

Checking the Bush While Keeping the Bird in Hand – The Advent of the “Go Shop” Provision in Acquisition Agreements

By Mark A. Metz*

When a publicly traded company receives an attractive unsolicited takeover offer, its directors must decide, often under significant time pressure, whether to pursue a sale of the company with the bidder. Although “just saying no” is an option, particularly where the company’s operating track record is good and the company has solid defensive measures in place, directors are often compelled by their fiduciary duties to the company’s shareholders to respond favorably to such an offer, especially when the offer represents a higher value to shareholders than pursuing the company’s current long-term strategy. An attractive unsolicited offer can present the directors with a dilemma: should they accept the offer and proceed toward a definitive acquisition agreement (which would typically include a prohibition on post-signing solicitation) without knowing whether a better deal might be available, or commence a sale process that might cause the attractive offer to be withdrawn and potentially cause the company to be viewed as “damaged goods” if no other substantial offers result from the process. In either case, the directors’ decision could be second guessed by disgruntled shareholders and lead to costly litigation.

Further compounding the problem, directors’ decisions made in the context of a sale of the company are not given the same degree of deference as decisions made in the ordinary course of business. Where directors have not checked the market prior to signing an acquisition agreement to determine the availability of other bidders or the value of the company in a sale transaction, and where there is no provision in the acquisition agreement allowing a check of the market after signing, legal challenges to the directors’ decision to accept an offer to sell the company have occasionally succeeded.

Largely because of these concerns, target companies have recently begun to insist on including provisions in definitive acquisition agreements that permit the target actively to solicit competing bids for a limited period *after* the definitive agreement is signed and to terminate the agreement in order to accept a superior offer. Although these “go shop” provisions do not insulate directors against claims that they breached their fiduciary duties, they can alleviate some of the directors’ concerns about whether there might be a better offer available and allow them more readily to accept an attractive offer. Go shop provisions allow directors to more comfortably accept the “bird in hand” offer, since they remain free to determine whether there are more “birds” in the bush.

Go Shop Provisions Defined

Go shop provisions are a recent phenomenon, so the “standard” terms of these provisions are not yet settled. Most go shops, however, particularly those in more recent agreements, share the following characteristics.

- A solicitation (or “go shop”) period, typically lasting between 35 and 50 days that commences upon signing the definitive acquisition agreement.
- During the solicitation period, the target has full rights to solicit other offers, provide information to prospective bidders, including confidential information (if the prospective bidder executes a confidentiality agreement in a form agreed to in advance by the buyer), and negotiate the terms of a definitive acquisition agreement.
- The target must notify the buyer when the board determines that an offer superior to the buyer’s has been received.
- If the target board decides to accept a competing offer that it has determined is

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superior to the buyer's, then, for a limited time, the target may terminate the agreement with the buyer after giving the buyer an opportunity to match the competing offer. If the buyer matches the competing offer, the original deal is modified and the termination right is extinguished.

- If the competing bid is not matched by the buyer and the target terminates the original agreement, or if the target's board withdraws its support for the original offer and the buyer terminates, the target must pay a termination fee to the buyer. The termination fee is often bifurcated so that the amount payable when termination occurs during the solicitation period is significantly lower than the termination fee payable under other circumstances, such as when termination occurs to accept a superior offer made after the solicitation period. In some cases, the lower fee is paid if the offer was determined during the solicitation period to be superior, or likely to become superior, even if termination did not occur until after the solicitation period ended. The connection of the lower fee to the go shop provision is intended to be less of a financial impediment to a competing bidder who makes its bid during the solicitation period. The connection also encourages competing bids during, rather than after, the solicitation period when a higher fee would be payable.
- Following the solicitation period, all solicitation activity must cease and the typical "no shop" and "fiduciary out" provisions apply. However, the target is often permitted to continue negotiations with parties who have submitted competing bids that are determined by the board to be superior, or reasonably likely to become superior, following negotiation. Otherwise, information may be provided, negotiations may occur, and the agreement may be terminated in favor of a superior offer only if the board has been advised that it must do so in order to properly discharge its fiduciary duties. Termination under these circumstances usually triggers the payment of the higher termination fee.

