M&A Break Fees:
US Litigation vs. UK Regulation

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The United States and the United Kingdom have well-developed economies and capital markets. They also share a legal tradition, including a liberal approach to economic activity. In some key areas of capital market governance, however, their legal systems formally diverge. One example – salient to merger and acquisition (M&A) academics – is the treatment of hostile bids (e.g., Armour & Skeel 2007). This paper analyzes another difference, one more routinely of importance to M&A practitioners: the treatment of "deal protection" – i.e., contracts that reduce the risk to a bidder of a competing bid, such as "break fees" paid by a target if acquired by a competing bidder. The UK caps such fees with a bright-line rule set by a regulatory body. In the US, courts review break fees in *ex post* litigation applying a standard developed over time in the common law tradition. This paper explores the effects of this formal contrast between regulation and litigation on the same behavior by two similar countries, using panel data to explore whether the formal difference matters in practice, and whether and how the two approaches to governance change and diverge over time.

Any comparison of law in two countries faces a serious and potentially misleading omitted variable problem, and one can only generalize so far about trade-offs between litigation and regulation from one law. Still, a comparison of deal protection in the UK and the US should yield some information. The two nations have similarly active M&A markets, with a large number of bids for large public companies (Rossi & Volpin 2004). They have similar corporate governance systems (e.g., Kraakman et al. 2009), with large companies and dispersed ownership (e.g., La Porta et al. 1999), which (as discussed below) generates the need for deal protection. And they have shared political, legal, and cultural traditions (U.S. State Department 2009), including M&A practitioners that work in both nations. The topic should also be of independent value to those who study or work in the M&A markets: deal protection is used regularly in friendly M&A, which is far more prevalent and may be more economically important than hostile bids.

Part I briefly reviews relevant literatures on (a) regulation and litigation, (b) the evolution of laws over time, and (c) deal protection, including the reasons deal protection contracts are used. Part I also briefly describes the legal treatment of break fees in the UK and the US, and conjectures why the nations have diverged in this aspect of capital markets governance. Part II summarizes data drawn from Thomson regarding M&A activity, including break fees, over the past 20 years. Trends in the incidence and size of break fees in the US and the UK are depicted against the backdrop of changes in regulation of break fees. Part III then relates break fee incidence and size to rates of deal competition

and deal completion, two deal outcome variables that break fees are intended to affect. Univariate and multivariate results are presented, and the robustness of the findings is tested with alternative specifications. Part IV concludes with observations on trade-offs between litigation and regulation and the evolution of law more generally.

Part I. Prior Literature

I.A. Regulation and Litigation

A growing literature in economics and law recognizes and explores trade-offs in different modes of political governance of economic activity.[1] One mode, associated with classical liberalism, is for the state to assign clear property rights ex ante, permit private parties to write their own legal rules through contract, enforce those contracts through privately initiated lawsuits heard by independent courts, and otherwise refrain from interfering with production or trade. Because this mode of governance relies on court enforcement of property and contract rights, it is often identified as "***litigation***." A second mode, associated with political reactions to industrialization in the late 19th and 20th centuries, is for the state to establish expert regulatory agencies, subject to political control, which "regulate" economic activity through explicit ex ante controls, enforce those controls directly with criminal or civil penalties imposed by state-controlled enforcement agencies, subject to judicial oversight, and override, forbid or modify private contracts. This mode is often identified as "***regulation***."

The contrasts between litigation and regulation are thus various, including general content, the method by which law is created and enforced, and features of the institutions charged with lawmaking and enforcement. A common focus of contrast, however, is the timing of lawmaking and enforcement (e.g., Shavell 1984a,b; Schwartzstein & Shleifer 2009). Regulation specifies and enforces entitlements in detail *ex ante*, before activities occur, so (if perfect) violations are avoided. Litigation relies on private parties to sue for money in court *ex post*, after activities and potential legal violations have occurred. If parties are judgment proof, for example, *ex ante* specification and enforcement may be beneficial (Shavell 1984a,b, 1993, Summers 1983). But courts can grant injunctions as well as award damages, and many economic harms are not so large as to cause insolvency. If economic activities have positive externalities and both *ex ante* regulations and *ex post* court decisions are prone to error, then regulation can improve welfare by eliminating or reducing the risk of mistaken ex post liability and so inducing socially beneficial activities, such as drug research (e.g., Schwartzstein & Shleifer 2009). But much regulation has been developed to address negative externalities, rather than positive ones, and spans domains of activity where the risk and potential harm of error in law enforcement varies significantly.

