

# REVERSE BREAK FEES IN AUSTRALIAN PUBLIC M&A

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Legal Briefings - By **Rodd Levy**

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## SUMMARY

- Reverse breaks fees compensate the target for a termination caused by something within the bidder's control.
- In Australia, they tend to match the quantum of any break fee (usually 1%), despite the US practice where reverse break fees of 5% or more seem to be routine.
- Difficult legal issues arise with reverse break fees and sometimes a more creative approach may be required.

## WHAT IS A REVERSE BREAK FEE?

A reverse break fee is a fee payable by a bidder to a target if a public M&A transaction (such as a takeover bid or scheme of arrangement) does not proceed due to an event within the control of the bidder.

Common triggering events include the bidder:

- failing to get its own shareholder approval,
- failing to get finance for the transaction, or
- failing to obtain a regulatory approval for the transaction to proceed.

The reverse break fee is designed to compensate the target for losses caused by the deal failing and also to provide an additional incentive for the bidder to comply with its obligations.

## HOW MUCH IS PAYABLE TYPICALLY?

Unlike a standard break fee payable by a target due to an event within the control of the target's directors (such as withdrawing their recommendation), reverse break fees are not subject to the Takeovers Panel's 1% rule of thumb.

The reason for this is that a reverse break fee would not ordinarily give rise to any anti-competitive effects on the target company. Therefore, the amount of the reverse break fee is largely a matter for negotiation.

The experience in Australia has typically been that reverse break fees often match the standard break fee payable by the target. That is, they are commonly 1% of the transaction value.

Listed below, are examples of break fees and reverse break fees agreed in some recent scheme of arrangement transactions:

Target (Bidder)	Break fee	Reverse break fee
Dyno Nobel (Incitec)	0.77%	0.77%
Spotless (PEP)	1.41%	1.41%
ING Industrial Fund (Goodman)	1%	1.77%
Heathscope (TPG / Carlyle)	1%	1.5%
Ausdrill (Brandrill)	1%	1%

While there is now a prohibition on break fees payable by a target company in the UK, reverse break fees are still permitted, although they are rare in practice. Consistent with the practice in Australia, reverse break fees tend to be confined to events within the control of the bidder, where the target's only recourse would be to the break fee in the event the fee is triggered. The size of reverse break fees in the UK is largely consistent with the Australian approach (ie break fees of approximately 1% of deal value).

Certain other examples stand out: most recently, for example, in the recent £32 billion takeover offer for Shire PLC by AbbVie Inc, the reverse break fee was 3% of deal value (approximately US\$1.63 billion). The takeover offer was conditional on the approval of AbbVie's shareholders and the reverse break fee was payable if the AbbVie board changed its recommendation and advised its shareholders to vote against the takeover offer. Following Obama's administration's proposal of new regulations designed to clamp down on so-called tax inversion transactions, the AbbVie board changed its recommendation and paid the break fee.<sup>1</sup>

The practice in Australia and the UK differs markedly from the US practice where reverse break fees of 5%, 6% and 7% are often encountered.

## **ISSUES WITH REVERSE BREAK FEES**

As the reverse break fee is payable on a breach of contract, the law of penalties may apply to the reverse break fee provision. Under the law of penalties, an agreed amount of damages payable on breach of contract will be regarded as a penalty and unenforceable if it does not represent a 'genuine pre-estimate' of the loss that may be suffered by the breach.

Therefore, a reverse break fee which is too high and which exceeds the amount the target company may have wasted as a result of the failed deal, may well be susceptible to challenge under the law against penalties.

In the case of a reverse break fee, this issue becomes acute as, in a failed deal, the target company would typically suffer a loss only of its out-of-pocket costs, which may not be significant in the scheme of things. The real losses are suffered by the target's shareholders and they are likely to be very significant, but, as the shareholders are not parties to the agreement, their losses are disregarded when assessing if the fee is a penalty.

To overcome this problem, it may be possible to structure the agreement so that, in the event of a breach, the bidder is liable to compensate shareholders who have lost money as a result of the failed transaction. This approach is based on the rule that applies in a takeover bid and was adopted in the AWB scheme of arrangement several years ago, although that has not become common market practice to any degree in Australia.

Another issue is whether the reverse break fee is expressed to be an exclusive remedy for the target in the event of a breach.

If a reverse break fee is the sole and exclusive remedy, the danger for the target is that, if the reverse break fee is not a significant sum, it may be regarded as akin to an 'option fee' which the bidder may choose to pay to walk away from a transaction without incurring any further liability for not proceeding.

Market practice in this regard is mixed, although it is not uncommon to see reverse break fees expressed to be the exclusive remedy for the target, which exacerbates this risk.

# OTHER WAYS TO PROTECT A TARGET

US merger agreements typically have further elaborate provisions which are designed to protect a target company from a bidder reneging on a transaction at the last minute.

This may include provisions obliging the bidder to pay an amount far in excess of a reverse break fee in the event of a default or which may entitle the target to step in and require the bidder's financiers to provide the funding for the transaction, even if the bidder is reluctant.

This approach has not been seen in the Australian market and it is an open question whether such provisions would be approved by courts administering a scheme of arrangement.

## CONCLUSION

Reverse break fees remain the exception rather than the norm in Australian public M&A transactions. They raise difficult legal issues, many of which have not yet been worked through.

## ENDNOTES

1. Herbert Smith Freehills' London office acted for AbbVie on its takeover offer for Shire.

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



**RODD LEVY**

PARTNER,

MELBOURNE

+61 3 9288 1518

[rodd.levy@hsf.com](mailto:rodd.levy@hsf.com)

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