Go shop provisions are becoming increasingly popular. Although there were fewer than 20 public company transactions with go shop provisions before 2007 and apparently none before 2004, more than 20 sales agree-

ments with go shop provisions were signed during the first six months of 2007.¹

The Board's Fiduciary Duties

Directors of a Michigan corporation generally have a fiduciary duty to act in the best interests of the corporation and its shareholders. The Michigan Business Corporation Act provides that directors have discharged their fiduciary obligations if they:

- act in good faith and on an informed basis after due consideration of the relevant material, including the input of legal and financial experts, and appropriate deliberation (referred to as the "*duty of care*"); and
- act in the best interests of the company and its shareholders and not for the purpose of advancing their own self-interests (referred to as the "*duty of loyalty*").²

When a decision by a board of directors is challenged, a Michigan court will usually apply the "business judgment rule," a legal presumption that the board acted in good faith, on an informed basis, and in the honest belief that the action taken was in the best interests of the corporation.³ In most circumstances, when the board acts in a fully-informed, deliberate manner, the board's action will be protected by the business judgment rule, even if the board's judgment ultimately proves to have been incorrect. A board's action is likely, however, to be examined more closely when it involves a sale of the company.

Michigan courts have rendered relatively few decisions upon which to base interpretations of law on the fiduciary duties of directors in the context of takeovers. As a result, Michigan courts are likely to regard Delaware decisions as persuasive in light of the significantly greater experience of the Delaware courts in this context.⁴ A long line of Delaware cases, beginning in the 1980s with a case involving Revlon, Inc.,⁵ holds that once a board of directors decides to sell control of a corporation, the board's actions are subject to "enhanced scrutiny" before the court will apply the business judgment rule's presumption. In essence, once the board decides to sell, this higher standard requires the board to abandon substantially all considerations other than obtaining the best, reasonably possible, current value for shareholders. When a board of directors is considering a single offer and has no reliable grounds upon which to determine whether it is the best reasonably possible current value, Delaware courts have

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generally held that a check of the market is necessary to determine if a better deal might be reasonably available.⁶

The Delaware courts grant the board considerable latitude to determine the method of conducting a sale of a corporation that maximizes value for shareholders. There are several methods that a board may use to satisfy this duty, including conducting an auction or some other canvas of the market prior to signing a definitive transaction agreement, or signing a definitive agreement that contains provisions allowing for post-signing solicitation or response to competing offers (a “post-agreement market check”). Delaware courts have held in a number of cases that a board of directors does not fail to satisfy the enhanced scrutiny standard by entering into an agreement with a single bidder followed by a market check.⁷ Although these cases generally involved a public announcement of the signing of the transaction agreement coupled with a fair opportunity for other bidders to make competing offers (commonly referred to as a “window-shop” process) rather than the relatively new concept of a “go shop” provision, Delaware courts have found these post-agreement market checks to have passed the *Revlon*-enhanced scrutiny test under the facts of those cases. The enhanced scrutiny standard requires only a reasonable decision, not a perfect one.⁸

When considering a post-agreement market check, a court will typically examine the provision in the context of the various deal protection measures in the acquisition agreement, which protect the original deal by increasing the chances that it will be consummated. These provisions usually limit the target’s ability to accept a better offer by limiting the length of the go shop solicitation period (if any), limiting the target’s ability to negotiate with other bidders, limiting the target’s right to terminate the agreement, giving the buyer the right to match a competing superior offer, and requiring the target to pay a substantial termination fee in the event that the initial transaction is terminated by the target due to the emergence of a superior proposal. A buyer will typically insist on including some combination of these provisions in view of the time, effort, and expense it has expended in making the initial offer and negotiating a definitive acquisition agreement with the target. While the courts acknowledge the legitimacy of such provisions at some level, a post-agreement market check

will not be considered effective for purposes of the *Revlon*-enhanced scrutiny standard if subsequent bidders would be unreasonably deterred by termination fees or other deal protections given to the first bidder.⁹ The Delaware Court of Chancery has stated that a board’s decision to sell a company does not prevent it from offering bidders deal protection measures, “so long as its decision to do so was reasonably directed to the objective of getting the highest price and not by selfish or idiosyncratic desire by the board to tilt the playing field toward a particular bidder for reasons unrelated to obtaining the stockholders’ ability to get top dollar.”¹⁰