[1] One can also contrast socialism, with state ownership of the means of production and/or trade, as with the U.S. Postal Service; and anarchy, with no clear specification of property rights, as with second-hand cigarette smoke, or no effective state enforcement of regulations or contract rights, as with trade in sex or drugs.

Given rational expectations, the timing of lawmaking matters because agents can better estimate their entitlements under regulation than under litigation. If they could perfectly foresee how courts would apply law to given facts, or if their ability to predict application of law to their behavior was invariant as between regulation and litigation, there would be no difference between litigation and regulation as a result of the timing of lawmaking and enforcement.[2] Research on litigation and regulation conceived this way is related to a separate line of legal research that also describes trade-offs between *ex ante* specification of law ("rules") and *ex post* application of general laws to specific facts ("standards") (Ehrlich & Posner 1974). That literature recognizes that courts sometimes develop "rules" that function much as do regulations (e.g., contracts cannot be enforced against persons under the age of 18), and emphasizes that such rules specified ex ante – whether by courts *or* regulatory agencies -- increase certainty and reduce the costs of legal advice and adjudication ex post, but are more costly to enact (Kaplow 1992) and more frequently lead to specific case outcomes that reduce welfare, by being both over- and under-inclusive (Kennedy 1986), particularly when they will apply over a broad range of behaviors over a long period of time, or where lawmakers' information is limited (Sunstein 1995).

One further point should be made. The general distinction between litigation and regulation as modes of lawmaking may obscure the fact that there are bodies of law that fall somewhere in between the two. Fiduciary duty law, for example, is widely thought to represent an attempt to supplement private contract not for any of the reasons summarized above for regulation, but because detailed specification of contracts ex ante is too expensive or in some cases impossible, whether because of imperfect information, collective action problems, or both. Fiduciary duty law is "regulatory" in the sense that, in general terms, private parties cannot opt out of it – it is binding on them whether they include it in their contracts or not, and often has a moral flavor similar to criminal laws. But it is enforced through private litigation ex post in courts; it remains relatively unspecified in detailed content ex ante (is a set of "standards"); and, in some cases, it may be "contracted around."

I.B. Evolution of Laws Over Time

Overlapping with the literature contrasting litigation and regulation is research exploring the degree to which particular kinds of laws change of time. Here, the contrast is made

[2] Other differences between the two general modes of lawmaking, such as expertise or political control of lawmakers or law enforcers, might still matter. If judges are generalists, and regulatory agencies specialists, for example, the latter may have expertise that may be beneficial (Landis 1938, Glaeser, Johnson & Shleifer 2001). But courts can be (and often are) specialized (e.g., Revesz 1990, who discusses 12 specialized Federal courts in the US, and Dreyfuss 1995, who discusses the Delaware Chancery Court, which specializes in business litigation). If regulatory agencies are subject to more and courts less political control, the latter could more optimally address harms imposed by politically powerful agents on politically weak agents (Pace 2007; Cook 2002). But in the US, at least, many regulatory agencies (e.g., the Federal Reserve Board) are arguably subject to weaker political control than judges, who are elected in most states [cite], and precisely the opposite argument has been made in favor of regulation on the ground that judges or law enforcers required to impose large *ex post* fines may be more vulnerable to persuasion or bribery (Becker & Stigler 1974, Glaeser & Shleifer 2003).

between "civil law" – codes and statutes that remain relatively unchanged over time – and "common law" – bodies of judicial decisions accompanied by some explanation of the principles used to reach specific outcomes that provide a degree (but only a degree) of guidance about future cases. The general relationship to the bodies of research summarized above should be apparent. Civil law is (the output of) regulation; it consists of many rules; it changes rarely. Common law is (the output of) litigation; it consists of many standards, made into rules only for purposes of each case as it happens; it changes adapts routinely, as every case presents at least some relevant facts that may distinguish it from prior cases.

One line of research explores whether and how a common law system would tend towards efficiency over time and, implicitly, whether and how the common law would evolve "rules" out of "standards" (as is commonly asserted or assumed in much legal scholarship, e.g., Kaplow 1992). Posner 1973 claimed appellate judges have personal or career incentives to maximize efficiency. Rubin 1977 proposed inefficient outcomes are more likely to be challenged in court, resulting in litigation that over time produces efficient laws, even if judges are unaware they are doing so. Llewellyn 1951 and Posner 2005 reasoned that even with biased judges the common law would evolve towards efficiency because it involves sequential decision-making of judges with diverse preferences, which would cancel out over time, although this assumes judges respect precedent, to some extent, else there would be no trend over time. Gennaioli & Shleifer 2007 suggest that appellate courts in a common law system tend towards efficiency because they preserve information by distinguishing current cases from prior decisions.

