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KIRKLANDPEN
Private Equity Newsletter

October 24, 2013

Time is Money — Ticking Fees

PENpoints

Ticking fees and other similar increasing fee arrangements create a quantifiable economic incentive for buyers to close 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.

Recently, we have seen signs of a resurgence — primarily in strategic deals — in the use of ticking fees, a dealmaking tool that incentivizes a buyer to move quickly through the sign-to-close process and compensates 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 increasing fee arrangements create a specific quantifiable economic incentive for a buyer to complete a deal in a timely manner.

Below we outline some recent examples of these tools.

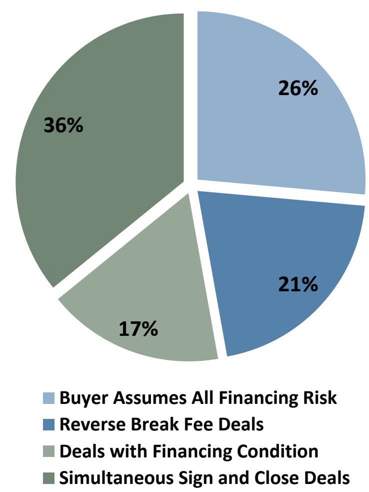
Classic Ticking Fees

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 may be tailored to the specific circumstances. For example, the increase may start at signing, at a later specified date or upon the occurrence (or non-occurrence) of a specified event. Similarly, the increase may be linear or 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 increase by a stated fraction of a penny each additional day that passed until the transaction ultimately closed (subject to tolling where the seller causes or contributes 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.

PENstats

Allocation of Financing Risk:
PE Buyer Deals from $100M to $500M



Dataset includes PE-buyer deals closed in the 18-month period ending September 30, 2013. This chart was generated from data in CTRAN, Kirkland's proprietary database which includes more than 750 private-target M&A transactions closed since 2008 in which Kirkland represented a transaction party.

INSIDE KIRKLANDPEN

Increasing Reverse Termination Fees

A few recent deals have combined the reverse termination fee remedy with the "pay-for-delay" principle ticking fee in the event that the period from signing to the termination event giving rise to the 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) payable to the seller upon a failure to obtain antitrust approval or 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 a buyer to avoid undue delay in closing may be found in the permitted dividend provisions in a merger agreement. A target that pays regular dividends often negotiates for the ability to continue to pay them with record and payment dates consistent with historical practice, as was seen in the recent acquisitions of Heinz and Duff & Phelps. While lacking the precision of a daily increase inherent in a classic ticking fee, the prospect of an additional upcoming dividend payment, a large one-time cost that depletes the target's cash resources that the buyer is acquiring, also motivates an acquirer to move quickly.

* * *

With increased focus on both the risks and timeline for obtaining regulatory approvals due to increasingly complex worldwide regulatory regimes, 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. The pressure to compensate sellers for delays in closing may be even more pronounced if interest rates rise, increasing a seller's opportunity costs. Although ticking fees are most often reluctantly conceded by buyers, a bidder in a competitive process might 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. A ticking or similar fee arrangement may 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 *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

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PENbriefs

The Interplay Between Delaware Law and the Exchange Rules in Assessing Director Independence

A recent Delaware decision addressed the interplay between stock exchange (e.g., the NYSE and NASDAQ) and Delaware requirements with respect to director independence. While in the recent decision the court found the exchange rules "useful" for assessing independence under Delaware law, in subsequent cases Delaware courts continue to conduct fact-intensive inquiries into director independence that look beyond bright-line exchange rules. To learn more, see our recent *Alert*.

Out of Context — Delaware Clarifies on "Weak" Fairness Opinions

A recent Delaware decision rejected plaintiff's attempt to challenge a merger based solely upon a financial advisor's "weak" fairness opinion, noting that criticism of a target board's reliance on a "weak" opinion in an earlier case was contextual. Nonetheless, financial advisors and target boards should remain aware and alert that plaintiffs and courts are more carefully scrutinizing the details of fairness analyses both as to substance and as to the adequacy of the public disclosure. To learn more, see our recent *M&A Update*.

PENnotes

Understanding the Securities Laws 2013
Chicago, October 24-25, 2013

This program provides an overview and discussion of the basic aspects of the U.S. federal securities laws by leading in-house and law firm practitioners and key SEC representatives. Emphasis will be placed on the interplay among the Securities Act of 1933 and the Securities Exchange Act of 1934 and related SEC regulations, and how those laws were affected by the Sarbanes-Oxley Act, the Dodd-Frank Act and the controversial Jumpstart Our Business Startups (JOBS) Act, which created the concept of "emerging growth companies." Kirkland partner Theodore A. Peto is a speaker at this event. Click here for more information.

Securities Filings 2013: Practical Guidance in a Changing Environment
Chicago, November 14-15, 2013

This program will analyze in detail the principal forms used for filings with the SEC under the Securities Act of 1933 and the Securities Exchange Act of 1934, with particular emphasis on the mechanics of and timing for assembling particular filings. Each segment of the program will incorporate practical drafting and disclosure tips. Ethics credit and recent legislation and SEC rule changes affecting disclosure obligations, in particular those resulting from the JOBS Act, will be woven within the topics covered. Kirkland partner Gerald T. Nowak will speak at the event. Click here for more information.

PLI Chicago Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2013
Chicago, November 19-21, 2013

This program will focus on the tax issues presented by the entire spectrum of modern major corporate transactions. Kirkland partner Jack Levin will participate on the topic titled "Structuring Leveraged Buyouts," partner Todd Maynes will present on the topic titled "Tax Strategies for Financially Troubled Businesses and Other Loss Companies," and partner Jeffrey Sheffield will participate in the panel titled "Current Issues in Divisive Strategies - Spin-Offs and Synthetic Spin-Offs." Click here for more information.

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis' nearly 400 private equity attorneys have handled leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 300 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in 2012 and 2013 by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. In addition, Kirkland was awarded "Best M&A Firm in the United States" at *World Finance*'s 2012 Legal Awards and was honored as the "Private Equity Team of the Year" at the 2011 *IFLR* Americas Awards.

The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011 and 2012*, and has consistently received top rankings among law firms in Private Equity by Chambers & Partners, *The Legal 500*, the Practical Law Company and *IFLR*, among others.

The Lawyer magazine has recognized Kirkland as one of its "Transatlantic Elite" every year since 2008, having noted that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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