A significant part of this analysis includes a review of the reasonableness of the termination fee to determine whether it unreasonably discourages competing bids. Most often, courts seem to apply a combination of analyses. This includes viewing the reasonableness of the fee in light of the amount of the fee as a percentage of the target’s equity value (generally determined by looking at the purchase price) and/or as a percentage of the total transaction value (the sum of the equity value plus the debt assumed by the buyer in the transaction) and then making a judgment as to whether the amount of the fee unreasonably deters rival bidders in light of the other deal protection measures in the acquisition agreement. The Delaware Court of Chancery has stated that it is difficult to see how a termination fee equal to 3.5 percent of equity value would deter a rival bidder who wished to pay materially more for the target.¹¹ The same court more recently noted that a termination fee that was 3.75 percent of equity value and 3.25 percent of transaction value might rebuff a bidder who wishes to top an initial bidder’s offer by a relatively insubstantial amount, but that such an obstacle is not unreasonable.¹² In an oft-cited case,¹³ the Superior Court of Delaware noted that a termination fee representing 2.8 percent of the proposed acquisition price was reasonable and referred to an article that suggested termination fees in the range of 1 percent to 5 percent were within a reasonable range.¹⁴

The Standard Applied – Some Post-Agreement Market Check Cases

In light of this background, it is instructive to look at some cases in which Delaware courts have examined post-agreement market checks under the *Revlon*-enhanced scrutiny

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standard. A recent example is *In re Pennaco Energy, Inc. Shareholders Litigation*. In *Pennaco*, the Delaware Court of Chancery stated that the mere fact that a target company's board of directors negotiated a favorable price with a single bidder without first seeking out other bidders does not alone support a breach of fiduciary duty claim.¹⁵ In the transaction that led to the litigation, the target received an unsolicited request to determine whether the target would be interested in exploring a business combination with a potential acquiror. After initial discussions, the target's board entered into a confidentiality agreement with the bidder and due diligence commenced. The target hired an investment banker and negotiated an agreement with the bidder at a price that was just above the valuation range determined by the investment banker. As of the date that the target's board voted to approve the transaction, the target had done nothing to see whether other buyers might exist. The agreement provided for a window shop market check and the bidder was not permitted to commence its tender offer until 17 days after the agreement was signed (the agreement was signed on December 22 and the parties agreed to delay the tender offer until after the holidays). The agreement included deal protection measures, including matching rights and a 3 percent termination fee. The court concluded that the plaintiffs would not be likely to succeed on their claim that the board breached its fiduciary duties.¹⁶ When analyzing the deal protection measures in the agreement, the court observed that there is no risk-free approach to selling a company and that dealing with one bidder at a time has advantages.¹⁷ The court noted that the target's board was careful to balance its single negotiation strategy by ensuring that an effective post-agreement market check would occur and that the agreement's provisions left the initial bidder exposed to competition from rival bidders. The court referred to the matching right and termination fee as "modest and reasonable advantages" for the original buyer.¹⁸

Similarly, in *MONY*, the Delaware Court of Chancery endorsed a process in which the target entered into a merger agreement without conducting an auction.¹⁹ The target had hired a financial advisor only to "quietly explore" merger opportunities. The agreement at issue in *MONY* provided for a window shop market check to be conducted after the agreement was signed, and it gave the tar-

get's board the ability to enter into an agreement with a rival bidder if its fiduciary duties so required. However, this right was limited by a requirement that the initial bidder be given a chance to match a competing offer. If the target terminated the agreement, then it would have to pay a termination fee to the initial bidder.²⁰ The court held that it was acceptable for the target's board to enter into an agreement with a single bidder, establishing a "floor" for the transaction, and then test the transaction with a post-agreement market check. The court went on to hold that the evidence supported a conclusion that the board acted reasonably in determining its course of action and met its fiduciary duties.²¹

Courts seem to recognize the tension between the parties' desire to preserve the initial bidder's proposal and the board's need to obtain reasonable assurance that the initial proposal is the best deal reasonably available to shareholders. This pragmatic view has been reflected in the two June 2007 Delaware decisions involving go shop provisions in the context of the enhanced scrutiny test of *Revlon*.

