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times of crisis and help to maintain sufficient flexibility to use loss-absorbing capacity within a G-SIB group where and when it is needed.

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Rising Popularity of Reverse Break Fees and Legal Challenges for Swiss Bidders

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Reverse break fees are becoming more and more popular in private but also public M&A deals. Compared to Switzerland, reverse break fees are often significantly higher in the US. The Swiss Takeover Board is limiting direct break fees in public offers. Reverse break fees, however, are not subject to any ex ante official control and might, therefore, expose the board members of target companies to ex post challenges.

By Urs Kägi / Daniel Küpfer

1) Introduction

In public M&A deals, bidding and target companies often agree on payments for the event that the deal cannot close. Direct break fees are payments from the target to the bidder. In turn, payments from the bidder to the target are called reverse break fees. Both types of break fees serve to protect the deal against risks in connection with a proposed takeover and to control parties' behavior.

The original function of (direct) break fees was to compensate the bidder for its expenses, which became useless after the target or its shareholders accepted a subsequent and higher offer after an agreement with the first bidder. However, to extent allowed under applicable law, break fees can also take on the function of deal protections, given that considerable time may elapse between the signing and the closing.

Conversely, reverse break fees compensate the target if the deal is not carried out because of issues that are either the bidder's responsibility (such as the lack of approval of its shareholders), or are outside of both parties' control (such as the refusal of regulators to grant merger approval). On the other hand, a reverse break fee, particularly if it is designed as a walk-away right, can be seen as the price for the bidder's option not to complete the transaction. Compared to (direct) break fees, reverse break fees are typically significant higher, and because they do not affect competition between bidders, are generally less heavily regulated.

2) The US market

Originating in US private equity deals in the early 1980s, break fees and reverse break fees have become the market standard in public M&A deals around the world. US market standard reverse break fees are between three and six percent of the transaction value, depending on the trigger event. Especially for failure of antitrust approvals, we have seen reverse break fees climbing up to 40% of the transaction value. In absolute terms, the largest reverse break fee ever agreed was, to our knowledge, $10 billion after Verizon Communications acquired Vodafone's 45% interest in Verizon Wireless.

Most recent studies in the US, however, show that average break fees and reverse break fees are more modest. In 2015, median values of reverse break fees were equal to 2.00% of the equity value for general breach, 4.30% for antitrust failure, and 6.94% for financing failure. The median of direct break fees, on the other hand, amounts to 3.45% of the equity value. Compared to 2014, both types of fees slightly increased. Alongside this development, also the number of deals which use break fee triggers is rising, which is probably due to the ever longer duration of transactions, among other things. To the extent already available, in 2016 both the overall average reverse break fees and overall average direct break fees appear to have slightly decreased by 0.3% and 0.1% to 5.2% and 3.5%, respectively, compared to 2015.

An illustrative example is AT&T. After having paid about $6 billion (15.4% of the transaction value) to T-Mobile in 2012 for the failure to obtain necessary antitrust approvals, AT&T considered in its 2016 acquisition of Time Warner that break fees are less relevant. If the deal does not go through for antitrust reasons, AT&T will have to pay Time Warner only $500 million, which is less than 0.6% of the $85.4 billion transaction value. Conversely, Time Warner agreed to pay a $1.7 billion break fee. A more recent (but less extreme) example is the 2015 announced merger between Staples and Office Depot which has been blocked for antitrust reasons. Staples finally paid a $250 million termination fee (4% of the transaction value) to Office Depot.

3) Swiss public M&A

a) Swiss precedents

In Switzerland, direct break fees are more common than reverse break fees. In the past 17 years, the median break fee in public M&A deals (conducted as a public offer) was equal to 0.66% of the transaction value, which is slightly below the arithmetic average of 0.88%.

The reason for these comparatively small figures is that the Swiss Takeover Board only accepts fees that correspond to the estimated bidder's actual costs. The Swiss Takeover Board highlighted in its decisions that there is no fix amount or percentage which parties must not exceed, but it simply takes all relevant circumstances into consideration when it has to approve direct break fee agreements. Last year, it reduced a $1.5 billion break fee which Syngenta would have had to pay to ChemChina, to $848 million (1.99% of the transaction value). This is the largest break fee to date in Switzerland but still ranks at the bottom of the global market practice. It is striking to see that no break fee in a public deal exceeded the 2% level in recent years. Insofar, such limit has turned out a kind of psychological barrier although the Swiss Takeover Board would deny the existence of any limits. At the same time, such limit can also be useful to targets in negations of the size of (direct) break fees.

Data on reverse break fees is scarce, although they turn out to be a more common feature of deals. ChemChina, for example, would have had to pay a $3 billion reverse break fee (7% percent) if the deal did not go through.

