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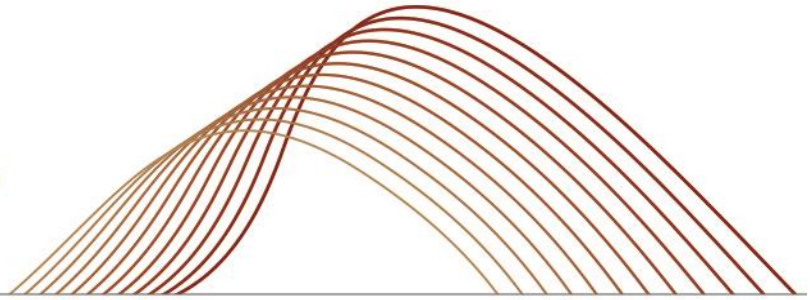

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The Use of "Ticking Fees" in M&A Transactions

By David Shine, Darcy White & Russell Franklin

The rare use of a so-called "ticking fee" is featured in the recently announced acquisition by Novartis AG of AveXis, Inc. Under the merger agreement, Novartis has the right to extend the "drop dead" date in order to obtain regulatory approvals. The ticking fee, which is directly tied to this extension right, has two components. The first is that if Novartis exercises its extension right, and the transaction closes, the $218 per share purchase price increases automatically by $7 per share. The second is that if Novartis exercises its extension right, and the transaction does not close, the amount of its reverse termination fee obligation ($434 million—about 5% of equity value), payable if the failure to close was due to the inability to obtain regulatory approvals, increases in increments of about $100 million based on the length of the extensions.

The use of a ticking fee is unusual so the Novartis transaction has piqued the interest of deal professionals. However, we do not believe that this transaction is necessarily a harbinger of deal terms to come because there are meaningful arguments both for and against ticking fees.

Arguments For

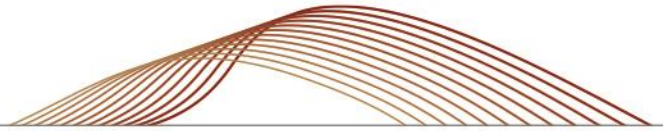
Acquirer incentives. The most basic argument for a ticking fee is that it discourages acquirers from intentionally "slow walking" a transaction and, in fact, provides highly meaningful motivation for an acquirer to seek to obtain regulatory approvals as fast as possible.

Acquirer optimism. Acquirers, seeking to entice targets, may sometimes be overly optimistic in their views as to regulatory risks and timing. A ticking fee may help curb such inclinations and thereby provide a target with a more nuanced understanding of the acquirer's realistic views.

Sign/close dichotomy. Acquisition agreements with delayed closings include aspects intended to mimic a simultaneous sign/close (e.g., representations brought down to closing and tight interim operating covenants). A ticking fee is arguably a logical progression of this rationale—it seeks to protect shareholders and the target from losses due to the inability of the acquirer to close promptly.

Attractiveness to shareholders. Because target shareholder approval is necessary for transactions of this type, a ticking fee, especially one that includes a potentially increased purchase price, may make a transaction more attractive to shareholders and so help encourage shareholder approval.

Director fiduciary duties. A ticking fee is, as noted above, an unusual boon to targets and their shareholders. It therefore may help bolster the ability of directors to demonstrate that they have (or rebut that they have not) satisfied their fiduciary obligations in approving the transaction.



Arguments Against

Unnecessary for incentives. If an acquirer has agreed to a meaningful reverse termination fee, the acquirer is fully incentivized to seek to obtain necessary regulatory approvals as fast as possible. This is especially true since the size of reverse termination fees is not limited by law as are typical break-up fees and so these fees can be very substantial.

Balance of information. Although an acquirer will undoubtedly have somewhat better insight into the likely regulatory process, antitrust-appropriate, due diligence cooperation by acquirers and targets is common. Therefore, both sides should be able to assess regulatory risks and likely timing, and an acquirer should not be subject to a special penalty if closing takes longer than the parties had jointly anticipated.

Sign/close dichotomy inapposite. Even though the sign/close argument may be meaningful with respect to representations and covenants, the U.S. deal market has never embraced this concept for delayed payment of purchase price. If it had, cash purchase prices would include a time-value-of-money component. However, transaction documents in fact typically expressly disclaim interest accruing on a cash purchase price.

Unnecessary for directors' duties or shareholder vote. As noted, ticking fees are not widely used. Yet transactions are regularly approved by shareholders, and directors are, in the large majority of transactions, able to satisfy their fiduciary duties. Ticking fees may therefore be unnecessary icing on the cake in these regards.

Potential interloper inducement. Once a transaction is announced, a potential interloper with perceived low regulatory risk may view a ticking fee as a signal that the parties have serious regulatory concerns. The existence of the ticking fee could therefore potentially act as inducement for an interloper to try to disrupt the transaction.

Given the balance of the foregoing arguments, it is not surprising that ticking fees are the exception rather than the rule. Notwithstanding the Novartis transaction, we therefore expect that discussions about, and applications of, ticking fees will continue to be on a case-by-case basis.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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