Other conjectures about the evolution of law can be found in the literatures reviewed above. Sunstein 1995 claims that a system of rules entails "no rapid changes in the content of law," consistent with a common view that civil law is less flexible or adaptable than common law, and that regulation tends towards sclerosis. Rajan & Zingales 1999 argue that civil law countries (i.e., countries that rely on regulatory agencies subject to political controls as their primary means of lawmaking) can undergo more rapid and transformative legal changes in response to changes in private interests, than can the common law. This claim could be consistent with claims about regulatory sclerosis if, over periods of time, private interests remain stable, producing little change in a regulatory system, but occasionally, in response to factor, technological or unrelated political shocks, private interests shift suddenly, leading to regulatory change that is more rapid and significant than could occur through litigation in a common law system. Kennedy 1986 suggests reasons (and offers some qualitative evidence) that rules and standards may cycle, evolving into the other over time: rules evolve into standards as the welfare loss commanded by a rule in a given case will induce a court to invent an exception, with the exceptions eventually swallowing the rule; conversely, standards induce rules, as private parties lobby for (or persuade courts to adopt) rules to assist them in planning.

Niblett et al. 2009 provide one of the few empirical tests of some of these claims by tracking the evolution of one aspect of US tort law (the economic loss rule) from 1970 to 2005 and find that while the law did appear to converge towards one version of the rule

in the first 25 years of their sample period, courts have begun to deviate and splinter in their approach to the rule – i.e., the law did not converge to any stable resting point. This paper attempts to provide another empirical test of theories of how common law evolves over time, in a different domain.

I.C. Deal Protection

In both the UK and the US, M&A involving public company targets face a law-derived risk of non-completion: (1) the law requires target shareholders to approve or accept a bid, either by tendering or voting; (2) compliance with disclosure and other laws governing the process of obtaining target shareholder tenders or votes entails delay, ranging from a minimum of 30 days up to six months in some situations; and (3) target shareholders may decide not to accept or approve a bid for any reason, including a third-party bid that emerges after agreements for an initial bid are signed. In effect, an M&A agreement or bid gives shareholders of a public target an option to accept the bid, and does not effectively bind the target or its shareholders to the bid, even if approved by the target's ordinary agents (i.e., its board or officers).

Deal protection contracts, including break fees, have emerged as a second-best way for bidders to protect their reliance interests in pursuing a bid for a public target. Even if they are unable to acquire the target, they can at least get paid a fee, if their bid is rejected and (typically) if the target is acquired by a competing bidder. Unlike the underlying bid, the target's promise to pay a break fee (often included in the deal agreement) is not generally subject to shareholder approval, in either the US or the UK. Targets, in turn, agree to break fees – even though they may reduce competitive bids – because they encourage bidder participation in the face of valuation uncertainty and bidding costs, including significant and difficulty-to-quantify opportunity costs, and to compensate a bidder for the inevitable release of valuable information to third parties (including potential competitors) upon the announcement of a bid for the target. Targets may also seek to use break fees to control a sales process where the failure of that process to produce a completed deal can harm the target. Alternatively, target managers may agree to break fees to favor a particular bidder out of personal interests – better jobs after the deal, higher severance pay, or other benefits.

Prior literature focused on break fees and other forms of deal protection can be found in both legal academic writing and in finance scholarship. In the US, legal scholars have long debated whether and when break fees can represent a breach of the duty of loyalty of a target's board of directors. Prominent theoretical articles in the legal literature include Schwartz 1986, who suggested a ban on break fees, to encourage bid competition; Ayres 1990, who noted that break fees reduce an initial bidders' valuation of a target as well as competing bidders, and would reduce welfare only if they deterred competing bids and not if a competing bidder in fact emerged; Fraidin and Hanson 1994, who applied the Coase theorem to argue for a permissive attitude towards break fees; and Kahan and Klausner 1996, who argued that courts should be more permissive towards break fees that induce an initial bid, and more skeptical of those granted to subsequent bidders,

particularly when solicited by target managers, whose choice of bidder may be biased by agency costs.

Empirical research on break fees was initiated by Coates and Subramanian 2001, who studied break fees and other forms of deal protection granted by US targets in friendly bids for control greater than $50 million in value in the period 1988 to 1999. They found that break fee size was dispersed and grew (again, non-monotonically) throughout the period, ranging from 1% (25th percentile) to 3% (75th percentile) in 1988 and from 2% (25th) to 4% (75th) in 1999, consistent with a potential "Lake Woebegone effect," in which bidders sought a fee that was slightly larger than the average fee in a recent period sample, producing ever-increasing fees.[3] They also found that fee size correlated with court decisions, including 1994 and 1997 Delaware Supreme Court decisions in *Paramount* and *Brazen*, and with other bid characteristics, including larger bid size and the use of a tender offer by the bidder. They found, finally, in both univariate and multivariate tests, that the fact and size of break fees correlated with completion rates, both in general and conditional on publicly reported bid competition.

