Time is Money — Ticking Fees

Ticking fees and other similar bespoke increasing fee arrangements create a specific and quantifiable economic incentive for buyers to complete a deal in a timely manner.

In any transaction facing a meaningful delay between signing and closing, dealmakers on both sides of the table spend a considerable amount of time thinking about allocating the various risks resulting from that delay (*e.g.*, regulatory, business and financing). Most of the discussion centers on "deal certainty," with sellers focused on contract provisions that force buyers to move quickly through transaction hurdles and obligate them to close despite potentially changed circumstances or unfavorable regulatory demands. In a prior *M&A Update* that focused on the allocation of antitrust risk, we addressed merger agreement terms that outline the required efforts and remedy concessions by buyers, as well as the possible use of a reverse termination fee payable to the seller if the deal terminates because of the failure to obtain required antitrust approvals.

Recently, we have seen nascent signs of a resurgence in the use of ticking fees, a dealmaking tool that addresses a related, but different, risk — namely, incentivizing the buyer to move quickly through the sign-to-close process and compensating target shareholders for the economic impact of extended/unexpected delays in reaching closing. This "pay-for-delay" compensation may be important because cash deals are nearly universally struck at a fixed cash price paid at closing, whenever that happens. Ticking fees and other similar bespoke increasing fee arrangements create a specific and quantifiable economic incentive for buyers to complete a deal in a timely manner.

Below we outline some recent examples of these tools.

Classic Ticking Fees

A classic ticking fee is an increase in the per-share cash consideration payable to seller stockholders as the time period between signing and closing passes certain milestones. Classic ticking fees are flexible devices that can be tailored to the specific circumstances at hand — for example, the increase can start at signing, at a later specified date or upon the occurrence (or non-occurrence) of a specified event. Similarly, the amount can go up on a straight line basis over the course of the relevant period or can be structured to fluctuate over time as certain deadlines are passed or events occur.

The recent Service Corporation/Stewart Enterprises and Thermo Fisher/Life Technologies merger agreements included an initial outside date, with an extension period if antitrust clearance was not yet obtained. If the initial outside date was extended, then the per-share merger consideration would be increased by a stated fraction of a penny-per-day for each additional day that passed until the transaction ultimately closed (subject to tolling where the seller caused or contributed to the delay). Note that these tools are not confined to antitrust approvals — they can be used to compensate for delays in obtaining other regulatory approvals (*e.g.*, Sunrise Senior Living/HCR) or even financing.

Increasing Reverse Termination Fees

A few recent deals have combined the more popular reverse termination fee remedy with the "pay-for-delay" principle of the ticking fee in the event that the period from signing to the termination event giving rise to the reverse termination fee obligation is extended. For example, in the recent Akorn/Hi-Tech Pharmacal transaction, if the buyer exercised an option to extend the outside date for one month in order to continue pursuing antitrust clearance, the reverse termination fee (rather than the merger consideration as in a classic ticking fee) payable to the seller upon a failure to obtain antitrust approval or the required debt financing would increase from $41 million to $48 million. A comparable provision was used in the 2012 sale of Western U.S. assets by BP to Tesoro. The buyer was required to fund a daily deposit of $330,000 for each day after the seller finished complying with any "second request" from the U.S. antitrust authorities until the deal closed or was terminated. The deposit (capped at $50 million) would be credited against the purchase price if the deal closed but would be forfeited (in essence as a growing reverse termination fee) if the deal terminated as a result of not obtaining antitrust approvals.

Ticking Dividends

A less obvious, but potentially equally effective, tool to economically discipline buyers to avoid undue delay in closing can be found in the permitted dividend provisions in a merger agreement. For targets that pay regular dividends, the sellers sometimes negotiate for the ability to continue to pay regular dividends with record and payment dates consistent with historical practice, as was seen in the recent acquisitions of Heinz and Duff & Phelps. This type of "ticking dividend" provision can incentivize the buyer to close the transaction as soon as possible. While lacking the finely tuned elegance and precision of a daily increase inherent in a classic ticking fee, the prospect of payment of an additional upcoming dividend, a large one-time cost that reduces the seller's cash the buyer is acquiring, can motivate an acquirer to move assiduously.

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With growing focus on both the risks and timeline for obtaining regulatory approvals due to increasingly complex regimes worldwide, parties may expand the traditional negotiation of allocation of antitrust risk to include mechanisms to share the economic risk of extended delays between signing and closing. Although the opportunity cost of an extended delay before closing has not been pronounced in the current low interest rate environment, the pressure to compensate stockholders for such delays may increase if interest rates rise as expected. Although ticking fees are most often reluctantly conceded by buyers, a bidder in a competitive process can also consider proactively proposing a ticking fee to level the playing field with other bidders who may be able to move a transaction to closing more quickly (*e.g.*, because of less competitive overlap) or to bargain for a longer time period to fight proposed regulatory remedies before being required to accede to regulators' demands. In appropriate situations and contexts, a ticking or similar fee arrangement can be a useful addition to the broader matrix of terms that form the risk allocation and economic incentive package between the parties.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

Daniel E. Wolf
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dwolf
+1 212-446-4884

David B. Feirstein
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dfeirstein
+1 212-446-4861

Joshua M. Zachariah
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/jzachariah
+1 212-446-6450
