

## REVERSE BREAKUP FEES: A RECENT TREND IN M&A STRATEGIC DEALS?

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Reverse breakup fees have been increasingly used in M&A transactions in Brazil at least over the past four years. The aim of this article is to provide a brief overview of the legal framework, relevant precedents and the practice of how reverse breakup fees have been used in M&A strategic deals in Brazil recently. The general perception of increasing enforcement of antitrust laws by the CADE in merger cases may have contributed for reverse breakup fees to become a trend when allocating antitrust risk-shifting provisions in merger agreements in Brazil.

The Guidelines for the Analysis of Previous Consummation of Merger Transactions (“Gun jumping Guidelines”), issued by CADE on May 20, 2015,<sup>1</sup> excludes breakup fees clauses as typical contractual provisions that could result in gun jumping violation under the Brazilian antitrust laws.<sup>2</sup> According to the Gun jumping Guidelines, the following contractual provisions, among others, can result in “premature integration of the activities of the merging parties”<sup>3</sup>:

*“c) clause for full or partial payment, non-reimbursable, in advance, in consideration for the target, **except** in case of (c.i.)*

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<sup>1</sup> CADE, GUIDELINES FOR THE ANALYSIS OF PREVIOUS CONSUMMATION OF MERGER TRANSACTIONS (2016) [hereinafter *Gun jumping Guidelines*], available at <http://en.cade.gov.br/topics/publications/guidelines/guideline-gun-jumping.pdf>.

<sup>2</sup> According to Article 88, Paragraphs 3 and 4, of Law No. 12,529/2011 (the “Brazilian Competition Act”), in the event of gun jumping violation, the Parties are subject to fines ranging from R\$ 60,000.00 to R\$ 60,000,000.00, as well as to the annulment of the acts performed by the Parties and the opening of an administrative proceeding to investigate potential antitrust violations.

<sup>3</sup> *Gun jumping Guidelines*, *supra* note 1, at 8.

*typical down payment for business transactions, (c.ii.) deposit in escrow accounts, or (c.iii.) **breakup fee clauses (payable if the transaction is not consummated).***<sup>4</sup>

By excluding breakup fee clauses as a potential gun jumping violation, these guidelines are, in contrast, admitting the use of such contractual provisions in M&A transactions in Brazil. The definition adopted under the Gun jumping Guidelines is that breakup fees are “payable if the transaction is not consummated.”<sup>5</sup>

The Gun jumping Guidelines do not differentiate breakup fees to reverse breakup fees. Breakup fees are payments from a seller to a buyer if the seller terminates the transaction for reasons specified in the agreement. Reverse breakup fees flows in the opposite direction – from a buyer to a seller – if an acquisition does not close for specified reasons set forth in the agreement, usually associated with private equity transactions or to regulatory (antitrust) approval in strategic deals.<sup>6</sup> It is our understanding that the Gun jumping Guidelines accept both types of breakup fees.

Although the Guidelines contain non-binding provisions only, they are used by CADE as an important mechanism of orientation when reviewing actual cases.

In the Administrative Proceeding to Investigate the Merger (*Procedimento Administrativo para Apuração de Ato de Concentração - “APAC”* - No. 08700.005408/2016-68, CADE analyzed the issue on whether a payment made by Reckitt Benckiser (Brasil) Ltda. to Hypermarchas S.A. in the total amount of R\$ 135 million (*i.e.*, correspondent to 20% of the total value of the transaction) as set forth in the agreement should be construed as (i) “partial payment, non-

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<sup>4</sup> *Id.* at 8.

<sup>5</sup> *Id.* at 8.

<sup>6</sup> See Darren S. Tucker & Kevin Yingling, *Keeping the Engagement Ring: Apportioning Antitrust Risk with Reverse Breakup Fees*, 22 ANTITRUST MAGAZINE 70, 70-71 (2008) (discussing the differences between breakup fees and reverse breakup fees), available at <https://ssrn.com/abstract=1306453>.

reimbursable, in advance”, thus in violation to gun jumping rules or (ii) as one of the exceptions provided in the Gun jumping Guidelines: (ii.a.) “typical down payment for business transactions”; or (ii.b) “breakup fee”.<sup>7</sup>