In *In re Lear Corporation Shareholder Litigation*,²² the court granted a preliminary injunction requiring additional disclosure before a vote on the merger could be taken, but the court denied the plaintiffs' preliminary injunction motion based on breach of fiduciary duty claims because the plaintiffs had not demonstrated a likelihood of success on the merits. In response to an unsolicited offer by Carl Icahn, a special committee of the Lear board authorized the company's CEO to negotiate merger terms with Icahn. Ultimately, after a cursory canvass of eight financial buyers that produced no serious interest in acquiring Lear, the board approved a merger agreement containing a 45-day go shop period followed by a traditional "no shop/fiduciary out" provision. The merger agreement also provided the buyer with a limited match right and a bifurcated termination fee of 2.79 percent of the equity value of the transaction if the merger was terminated before the go shop period ended and 3.52 percent of the equity value if the merger was terminated after the period.²³ Due to Icahn's 4.9 percent ownership stake and his threat that if the board conducted a pre-signing auction he would withdraw his offer, wait for the price to fall, and make a later bid at a lower price, the board determined that locking in the "floor" price by signing a deal with

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Icahn that permitted a full auction post-signing would most likely maximize the price of the company for shareholders. The court expressed some skepticism that the 45 day go shop period constituted enough time for a competing bidder to conduct due diligence, make a superior offer and negotiate a definitive acquisition agreement so that it could avail itself of the lower termination fee available to the maker of a superior bid in favor of whose transaction the Icahn agreement was terminated. Nevertheless, the court was not convinced that the plaintiffs would be able to prove at trial that the Lear board acted unreasonably.²⁴ The court also held that the termination fee was not of a magnitude that would seriously deter a competing bid and was a reasonable concession to Icahn in view of the ability to shop the company, the amount of capital Icahn had to reserve for the deal during the solicitation period, and Icahn’s agreement to vote his shares for any superior bid. The court also rejected the plaintiff’s argument that the limited match right was unreasonable.

Similarly, in *In re Topps Co. Shareholder Litigation*,²⁵ the court granted a preliminary injunction on other grounds,²⁶ but it denied the plaintiffs’ preliminary injunction motion based on the breach of fiduciary duty claims. In response to overtures from Michael Eisner to acquire Topps, an ad hoc committee of the board authorized negotiations between one of the Topps independent directors and Eisner. The committee was divided over whether a full auction would yield a better offer than the Eisner offer being considered. Within the past year, Topps had tried and failed to sell one of its two divisions, and discussions with two potential financial buyers had failed to yield any serious offers. Eisner told the board that he would withdraw his proposal and discontinue his efforts to acquire the company if Topps commenced an auction.²⁷ Against this background, the Topps board ultimately approved a deal with Eisner, and the parties executed a definitive agreement. Because there had been no pre-signing market check, the board secured a 40-day go shop period with a limited match right and a bifurcated termination fee of 3.0 percent of the transaction value if the agreement was terminated during the go shop period and 4.6 percent of the transaction value if terminated thereafter.²⁸ Following a detailed analysis of the circumstances, the court concluded that the terms of the merger agreement were not an unreason-

able approach to maximizing value, noting in particular the 40-day go shop period and the board’s ability to continue discussions after the go shop period with any bidder who surfaced during the go shop period whom the board determined was likely to make a superior proposal. Further, the court stated that it did not believe the advantage given to Eisner by the merger agreement—including a right to match a competing bid and a termination fee—was unreasonable. The court noted that while the fee was a bit high in percentage terms, it was likely attributable to the relatively small size of the deal and was not large enough to have deterred a bidder with an interest in outbidding Eisner.

The *Topps* court took note of the advantage to the company of having a signed deal with Eisner and its potential utility in gaining a higher bid.

In finding that this approach to value maximization was likely a reasonable one, I also take into account the potential utility of having the proverbial bird in hand. Although it is true that having signed up with Eisner at \$9.75 likely prevented Topps from securing another deal at \$10, the \$9.75 bird in hand might be thought useful in creating circumstances where other bidders would feel more comfortable paying something like [competing bidder] Upper Deck now says it is willing to bid [\$10.75]. Because a credible buying group ... had promised to pay \$9.75, other bidders could take some confidence in that and have some form of ‘sucker’s insurance’ for considering a bid higher than that. ... [R]ecognizing our own limitations, we often, quite rationally, take comfort when someone whose acumen and judgment we respect validates our inclinations. A credible committed first buyer serves that role. ... Signing up a sure thing with Eisner forced Upper Deck to get serious about the whole company, and set a price floor that Upper Deck knew it had to beat by a material amount.²⁹

