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TICKED OFF ABOUT SUPERSIZED REVERSE BREAK FEES?

“Target secures reverse break fee worth hundreds of millions!”

Headlines like this grab attention and are often heralded by target boards and their advisers as a triumph in securing deal certainty, or at least an indicator of negotiating prowess over the bidder (and their adviser counterparts!). In this edition of M&A in the City, we peel the lid on ‘supersized’ reverse break fees and take a proper look at whether they deliver the deal certainty sought by targets.

In our previous edition of M&A in the City, we explored a recent trend in bigger reverse break fees – in particular, we looked at a number of high value, Australian transactions where “supersized” reverse break fees had been negotiated.[1]

Supersized reverse break fees are not a new phenomenon. They have been a feature of Australian deals for a while[2] and have on occasion exceeded more than 10% of the target equity value.[3] While less common in Australia, supersized reverse break fees are commonplace in North American markets where they are generally in the range of 4% - 6%, although conditionality and complexity can push them even higher. In cross-border transactions, overseas bidders are often pleasantly surprised to learn that the quantum of reverse break fees in Australian deals is (in the interests of reciprocity) regularly the same amount as the target break fee – i.e. capped at 1% of target equity value to track Takeovers Panel guidance.

With the Takeovers Panel’s apparent endorsement of supersized reverse break fees in *Westgold Resources Limited*,[4] we investigate whether supersized reverse break fees are the be-all and end-all for target boards and their shareholders (and should be a key negotiating point in the boardroom), or whether there’s a better approach to keeping an agreed deal on track.

WHY NEGOTIATE A SUPERSIZED REVERSE BREAK FEE?

As we’ve previously explored, supersized reverse break fees are seen as helping targets secure deal certainty – in that, the magnitude of the reverse break fee holds the bidder’s feet to the fire – whether it’s in satisfying regulatory approval conditions or otherwise performing its obligations under the implementation agreement. We’ve explained that supersized reverse break fees can be justified in the sense that, having been “marched up the hill” by the bidder, it is the target who will bear costs that far exceed those of the bidder – given the disproportionate impact of the bidder’s offer on the target’s business (whether this is indeed the case will of course depend on the particular transaction).

But surely size isn’t everything? And does it really assuage target shareholders’ disappointment – they’ve still lost the deal.

Perhaps it is time to step back and reflect: is the energy and time spent negotiating the quantum of a supersized reverse break always worth it? Could that effort be deployed in other ways that better deliver the fundamental objectives of deal certainty and value to target shareholders?

1. We consider a reverse break fee to be “supersized” if the quantum of the fee exceeds 1% of the equity value of the target.
2. For example, the Recall Holdings / Iron Mountain Inc. A$2.6 billion scheme in 2015 included a reverse break fee of A$76.5 million (in respect of antitrust regulatory approvals), representing 3% of deal value and over 3.3% of target equity value.
3. For example, the Sirtex Medical / CDH Genetech and China Grand Pharmaceutical A$1.9 billion scheme in 2018 included a reverse break fee of A$200 million, representing 10.5% of deal value and more than 10% of target equity value (on signing the implementation agreement).
4. [2024] ATP 15. For completeness, we note that the Panel did not reach a concluded view on whether the ‘Termination Fee’ should be properly characterised as a ‘reverse break fee’.

WHEN IS A SUPERSIZED REVERSE BREAK FEE JUST FOR SHOW?

It's important to remember that reverse break fees are only negotiated in the context of an agreed deal – where the target board has determined it is in the best interest of its shareholders to pursue the deal.

At this stage of a transaction, the target's focus should be on securing the transaction – that is, reaching implementation - and ensuring the consideration offered is ultimately delivered to target shareholders. With this objective in mind, the financial 'stick' of a large reverse break fee is intended as a device to increase, or at least maintain, deal certainty: by making a bidder think twice before triggering a payment obligation (for example, by breaching the implementation agreement).

But do supersized reverse break fees (cf. 'standard' reverse break fees) actually have this deterrent impact on bidders, especially those with a broad base of their own shareholders, or are there better ways to promote the same thing?

