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# CORPORATE & COMMERCIAL ALERT

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### The deal with break-fees

The term "*headed for an economic downturn*" has the look and feel of a buzzword that has overstayed its welcome on newspaper headlines. Now more than ever taking the first step to start a corporate transaction in the current state of the global economy is a daunting task for all parties concerned. The high costs and reputational risks of a failed deal have demanded that corporate lawyers come up with new and innovative ways to ensure that a commercial deal succeeds. This article assesses the payment of break-fees also known as ("break-up fees" or "termination fees") in merger and acquisition transactions (M&A Transactions) to protect the consummation of deals.

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## The deal with break-fees

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The term “*headed for an economic downturn*” has the look and feel of a buzzword that has overstayed its welcome on newspaper headlines. Now more than ever taking the first step to start a corporate transaction in the current state of the global economy is a daunting task for all parties concerned. The high costs and reputational risks of a failed deal have demanded that corporate lawyers come up with new and innovative ways to ensure that a commercial deal succeeds. This article assesses the payment of break-fees also known as (“break-up fees” or “termination fees”) in merger and acquisition transactions (M&A Transactions) to protect the consummation of deals.

There are generally two types of break-fees, namely a standard break-fee and a reverse break-fee. Both types of break-fee provide a form of quasi-insurance to one of the parties to safeguard against the risk of a failed deal and losing substantial costs in an M&A Transaction if the deal ultimately fails due to some or other action by the other party. Break-fees are relatively uncommon in private M&A Transactions in South Africa, but are frequently used in public M&A Transactions.

The preliminary phase of a M&A Transaction can be costly for an acquirer, in the sense that it usually involves (i) various due diligence investigations (e.g. legal, financial and commercial), company valuation,

obtaining legal and tax advice on how the deal should be structured and ultimately culminating in the drafting and negotiation of legal agreements and the preparation and filing of a merger filing, and (ii) management’s time and resources in considering, evaluating and negotiating the deal. If the M&A Transaction is unsuccessful, these costs run the risk of not being recovered.

In a conventional break-fee scenario, break-fees are imposed by a purchaser and payable by a seller or target company in the event that the seller or the target company does something or does not do something which ultimately results in an M&A Transaction failing or not being implemented in accordance with the terms originally agreed to. Break-fees act as a form of compensation for a purchaser’s time and resources in facilitating the deal and as an incentive for the seller to commit to and implement the deal.

The triggers for the penalty break-fee must be agreed upfront in the contract and clearly defined in order to ensure that it is enforceable. The common triggers for the payment of a break-fee include:

1. the target company accepts a competing offer;
2. failure to obtain a regulatory approval (e.g. competition approval);
3. failure to accept any conditions imposed in a regulatory approval; or
4. the seller or target company repudiates or commits a material breach of the transaction agreement.

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## The deal with break-fees ...continued

Reverse break-fees are uncommon in the South African market.

Break-fees are generally quantified in two ways or a combination of both: either as a fixed cost (which is usually a function of the costs expended by the purchaser in facilitating the M&A Transaction) or as a percentage of the overall deal value. The Takeover Regulation Panel (TRP) which regulates "affected transactions" and offers in respect of a "regulated company" provides some guidance on the quantum of acceptable break-fees in a public M&A transactions.

In 2012, the TRP published a guideline titled "Guideline 1/2012 Break Fees" in which it advised that (i) the TRP will allow the payment of a break-fee provided that the aggregate amount of the break-fee is no more than 1% of the value of offer, and (ii) the details of the payment of the break-fee must be disclosed in a circular to be sent to shareholders including the amount and the circumstances under which the break-fee is payable.

Reverse break-fees are more commonly being used to incentivise purchasers to commit to and implement a deal. A reverse break-fee is a break-fee that the seller or target company imposes on the purchaser, with the triggers for payment thereof being similar to those used in a standard break-fee scenario (other triggers could include failure to obtain the requisite board or shareholder approvals or being unable to obtain funding for the acquisition). Reverse break-fees are uncommon in the South African market.

Although break-fees can be criticised for being a tool used to force target companies to accept a deal, they have become a common feature in M&A Transactions and they have the strong ability to reassure a transacting party to proceed with a transaction with the comfort of knowing that if the deal is not successful due to a specified event, they be able to recover some of their invested costs.

*Melissa Mtolo and Anita Moolman*

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The module will empower your organisation with a greater appreciation and understanding of what constitutes sexual harassment, how to identify it and what to do it if occurs.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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