Conclusion

When faced with the difficult choice between accepting an attractive bid without having an opportunity to gauge the market’s interest in the company or actively shopping

the company but likely losing the attractive bid, the target board is no longer left to choose exclusively between preserving “the bird in the hand” or pursuing the “birds in the bush.” The inclusion of a go shop provision in a definitive sale agreement permits a board to accept the attractive bid while preserving the board’s ability to determine whether a more attractive bid is available. The decisions in *Lear* and *Topps* confirm that the Delaware courts will continue to review the post-agreement market check mechanism in an acquisition agreement in light of the related deal protection measures to determine whether the market check was designed to obtain the best transaction reasonably available to the target and will approve the board’s course of action, if reasonable. Given Michigan courts’ deference to Delaware on these matters, it is likely that in the right circumstances, the board of a Michigan corporation may choose to accept an attractive bid and use a go shop provision to conduct a post-agreement market check if the board determines that preserving the “bird in hand” is the best way to maximize shareholder value in a sale of the company.

NOTES

1. These include the sale agreements with the following companies: Nuveen Investments Inc. (June 2007), Horizon Offshore Inc. (June 2007), James River Group, Inc. (June 2007), Avaya Inc. (June 2007), Everlast Worldwide Inc. (June 2007), CKX, Inc. (June 2007), CDW Corp. (May 2007), Bausch & Lomb, Inc. (May 2007), Harman International Industries, Inc. (Apr 2007), Myers Industries, Inc. (Apr 2007), Symbion, Inc. (Apr 2007), First Data Corp. (Apr 2007), Vertrue Inc. (Mar 2007), Catalina Marketing Corp. (Mar 2007), K&F Industries, Inc. (Mar 2007), Aeroflex Inc. (Mar 2007), Bristol West Holdings Inc. (Mar 2007), HUB International, Ltd. (Feb 2007), TXU Corp. (Feb 2007), Semco Energy, Inc. (Feb 2007), Lear Corp. (Feb 2007), Triad Hospitals, Inc. (Feb 2007), Laureate Education, Inc. (Jan 2007), and United Surgical Partners International Inc. (Jan 2007).
2. MCL 450.1541a. See *Estes v Idea Eng’g & Fabrications, Inc.*, 250 Mich App 270, 649 NW2d 83 (2002).
3. See Schulman, *Moscow & Lesser*, Michigan Corporation Law & Practice § 5.9 nn.74 & 78 (Aspen 2006), and cases cited therein.
4. See *Edelman v Fruehauf Corp.*, 798 F2d 882 (6th Cir 1986); *Russ v Federal Mogul Corp.*, 112 Mich App 449, 455 n.1, 316 NW2d 454 (1982).
5. *Revlon, Inc v MacAndrews & Forbes Holdings, Inc.*, 506 A2d 173 (Del 1986).
6. *Barkan v Amsted Indus, Inc.*, 567 A2d 1279, 1287 (Del 1989).
7. See, e.g., *In re MONY Group Inc. Shareholder Litig.*, 852 A2d 9, 30 (Del Ch 2004); *In re Pennaco Energy, Inc. Shareholders Litig.*, 787 A2d 691, 707 (Del Ch 2001); *In re Fort Howard Corp Shareholders Litig.*, No 991, 1988 LEXIS 110, at *35, 38 (Del Ch 1988). However, see *In re Netsmart Technologies, Inc Shareholders Litig.*, 2007 WL 1576151, at *19 (Del Ch Mar 14, 2007) (“The ‘no single blueprint’ mantra is not a one way principle. The mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics.”).
8. *Paramount Communications Inc v QVC Network Inc.*, 637 A2d 34, 45 (Del 1994). See also *Barkan*, supra note 6, at 1287 (acknowledging that a post-agreement canvas of the market can be an acceptable means for directors to judge the adequacy of a single offer).
9. *In Pennaco*, supra note 7, at 707, the Delaware Court of Chancery stated that the validity of a board’s decision to enter into an agreement with a single bidder and then conduct a post-agreement market check with a fiduciary out would be subject to great skepticism if the board acceded to demands from the prospective buyer to lock up the transaction from later market competition by including in the transaction agreement onerous deal protection measures that presented a formidable barrier to the emergence of a superior offer.
10. *In re Toys “R” Us, Inc. Shareholder Litig.*, 877 A2d 975, 1000-01 (Del Ch 2005) (quoting *Barkan*, supra note 6, at 1286). See also *In re Fort Howard Corp Shareholders Litig.*, supra note 7, at 35.
11. *McMillan v Intercargo Corp.*, 768 A2d 492, 505 (Del Ch 2000).
12. *In re Toys “R” Us*, supra note 10, at 1021.
13. *Kysor Indus Corp v Margaux, Inc.*, 674 A2d 889, 897 (Del Super 1996). The one-to-five percent range described in *Kysor* was cited in *MONY*, supra note 7, at 24, and in *Matador Capital Mgmt Corp v BRC Holdings, Inc.*, 729 A2d 280, 291 (Del Ch 1998).
14. *Kysor*, supra note 13, at 897. See also *Pennaco*, supra note 7, at 707 (finding a 3.0% of equity value termination fee to be “modest and reasonable”); *MONY*, supra note 7, at 24 (stating a fee representing 3.3% of equity value and 2.4% of transaction value was “well within a reasonable range”); *Matador Capital Mgmt Corp.*, supra note 13, at 291 (stating defensive measures as a whole, including a 4.0% of equity value termination fee, did not prevent a third party from making a higher offer); *Phelps Dodge Corp v Cyprus Amax Minerals Co.*, Nos CIVA 17398, CIVA 17383, CIVA 17427, 1999 WL 1054255, at *5 (Del Ch 1999) (stating in dicta that an acquisition agreement’s 6.3% termination fee certainly seemed to stretch the definition of reasonableness and probably stretched the definition beyond its breaking point).
15. *Pennaco*, supra note 7, at 706.
16. *Id.* at 706-07.
17. *Id.* at 706
18. *Id.* at 707.
19. *MONY*, supra note 7, at 20-21.
20. *Id.* at 18.
21. *Id.* at 24. See also *Fort Howard*, supra note 7, at *35. In *Fort Howard* the court held that a company’s board of directors did not breach its fiduciary duties by entering into an agreement for a management buyout transaction without performing any form of pre-agreement canvas of the market. The agreement provided for a post-agreement window-shop period that included a public announcement of the proposed transaction and a description of the window-shop process.
22. *In re Lear Corp Shareholder Litig.*, No 2728-VCS, 2007 WL 1732588, at *1 (Del Ch June 15, 2007).
23. *Id.* at *12. The court included both the termination fees of \$79.5 million and \$85.225 million and the maximum expense reimbursement amounts of \$6.0 million and \$15.0 million in its calculation of the fee