The General Superintendence (“SG”) at CADE understood that the payment was made in violation to the gun jumping rules and recommended to CADE’s Tribunal the imposition of the penalties set forth in the applicable legislation.<sup>8</sup>

CADE’s Tribunal, by unanimous decision, held that, according to the specific provisions of the agreement, the down payment could be construed as “typical for business transactions” and that it could automatically be compensated into a reverse breakup fee in case CADE blocked the deal, without the need of the Parties paying further amounts among themselves. Therefore, CADE’s Tribunal rejected SG’s opinion and determined the shelving of the investigations without imposing any penalties on the Parties.<sup>9</sup>

In its opinion on the case, the Reporting Commissioner at CADE, Paulo Burnier da Silveira, provided a few guidelines for Parties willing to include down payments and breakup fee clauses in their transactions: “[...] high amounts, which are not typical down payments for business transactions in the market involved, could lead to the understanding that such amount would not be correspondent to down payment. It is recommended, therefore, that companies be very cautious when implementing down payments and that they should use amounts that could not be understood as illegal payments under the applicable gun jumping legislation. Specific references in the agreements that such

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<sup>7</sup> CADE, APAC No. 08700.005408/2016-68, Reporting Commissioner Paulo Burnier da Silveira, 17.8.2016.

<sup>8</sup>SG’s Opinion, APAC No. 08700.005408/2016-68, available at [https://sei.cade.gov.br/sei/modulos/pesquisa/md\\_pesq\\_documento\\_consulta\\_externa.php?DZ2uWeaYicbuRZEFhBt-n3BfPLlu9u7akQAh8mpB9yO8jHez1UFNXDK-fOPhZUasm5YkRzoYf3-ci982xavM-gsYZGXRDeCazPtFwxr6eMLsKY\\_Sg\\_Dpou4ZeiMtdrj](https://sei.cade.gov.br/sei/modulos/pesquisa/md_pesq_documento_consulta_externa.php?DZ2uWeaYicbuRZEFhBt-n3BfPLlu9u7akQAh8mpB9yO8jHez1UFNXDK-fOPhZUasm5YkRzoYf3-ci982xavM-gsYZGXRDeCazPtFwxr6eMLsKY_Sg_Dpou4ZeiMtdrj).

<sup>9</sup> *Id. supra* note 7.

obligations refer to typical down payment for business transactions, or to breakup fees, may be considered as evidence on the inexistence of illegal payments, and the companies shall have this in mind when drafting the language of their agreements.”<sup>10</sup>

In practice, reverse breakup fees have been increasingly used in strategic deals in Brazil over at least the past four years and the amount of such fees have also been raising since then. According to an article published by Valor on March 20, 2018,<sup>11</sup> the following transactions involving Brazilian companies have relied on reverse breakup fees:

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<sup>10</sup> Opinion of Reporting Commissioner Paulo Burnier da Silveira, APAC No. 08700.005408/2016-68, *available at* [https://sei.cade.gov.br/sei/modulos/pesquisa/md\\_pesq\\_documento\\_consulta\\_exter\\_na.php?DZ2uWeaYicbuRZEFhBt-n3BfPLlu9u7akQAh8mpB9yO7WrDNfTyXKqdogDjx7JGD\\_77fpfUlk-a90DoDdfDfgXU2ufMofGPrnRwMhlXSb4gK3sQyF6Z-RRBnQL4ubbuY](https://sei.cade.gov.br/sei/modulos/pesquisa/md_pesq_documento_consulta_exter_na.php?DZ2uWeaYicbuRZEFhBt-n3BfPLlu9u7akQAh8mpB9yO7WrDNfTyXKqdogDjx7JGD_77fpfUlk-a90DoDdfDfgXU2ufMofGPrnRwMhlXSb4gK3sQyF6Z-RRBnQL4ubbuY).

<sup>11</sup> Maria Luíza Filgueiras, *Breakup fees start emerging in Brazil's M&A market*, Valor, Mar. 20, 2018, <http://www.valor.com.br/international/news/5395141/breakup-fees-start-emerging-brazils-ma-market>.