In many cases, the quantum of a supersized reverse break fee - while eye-watering - may simply reflect the differing sizes of the target and bidder. While the reverse break fees in each of the below deals were 'supersized' (i.e. being more than 1% of the target equity value), it was either equal to or less than 1% of the bidder equity value.

Deal	Break Fee (BF)	BF Target Equity Value (~%)	Reverse Break Fee (RBF)	RBF Target Equity Value (~%)	RBF Bidder Equity Value (~%)	RBF Multiple Of BF (Quantum)
Newcrest / Newmont*	US$174 million	1.0%	US$374.7 million[5]	2.01%	1.0%	2.15x
Altium* / Renesas	A$91.3 million	1.0%	A$410.8 million	4.55%	0.9%	4.49x
Alumina* / Alcoa	US$22 million	0.6%	US$50 million	1.3%	0.9%	2.27x

KWM acted for Newmont, Altium and Alumina

In cases where the agreed break fee and reverse break fee are proportional to the target and bidder's respective equity values (say, 1% respectively), it is questionable whether the reverse break fee actually provides the bidder with any additional motivation to comply with the implementation agreement and to 'get the deal done' than the corresponding break fee imposes on the target. Of course, if we weren't talking 'mega deals', the proportionality vs motivation argument could be more nuanced (and potentially harder to sustain).

'Back in the day', break fees *per se* were considered inconsistent with doing deals 'the Australian way', regardless of their quantum; and their introduction to our market was borne out of a desire to promote competitive tension in contested transactions, especially those with a cross-border element (rather than impose a potentially coercive obligation on a target and its shareholders). Our pals in the UK have taken the other path, effectively outlawing break fees and all manner of exclusivity/deal protection fun.

Generally, a reverse break fee is triggered by a circumstance within the control of the bidder – for example, if the bidder ceases to support the transaction or otherwise commits a material breach of the implementation agreement. It makes sense that the stronger your commitment, the more likely you are to agree to a large reverse break fee: assuming the triggers are tied exclusively to your own commitment and ability to control them – particularly if you can extract meaningful concessions from the target in return.

Where a reverse break fee is triggered by a circumstance beyond the control of the bidder, the bidder will generally seek to agree a lower amount payable for those events to justify the trigger. In the Newcrest / Newmont transaction, the reverse break fee payable for a failure to obtain Newmont stockholder approval was not 'supersized' – it was limited to third-party costs and expenses actually incurred by Newcrest – being a trigger not entirely within bidder's control but suitably differentiated from the normal deal risk here in Australia, where bidder shareholders are rarely required to approve a deal (thanks ASX Listing Rules!). There was no reverse break fee (let alone a 'supersized' reverse break fee) payable if Newmont failed to secure any other regulatory approvals (other than where the failure was linked to a material breach by Newmont).

5. The reverse break fee trigger in the Newcrest / Newmont transaction that Newmont obtain Newmont stockholder approval for the transaction was limited to third-party costs and expenses incurred by Newcrest.

And this real-life example brings us to one of the (relatively) unspoken things about supersized break fees: are they actually enforceable, or is it more about the show? Like all break fees, a reverse break fee ought to align with genuine reimbursement of costs (in this case, the target's). If it is out of all proportion to the target's legitimate commercial interests in the bidder performing the scheme, such that it is unconscionable for the target to enforce the reverse break fee (which super-dooper sized reverse break fees could be), it could very well amount to a penalty and be unenforceable to the extent it is not compensatory. Also, there must come a point where a supersized reverse break fee is so large that its effect is anti-competitive or operates as a poison-pill / unacceptable lock-up device in respect of the bidder. Unlike in the US and even the UK, there is no direct judicial authority to guide the application of the penalties doctrine in public M&A deals Down Under. And we all tend to focus on the Takeovers Panel's guidance – which is limited when it comes to a break fee in reverse – in deal negotiations.

BUT REGULATORS ARE MAKING DEALS SO MUCH LESS CERTAIN!?

