Deal Focus

Bridging the Value Gap: Sanofi-Aventis, Genzyme and Contingent Value Rights

By John Haggerty

Over the course of the past year, one of Massachusetts' leading biotechnology companies, Genzyme Corporation ("Genzyme"), engaged in a high profile takeover battle with Sanofi-Aventis ("Sanofi") that drew global attention. Sanofi, a global-healthcare company based in France and the fourth largest pharmaceutical company by prescription sales, set its sights on acquiring Genzyme and, undeterred by Genzyme's initial resistance, continued to press for a deal, to the point of launching an unsolicited tender offer. Early in this high-stakes drama, the parties reached a stand-off over their divergent views of the intrinsic value of Genzyme. Charged with protecting the best interests of the stockholders, the Genzyme board of directors was steadfast in its opposition to any deal that did not reflect its view of Genzyme's intrinsic value. In the end, the parties were able to bridge the value gap by using contingent value rights that focused on specific areas of disagreement.

A contingent value right, or CVR, is a right distributed to stockholders that entitles them to receive additional cash consideration at a future date upon the achievement of specified targets or milestones. While deal structures that provide sellers the right to contingent future payments are relatively common in private company acquisitions, they were historically used infrequently in public company acquisitions because of

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various business and legal hurdles. They are, however, becoming increasingly popular, especially in the life sciences sector. Any time a seller turns over its business to new owners, but has to depend on the new owners for future payments, the situation is ripe for disputes. Sellers push for “efforts covenants” obligating buyers to invest resources in achieving the milestones (e.g., “commercially reasonable efforts” or “diligent efforts”) and for audit rights, while buyers seek to maximize their operational flexibility in running their business post-closing and struggle with the added burdens of securities disclosure and fair value accounting under SFAS 141R, which requires that buyers mark to market quarterly their potential liability under the CVRs. Whether contingent value rights can be used successfully depends on the ability to fashion clear milestones that both bridge the parties’ differences and minimize the risk of future disputes. Pharmaceutical and biotechnology companies frequently provide an opportunity for clear milestones in which both buyer’s and seller’s interest align, such as FDA approval of a drug product candidate.

In the spring of 2010, Sanofi made its initial overture to Genzyme. Believing that the time was not right for a transaction that would provide its stockholders with adequate value, Genzyme postponed talks with the intent of focusing on its strategic plan. Undeterred, Sanofi delivered an unsolicited proposal on July 29, 2010 to acquire Genzyme in an all-cash deal for $69.00 per share, which represented a 38.4% premium over the share price on July 1, 2010, when rumors of Sanofi pursuing a U.S. acquisition first surfaced.

The Genzyme board rejected Sanofi’s offer on August 11, 2010 on the basis that the offer did not appropriately value Genzyme’s business. Specifically, the Genzyme board pointed to two factors: the potential value of alemtuzumab (also known as Lemtrada), a drug for the treatment of multiple sclerosis, which Genzyme believed had blockbuster potential, and the effect of certain manufacturing problems with the drugs Fabrazyme and Cerezyme that had adversely impacted revenue but that the Board believed were in the process of being remedied.

Over the next few months, Sanofi continued to press for Genzyme to actively engage in acquisition negotiations and Genzyme continued to hold the line that the Sanofi bid undervalued the company. In early January 2011, the companies publicly announced that ongoing discussions between them now included potentially using CVRs to

address their differing views on the value of alemtuzumab — a break in the impasse that ultimately led to the parties signing a definitive merger agreement on February 16, 2011, which provided for a transaction in which each Genzyme share would be converted into $74.00 of cash and one contingent value right, with a potential value of up to $14.00 per share.

The contingent value rights in the Sanofi/Genzyme transaction set out specific milestones for triggering the payouts of additional value:

- $1.00 upon receipt of FDA approval of Lemtrada for treatment of multiple sclerosis on or before March 31, 2014.
- $2.00 if total Lemtrada sales over a specified period equal or exceed $400 million.
- $3.00 if global sales of Lemtrada equal or exceed $1.8 billion during any four consecutive quarters (which increases to $4.00 if FDA approval for Lemtrada is not approved by March 31, 2014 such that the first milestone is not achieved).
- $4.00 if global sales of Lemtrada equal or exceed $2.3 billion during any four consecutive quarters.
- $3.00 if global sales of Lemtrada equal or exceed $2.8 billion during any four consecutive quarters.
- $1.00 if, on or before December 31, 2011, the following are produced and released for shipment: (1) at least 79,000 units of Fabrazyme, and (2) at least 734,600 units of Cerezyme.

In addition to the business risks, the use of CVRs in public company acquisitions raises securities law issues that Sanofi and Genzyme had to address. If they are transferable, contingent value rights generally qualify as “securities” for purposes of the Securities Act of 1933, as amended, and, therefore, must be issued pursuant to an effective registration statement. Registration under the Securities Exchange Act of 1934, as amended, may be required as well if there are more than 500 holders (Section 12(g) of Exchange Act) or if the CVRs are being listed on an

exchange. Exchanges have their own conditions to be met for listing CVRs. *See* Nasdaq Rule 5730(a) and NYSE Rule 703.18.

The Genzyme CVRs are freely transferable and listed on the Nasdaq Capital Market. Thus, stockholders may be able to obtain immediate liquidity instead of waiting to determine if the milestones are ultimately met, though they risk selling at a price heavily discounted to the ultimate value of the CVR. While Sanofi currently provides public disclosure in the United States, many private and foreign buyers will find ongoing disclosure burdens unacceptable, particularly if it requires disclosing the specific financial metrics for key products, and, therefore, these buyers will likely take measures such as restricting transferability to ensure their CVRs are not "securities".

The Sanofi/Genzyme transaction represents a situation in which CVRs were successfully used to bring the parties to an agreement. Contingent value rights will not resolve every valuation gap between acquisition parties and will inevitably create substantial additional complexity. The keys to the CVRs in the Sanofi/Genzyme deal were the ability of the parties to use specific bright line milestones that both sides could readily identify as having been achieved or not and a willingness to work through the complexity. In the pharmaceutical and biotechnology sectors, the speculative nature of value that can swing drastically depending on FDA approval or the performance of a single drug makes CVRs particularly useful in structuring acquisitions. In fact, in the last two years, CVRs have been used in several deals in the sector, including Celgene Corporation/Abraxis Bioscience, Endo Pharmaceuticals/Indevus Pharmaceuticals, The Medicines Company/Targanta Therapeutics, and Clinical Data/Avalon Pharmaceutical. While only time will tell which side had a better handle on the ultimate value of Genzyme, one thing is clear: the Genzyme stockholders have an opportunity to participate in the future upside of their investment that they would not have had in a straightforward cash merger. ■