### Transactions with reverse breakup fees in Brazil

Year	Seller	Buyer	Economic sector <sup>1</sup>	Total amount of the reverse breakup fee	Result
2015	Whitney do Brasil	Ânima Educação	Education	R\$ 46 million	Buyer desisted from the transaction due to regulatory changes in the industry and paid the fee to the Seller in 2017.
2015	Cetip	BM&F Bovespa	Stock exchange; futures and commodities exchange	R\$ 750 million	The transaction was closed, and payment of the fee was not necessary. <sup>2</sup>
2016	Magnesita	RHI	Refractories	R\$ 70 million	The transaction was closed, and payment of the fee was not necessary.
2016	Vale Fertilizantes	Mosaic	Fertilizers	R\$ 407 million	The transaction was closed, and payment of the fee was not necessary.

<sup>1</sup> The column “Economic sector” has been added by the author to the original chart prepared by Valor. *Id. supra* note 11.

<sup>2</sup> Although the BM&F Bovespa / Cetip was not referenced in the original chart prepared by Valor, the article included relevant information on the transaction which allowed the author to add it to the chart. *Id.*

Year	Seller	Buyer	Economic sector <sup>1</sup>	Total amount of the reverse breakup fee	Result
2016	Estácio	Kroton	Education	R\$ 150 million	Buyer paid the fee to the Seller in 2017, after CADE blocked the deal.
2017	Liquigás (Petrobras)	Ultragaz (Grupo Ultra)	Liquefied petroleum gas (LPG)	R\$ 280 million	Buyer paid the fee to the Seller in 2018, after CADE blocked the deal.
2018	Fibria <sup>3</sup>	Suzano	Pulp and paper	R\$ 750 million	Antitrust approval of the transaction is pending.

Source: Valor.<sup>4</sup>

<sup>3</sup> According to articles published by the press, Fibria rejected an offer made by Paper Excellence, which included a reverse breakup fee in the total amount of R\$ 4 billion. *See e.g.*, Stella Fontes, *Paper Excellence makes competing offer for Fibria*, Valor, Mar. 13, 2018, <http://www.valor.com.br/international/news/5380295/paper-excellence-makes-competing-offer-fibria>.

<sup>4</sup> *Id. supra* note 11.

The average amount of the reverse breakup fees in Brazil would correspond to 8.2% of the total value of the transaction, according to the article published by Valor,<sup>1</sup> which is higher to the 5.3% average amount currently in place in the United States.<sup>2</sup> Notwithstanding this, the number of deals considered in each case are largely different: while the United States had 142 transactions (12.5% of the total) with antitrust reverse termination fees out of 1140 strategic negotiated transactions announced between January 1, 2005, and December 31, 2017,<sup>3</sup> Brazil had only 10 transactions (0.5% of the total) with antitrust reverse breakup fees out of more than 2,000 deals (not necessarily strategic transactions) announced between 2003 and 2015.<sup>4</sup>

As indicated in the chart above, 7 out of the 10 transactions with antitrust reverse termination fees in Brazil were announced between 2015 and 2018, which may indicate that they have been increasingly used in M&A transactions in Brazil only over the past few years.

Since 2016, CADE has blocked 4 transactions and approved 16 others with restrictions or imposing remedies.<sup>5</sup> The general perception of increasing enforcement of antitrust laws by CADE may have also contributed to the dissemination of reverse breakup fees in M&A transactions in Brazil. It is likely that this trend will continue over the

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<sup>1</sup> *Id.*

<sup>2</sup> Dale Collins, *Antitrust Reverse Termination Fees--2017 Q4 Update*, SHEARMAN & STERLING ANTITRUST UNPACKED – ANTITRUST LAW BLOG (Jan. 10, 2018), <http://www.shearmanantitrust.com/?itemid=57>.

<sup>3</sup> *Id.*

<sup>4</sup> *Id. supra* note 11.

<sup>5</sup> CADE, CADE EM NÚMEROS, <https://cadenumeros.cade.gov.br/QvAJAXZfc/opendoc.htm?document=Painel%2FCADE%20em%20N%C3%BAmeros.qvw&host=QVS%40srv004q6774&anonymous=true> (last update on Mar. 1, 2018). The data made available by CADE had been updated only with respect to cases reviewed by CADE's Tribunal until the Plenary Session No. 116, held on December 13, 2017. The author has updated relevant data until the Plenary Session No. 119, held on March 14, 2018.

next years and that CADE may review other cases in the near future dealing with potential issues involving allocation of antitrust risks and the adoption of reverse breakup fees.