As the old adage goes: "time kills deals". It's fair to say that the threat of paying a supersized reverse break fee might motivate an otherwise recalcitrant bidder to deploy additional focus and resources on securing prompt regulatory approvals, or push an increased willingness to agree to a regulator's conditions. And with the general uncertainty that the pandemic brought with it, it's fair to say that reverse break fees grew in prominence, and have continued to do so.

An implementation agreement will generally include obligations on the bidder to do all things necessary to obtain relevant regulatory approvals, and may prescribe a timetable for relevant filings to be made. Alas, once a filing has been made, there is of course little that a bidder can actually do to meaningfully expedite a regulator's consideration of the deal – and a supersized break fee may make little practical difference to the outcome.

Turning back to the context of an agreed deal, and especially one involving bidder scrip consideration, isn't the onus on both the target and the bidder to cooperate in obtaining the necessary approvals as a vital step in expeditiously delivering the transaction to their respective stakeholders? And in ensuring that the combined group that ultimately results from the deal is optimised, both in remaining 'in tact' and appropriately positioned for ongoing regulatory compliance. The prospect of being paid a significant lump sum seems like a distant consolation prize for failing to deliver a transaction the target has committed to championing and securing for its shareholders – and questions could be asked of the target board as to the concessions given in extracting that supersized amount.

ARE TICKING FEES THE ANSWER?

While reverse break fees are an established feature of Australian public market deals and are here to stay (in a supersized form or otherwise): target boards should be encouraged to explore devices that can be deployed in tandem with a reverse break fee – rather than simply seeking to extract the largest possible fee from the bidder – and ones that directly flow through the shareholders.

Returning to the premise that the target should be motivated to complete an agreed deal, one approach is the use of ticking fees.[6]

Ticking fees are traditionally delivered directly to target shareholders in the form of an uplift to the consideration payable, and compensate shareholders for deal delay (for example, due to regulatory approvals taking time to obtain). Generally, a ticking fee is additional consideration per share that accumulates per day (beyond a certain prescribed period) – in the context of scrip consideration it may take the form of a permitted dividend paid by the target to its shareholders on completion of certain deal milestones (requiring the target board to determine whether the payment of a permitted dividend, from the company's funds, is appropriate in all the circumstances).[7] Although less common to date, the fee could be provided in the form of scrip via an increase to the scrip exchange ratio.

We see a number of benefits to ticking fees, including that they:

- reinforce the parties' commitment to the transaction (for example, the ticking fee is generally payable on completion – the target is not put in a potential conflict position of deciding whether to terminate and be paid a reverse break fee or whether to continue to pursue the deal) and the magnitude of the ticking fee is generally insufficient to motivate a target to deliberately 'go slow' in doing its bit;
- are delivered directly to target shareholders (i.e. target shareholders receive the additional consideration, whereas a reverse break fee is paid to the target); and
- are generally proportionate to the loss or additional, genuine cost incurred by the delay (for example, they effectively provide interest to target shareholders as compensation) and there should be little risk of a ticking fee being an unenforceable penalty or anti-competitive.

It may be advisable for a target board to seek to extract a supersized reverse break fee in conjunction with a ticking fee, so we're definitely not suggesting the two are mutually exclusive.[8]

Target boards and their advisers should negotiate an appropriate package of devices to increase deal certainty, deliver meaningful value to shareholders and mitigate potential delays – and bidders should carefully consider the kind of devices they agree to, with a broader perspective on what will motivate both parties and legitimately compensate the target and its shareholders for delay. It is not simply the case that 'bigger is always better' – for example, a target (and its shareholders) may benefit from extracting a smaller reverse break fee in conjunction with an appropriate ticking fee – provided the target is prepared to forego the flashy headline in the interests of deal certainty!

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6. For recent examples of agreed ticking fees in Australian public market transactions, see: CSR Limited / Compagnie de Saint-Gobain (2024), Pacific Smiles / National Dental Care (2024), Origin Energy / Brookfield (2023) and Alliance Aviation Services / Qantas (2022).
7. For example, the Alliance Aviation Services / Qantas deal.
8. See CSR Limited / Compagnie de Saint-Gobain for an example of a combination of a reverse break fee and ticking fee.

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