percentages. The court also noted these fees in terms of percentage of enterprise value, or equity value plus debt acquired, and stated that enterprise value is probably the better metric because the buyer typically must refinance all the target company's debt.

24. *Id.* at *24-25.

25. *In re Topps Co Shareholders Litig*, Nos 2998-VCS, 2786-VCS, 2007 WL 1732586, at *1 (Del Ch June 14, 2007).

26. *Id.* at *27. The court enjoined the merger vote until Topps waived the standstill provision in the confidentiality agreement signed by the competing bidder to permit the competing bidder to make a bid at least as high as the one it had previously indicated a willingness to make and to communicate with the Topps shareholders about its version of certain events relating to the sale process that it claimed had been mischaracterized in Topps' proxy materials.

27. *Id.* at *9.

28. *Id.* at *6. The court included both the termination fees of \$8.0 million and \$12.0 million and the maximum expense reimbursement amounts of \$3.0 million and \$4.5 million in its calculation of the fee percentages.

29. *Id.* at *26.



Mark A. Metz, a member of the Corporate Finance Practice group at Dykema PLLC, provides general corporate and securities representation for many of the firm's publicly-held corporate clients in areas such as defensive planning, directors' duties, periodic reporting, disclosure, the responsibilities of corporate insiders, stock-based benefit plans, and insider trading rules. He has extensive experience in public and private securities offerings, acquisitions and dispositions of public and private companies, subsidiaries and divisions, and private debt transactions, including single- and multi-bank credit facilities and institutional private placements. Mr. Metz is the leader of Dykema's Corporate Governance Task Force, a multi-disciplinary team dedicated to monitoring legal developments, including those related to the Sarbanes-Oxley Act of 2002, and advising clients on various corporate governance and compliance issues. Mr. Metz also provides representation and guidance to privately-owned clients, including emerging businesses.