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Undressing the No-Vote Fee

A break-up fee payable by a public target company associated with a competing proposal is a near universal feature of public company sales. The fee is typically payable if the target exercises a fiduciary termination right to accept a superior proposal or in a "tail" situation where a competing proposal is completed during a set period after a termination of the current deal as a result of a no-vote of the target shareholders where a competing proposal had been made public prior to that vote. While the size of the fee varies based on deal-specific circumstances, recent studies show an average in the range of 3% of deal value.

M&A parties also often discuss the consequences of a straight no-vote by the target company shareholders in the absence of a competing bid — a so-called "naked" no-vote. These conversations have taken on more practical relevance with the increase in activists seeking to disrupt M&A transactions — a recent study showed 18 different U.S. deals challenged in the first half of 2019.

Here the prevalence of a set break-up fee payable by the target is more limited. Deal studies show such a fee being used in a relatively small number of deals; instead, it is more common (roughly one-third of deals) to have a capped expense reimbursement in favor of the jilted suitor ranging anywhere from a few million dollars to tens of millions depending on deal size. The set fee and expense reimbursement constructs produce some interesting contrasts. The pending Google/Fitbit transaction includes a fee of 1% of deal value payable on a no-vote ($20 million). By comparison, the recently closed Celgene acquisition had a capped expense reimbursement of nearly double that amount — $40 million — but representing only about 1/20 of 1% of the deal value.

The hesitation to mandate a significant termination fee in this circumstance is usually attributed to sensitivity about the fiduciary implications and coercive impression of incurring a significant fee obligation arising from the target's shareholders simply exercising their right to vote against the proposed sale.

While there is a long line of cases on the acceptable amount of traditional superior proposal break-up fees, the case-law on naked no-vote fees or expense reimbursements is much more limited. The primary Delaware case on the issue is the 2008 *Lear* decision where then-Vice Chancellor Strine approved a naked no-vote fee of 0.9% of deal value. Notably, the fee in the *Lear* case was added to the deal in the context of a post-announcement price bump, which may have influenced the court's views on the propriety of the fee. And in a bit of trivia, the fee was actually paid by Lear when its shareholders voted down the Icahn acquisition in a rare naked no-vote.

Increased activist opposition to deals has sharpened the focus on fees and expense reimbursements payable in the event of a "naked" no-vote by target shareholders.

It is worth noting that the no-vote fee discussion and the associated fiduciary questions also are relevant when a buyer vote is required because of the size of the acquirer's share issuance. While buyer shareholder approval historically was viewed as almost a foregone conclusion, recent activist-driven challenges to buyer shareholder votes have resulted in more focus on the vote risk and the consequences of a failure.

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

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