Subsequent research, using US data 1988 to 2000, confirmed their findings, and also found that break fees reduce the incidence of subsequent publicly reported competing bids, and (using a simultaneous equations system) that deal premiums were higher where targets agreed to pay break fees, consistent with the hypothesis that – at least at the fee levels observed in the sample period, and conditional on judicial scrutiny, discussed below – break fees were on average effective both at reducing bid competition and beneficial for target shareholders (Officer 2003, Bates & Lemmon 2001; see also Burch 2001, who examines deal protection in the form of stock options). Empirical research on break fees has also been reported for Canada (Andre et al. 2007), which reaches similar general conclusions, and for Australia (Chapple et al. 2007), which finds that break fees in Australia – which must comply with a bright-line rule similar to the one imposed in the UK – appear actually to correlate ***inversely*** with bid completion, and with bid premiums. No studies appear to have been done of break fees in the UK, and none compares break fee incidence, size, or their effects between the UK and the US.

I.D. Legal Treatment of Break Fees

Why is deal protection regulated at all? There are three related justifications for regulation of break fees. First, they can deter bids, reduce competition, and reduce welfare by allowing the target to be transferred to a lower-valuing bidder. Normally, however, the law does not compel sellers of assets to sell to the buyer that will pay the

[3] Boone & Mulherin 2006 find (and Andre et al. 2007 confirm) that Thomson's data on break fee incidence is biased in several respects: first, there is a general underreporting of fees and other forms of deal protection, relative to what is revealed by a careful review of SEC filings; second, there is a greater underreporting earlier in time, creating the spurious impression of time trends in fee incidence; and third, there is greater underreporting for smaller bids, creating the spurious impression of a relationship between toeholds and break fees. Since these biases emerge from underreporting by Thomson, they should not affect data on fee size, since such data is only available where Thomson reports fee data. They also confirm the finding, reported in Coates & Subramanian 2001, that fee incidence increased significantly after the 1994 Delaware Supreme Court decision in *Paramount*.

most – having assigned a property right in a given asset, the law presumes that the owner of the asset will be best positioned to choose a buyer, taking into consideration all relevant factors, including value that may not be reflected in the sale price (e.g., a sale to family members, to neighbors, to a repeat customer, etc.). But for public targets, the "owners" are dispersed shareholders, who cannot effectively represent themselves in the sales process. Target managers effectively choose among bidders in the first instance, subject to shareholder approval. Target manager preferences over bidders, moreover, can be expected to systematically differ from those of target shareholders. Traditional fiduciary duty law would thus be expected to constrain, to some extent, target managers' ability to use break fees to favor one bidder over another, absent a justification, particularly if the target managers had some evident tangible interest in the choice, such as a better job or severance package. Third and finally, there is a broader justification rooted in the basic structure of corporate law common to the UK and its former colonies, which is that a fee cannot be so large as to essentially eliminate the option target shareholders have to accept or reject the bid. Put differently, even if there is no specific concern about target managers in the context of a particular bid, a law permitting any and all break fees to be enforced would crucially undermine more generally laws requiring shareholder consent for sale of the company. Those more general laws can be justified either on contract grounds – they were part of the bargain by virtue of being part of corporate law at the time investors purchased stock in a company – and on efficiency grounds – shareholder approval or consent requirements constrain agency costs in general, even if they are unnecessary or even inefficiently costly for a given company with given managers in the context of a given bid. For any or all of these reasons, the law in each of the US and the UK constrains break fees. But it does so differently in each nation.

I.D.1. UK

In the UK, break fees are constrained in theory by three sets of laws, but in practice only two are binding, and both have identical effects. The Takeover Code essentially limits break fees to one percent of the value of the bid. That Code was originally a set of formally self-imposed rules adopted voluntarily by major institutional participants in the City, including representatives of the Bank of England, the London Stock Exchange (LSE), leading merchant banks, and organizations representing institutional investors, and is now statutorily binding on all tender offers for public companies in the UK, by virtue of the UK's implementation of the EU-wide Takeover Directive. Previously, the Takeover Code did not formally have the force of law, but was practically did, because the sanction for flouting its requirements was expulsion from the LSE and trade organizations representing institutional investors, disinvestment by the British institutional investor community (who were required by the terms of the Code to divest from anyone breaking the Code), and an inability to obtain services or other assistance from others subject to the Code. In essence, Code enforcement was piggy-backed on private organizations and relationships that would be considered essential for ongoing business activities in the UK.

