-shop provision to seek lost profits as if the merger had taken place, or even its increased costs in buying a replacement merger target. *See WaveDivision Holdings v. Millennium Digital Media Systems,* 2010 WL 3706624, at *19 (Del. Ch. Sept. 17, 2010).

Remedies

A state's default damages rules may be avoided by explicitly specifying remedies within the LOI. Drafters could select for the breach of a no-shop provision to result in reliance damages, expectation damages, liquidated damages, or some other form of damages. *See, e.g., Three Brothers Trading v. Generex Biotechnology*, 2020 WL 1974243, at *3 (S.D.N.Y. Apr. 24, 2020). Potential acquirors may prefer expectation damages or substantial liquidated damages, while targets may prefer a reliance-damages limitation.

Drafters should also consider whether to specify the availability of injunctive relief in the event of a breach. Although a court is unlikely to require consummation of the ultimate transaction because of the breach of a no-shop provision, it might temporarily enjoin the target's sale to a third party, increasing the potential acquiror's leverage. *See Main Street Baseball v. Binghamton Mets Baseball Club*, 103 F. Supp. 3d 244, 263 (N.D.N.Y. 2015).

Conclusion

No-shop provisions can be difficult to enforce in litigation and thus fraught for honest negotiators to rely upon. But simple drafting decisions can turn a relatively innocuous no-shop provision into a clause with real teeth. Parties to an M&A negotiation should be aware of these critical decisions and calibrate their choices to their available leverage and level of commitment to the ultimate transaction.

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