Break fees can also be seen outside of classical takeovers by public offer. In contrast to public offers, other forms of a takeover, such as a statutory merger, are not subject to regulation by the Swiss Takeover Board. In Switzerland, a statutory merger without a prior public offer cannot be deployed as a takeover tool as easily as, e.g., in the United States. A main reason is that the merger consideration needs to (at least substantially) consist of shares of the surviving company, as the 90% threshold of all issued shares required for a squeeze-out merger typically cannot be achieved by a public company. However, a merger can be an appropriate mechanism if the shareholders of the target should receive shares or if the target is based outside of Switzerland. In particular, Swiss companies have used a triangular merger to merge with US companies, by which the US company was merged into a US subsidiary under applicable US state law and the Swiss company issued shares as part of the merger consideration. In such transactions, break fees have been recently agreed: In their 'merger of equals' announced 2017, each of (Swiss) Clariant and (American) Huntsman agreed to pay to the other party up to $210 million (2.1% of the transaction value) in the event of a change in recommendation for the merger or of the stockholders' failure to approve the merger. In 2015, (Swiss) ACE acquired (American) Chubb. Chubb agreed to pay to ACE a break-up fee of $930 million (3.29% of the transaction value) if the merger agreement would have been terminated because Chubb's change in recommendation for the merger or breach of the no-shop clause, while ACE was able to avoid a reverse break fee.

b) Challenges for board members

Involving Swiss bidding companies in international M&A transactions might expose their board members to challenges. As part of their strategic duties, Swiss board members must scout for business opportunities and present them to shareholders for a vote in the event of a merger or if the acquisition is equity financed.

Reverse break fees may be an essential element to create these opportunities for the general meeting to vote on. This is because the target company may not otherwise be willing to enter into the necessary transaction agreements, and only the board can negotiate a deal, even where shareholders' approval is required.

However, under Swiss law, where shareholders' approval is required, the board may not force shareholders into accepting a transaction by agreeing to a high reverse break fee. If it is a considerable amount, shareholders may feel compelled to approve a proposed deal only to avoid the payment of the agreed break fee.

In such a situation, the board may not agree to the fee unless it considers such a promise to be a necessity and a risk worth taking under the circumstances given the overall advantages of the envisaged transaction, with no better negotiations being possible. Furthermore, reverse break fees should not seriously interfere with a company's financial soundness, as this could be considered an *ultra vires* act. In other words, the board must feel confident that the agreed fee is in the company's best interest.

The board should carefully decide on this, i.e., following a diligent review process based upon adequate information and without conflicts of interest. Unlike for direct break fees, Swiss tender offer rules do not limit or apply to such reverse break fees. Therefore, they do not protect the board members. Obtaining external advice or a legal opinion from renowned experts can, however, help to increase their level of comfort.

c) Business judgment rule

Swiss corporate law gives the board considerable discretion in its business decision making. Since 2012, the Supreme Court has acknowledged the so-called business judgment rule as the standard for determining whether a board decision is within its discretion. If the business decision was made free of conflicts of interest and following a diligent review process based on adequate information, the business judgment rule provides that the merits of the board's decision can only be restrictedly reviewed by courts.

3) Trends

Another increase of the percentage values of reverse break fees is on the horizon. This also means that the average multiple of reverse Break Fee compared to direct break fees is growing. The increase will further challenge the decision-making in Swiss companies' boards. Consequently, the structure of reverse break fees will become more sophisticated. This can be achieved by negotiating different triggers and multi-tier fees with varying fee amounts. E.g., the bidder would agree to pay to the target a lower fee in case it fails to obtain its own stockholder or a recommendation change to its shareholders. If there is a failure to obtain required antitrust clearances or regulatory approval, the agreed reverse break fee could be significantly higher. And if a transaction fails to close due to the acquirers financing failure, the parties might agree on a medium-range fee. Another trend is to increase fees depending on the duration of the respective approval proceedings. Furthermore, parties more and more foresee reverse break fees as the exclusive indemnification where a transaction is terminated (so effectively providing for a walkaway option). Finally, in addition to direct break fees, the use of reverse break fees has recently gained and is going to increasing importance, particularly in strategic deals.

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Idorsia Ltd demerges from Actelion and lists on SIX Swiss Exchange

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On June 16, 2017, having completed its demerger from Actelion Ltd, Idorsia Ltd ("Idorsia") commenced trading on SIX Swiss Exchange. On its first day of trading, the shares of Idorsia Ltd opened at a price of CHF 10.00. Idorsia is an independent biopharmaceutical company specialized in the discovery, development and commercialization of small molecule therapeutics to meet significant unmet medical needs. It is based in Allschwil, Switzerland and has over 600 employees.

Landis+Gyr Initial Public Offering on SIX Swiss Exchange

Reference: CapLaw-2017-48

On 21 July 2017, Landis+Gyr Group AG ("Landis+Gyr") announced the pricing of its initial public offering on SIX Swiss Exchange at an offer price of CHF 78 per share, pricing at the top half of the offer price range. Trading of the Landis+Gyr shares on SIX Swiss Exchange commenced on the same day. With a total offer size of CHF 2.3 billion, the IPO of Landis+Gyr has been the largest IPO on SIX of the past ten years and thus far the second largest IPO in Europe of this year. Landis+Gyr is a leading global provider of smart metering and energy management solutions, operating one of the largest installed bases in the industry with over 300 million devices. Building on over 120 years of industry experience, Landis+Gyr has been at the forefront of the evolution of the global utility industry, enabling its transition from traditional towards "smart" grids.