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Reverse Break Fees
Breaking up is hard (and expensive) to do

When Google announced its acquisition of Motorola Mobility for $12.5 billion recently, commentators reported on the typical deal metrics – premium (Google's offer represents over a 63% premium), and multiples. However, Google's offer of a $2.5 billion reverse break fee, an unprecedented amount, also caught people's attention. Google's exposure to Motorola Mobility if they cannot complete the deal is just over 25% of the transaction's enterprise value and considerably more than reverse break fees announced in various public deals since 2010. The reverse break fee is payable if regulatory clearance is not achieved. Competition/antitrust clearance to complete the transaction needs to be obtained in the US, EU, Canada and certain other countries. In addition, Google has agreed that it will use "reasonable best efforts" to obtain antitrust clearances and failing to do so will entitle Motorola Mobility to claim a further $1 billion from Google. By contrast, Motorola Mobility is obligated to pay Google a fee of $375 million if it is unable or unwilling to complete.

This reverse break fee is significantly higher than AT&T's reverse break fee in its deal to acquire T-Mobile, which is approximately 7% of the total price, payable if AT&T does not complete its bid. AT&T's bid is currently at risk because of regulatory concerns. Until Google's offer, reverse break fees were running at approximately three to ten percent of total bid price. Is a much higher break fee a trend?

Google is thought to be principally interested in Motorola's approximate 17,000 registered and 7,500 pending patents. These patents are useful to Google in providing what has been described by Google itself as an "antidote" to Apple, Microsoft, Oracle and others challenging the android phone and app market. Having lost out on the Nortel patent purchase, Google's motives may be as defensive as they are accretive. In addition to the healthy premium, the offer of a very high reverse break fee (also called a reverse termination fee), is at least one indication that this is an important purchase for Google.

A reverse break fee satisfies different concerns for buyers and sellers. In 'up' markets, where a seller has the luxury of a number of suitors, the seller might demand a higher reverse break fee to protect its business in the case of a failed bid. Results from the US have shown that target companies engaged in a failed transaction not only see their stock price drop dramatically after the deal termination, but some never quite recover to their pre-bid levels. As a result, if the best opportunity is with a strategic purchaser and there is a high risk of competition authorities not approving the transaction, the seller will be motivated to achieve a high reverse break fee. Strategic purchasers in a competitive bid environment may well decide that they need to offer up substantial deal risk coverage to a target in future.

In a more challenging market, a buyer wanting to limit its exposure to the consequences of a broken deal might offer a reverse break fee in a manageable amount. As we saw in the US, buyers did exercise their right to walk for a specified price when financing terms were not obtainable. The key to the seller is to ensure that the reverse break fee does not make it easy for a buyer to make that choice.

In use in the US for several years, we are now seeing more notable references to reverse break fees in Canadian transactions. Most recently, the Maple Group, a consortium of Canadian banks and significant pension funds, included a $39 million reverse break fee in their offer to acquire the TMX Group. The deal concern in the case of the Maple Group is that it will face potential competition review issues. As well, Cara Operations Limited (the owner of Swiss Chalet, Harvey's, Kelsey's and Milestones) also made an offer for Prime Restaurants Inc., (the owner of East Side Mario's amongst other restaurant and pub outlets) and Cara has agreed to a reverse break fee of $3 million as part of this deal (on a $59 million purchase price). The Cara/Prime transaction is subject to a number of conditions, including the completion of Cara's financing necessary to complete and the approval of Prime's shareholders.

The biggest risk would be if Cara is unable to line up its financing. Without the certainty of financing in advance of a deal offer, it is certainly important to the target to have, at the least, a reasonable reverse break fee. Notwithstanding the fee, presumably both parties are comfortable about financing conditions.

Given the attraction of a reverse break fee both to purchasers and sellers, and in both competitive and challenging market environments, we would expect to see reverse break fees negotiated and at potentially higher amounts in future. Any transaction that presents a regulatory risk of completion would certainly warrant, from a target's perspective, healthy coverage if the transaction does not complete given the risk of a broken deal.

Sellers might also consider two-tier reverse break fee structures where there is a higher fee payable for 'right to walk' reasons such as an inability to secure financing as opposed to other reasons for termination, or where a bid has been accepted notwithstanding a potentially concerning regulatory approval risk. Every deal has its own unique circumstances and every party who enters into a transaction agreement wants that deal to complete, however it is worth considering what happens if it does not. Reverse break fees and how they are structured may be part of that consideration.

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