Because the Takeover Code cap of one percent is publicly stated in the Code itself, it effectively functions as a bright-line rule, and there are few if any disputes concerning the rule. (This is supported in the data discussed below.) It is effectively self-enforcing, having been promulgated by an expert regulatory body, and can only be deviated from with advance permission of that same body, which reportedly they rarely grant. (This is also supported in the data discussed below.)

In addition, a second law – the Company Code -- has long forbidden public companies in the UK from providing "financial assistance" to anyone purchasing their shares, including in the context of a takeover bid. "Financial assistance" for this purpose includes any contingent payment to the bidder by the target, with certain exceptions. Break fees are covered, unless they are less than one percent of the bid value. Violations of the law could result in civil and even criminal penalties for any officer or director of the target that approved the violation. Thus, even if a bidder would be prepared to endure expulsion from the UK financial community in order to obtain a break fee larger than one percent, targets risk significant sanctions if they agree. Agreements for such fees would also be unenforceable in UK courts, making it risky for a bidder to rely on an agreement for such a fee, even if a target were willing to risk sanctions.

Third, and unimportantly in the UK, there are background fiduciary duty obligations, enforced in a common law fashion by the UK courts. Because the Takeover Code and Company Code provisions described above effectively rule out legally controversial break fees, no competing bidders have sought an injunction or other judicial remedy as a result of a break fee on fiduciary duty grounds.

I.D.2. US

In the US, there is no equivalent to the Takeover Code or the general UK ban on "financial assistance." Instead, there is just the background fiduciary duty law that also applies, formally, in the UK. Target shareholders – including a competing bidder that purchases a single share of the target – have standing to sue in court on the ground that the agreement to pay a break fee was disloyal, grossly negligent, or both. While courts typically defer to the "business judgment" of a company's board in such cases, if the bidder can plausibly argue that the fee was designed to favor incumbent managers, it will often be able to get a court to scrutinize the facts surrounding the fee agreement. One relevant consideration, but only one, will be the size of the fee. Other factors, such as the target board's plausible interests in favoring a particular bidder, the information they had at the time they granted the fee, the process that preceded the grant of the fee provision, and the size of comparable fees in comparable transactions, will all generally be considered by the reviewing court.

Because there is no bright-line rule setting a maximum amount for break fees in the US, bidders or target shareholders unhappy with a given fee must seek to attack it ex post, in court, without any assurance as to the outcome. Bidders that want break fees must negotiate for them without knowing precisely how large the fee can be without risking a court finding that it represents a breach of the target's fiduciary's duties. (Courts view a

bidder as aiding and abetting any violation represented by an agreed-upon fee, so that a bidder may not simply claim a contract entitlement separate from the claimed breach by the target's directors.)

I.D.3. Why the Divergence?

Why have the US and the UK diverged in their treatment of break fees? [Brief history of Takeover Panel and Takeover Code to come].

Part II. Data on Break Fees in the US and the UK

II.A. Sample Description

The sample is drawn from Thomson Financial's M&A Database. All bids for UK or US targets in the time period 1989 through 2008 are initially drawn. Because bid techniques (including deal protection) vary by deal size (see Coates & Subramanian 2001), because deal size may vary between the UK and the US, and because bid size has varied over time, the sample is then constrained to consist of only the largest bids in any given year. Specifically, all bids below the 9th decile of bid value are dropped, leaving the largest 10% of all bids per year, consisting essentially of $1+ billion bids (with the precise lower bound on bid size varying by year). (None of the qualitative findings reported below depend on the precise size cut-off.) This produces a total of 5,171 bids.

Bids that are reported by Thomson as still pending – i.e., bids with no effective date or withdrawal date – are dropped, leaving 4,404 bids. Of those, 865 are classified by Thomson as "hostile," meaning the target resisted the bid. Because a target's consent is required to obtain standard deal protection, deal protection is not likely to be found in hostile bids, and they are dropped.[4] Of the remaining bids, 194 bids sought less than a controlling interest, and are accordingly dropped. Finally, banks and other financial institutions are generally cash- and capital-constrained, making conventional cash break fees difficult or impossible to pay (see Coates and Subramanian 2001 for a discussion and evidence in the US context); while economic substitutes are available (e.g., stock or asset options), they are regulated differently than break fees, at least in the US. Bids for targets with SIC codes 6000-6999 (n=766) are dropped.

These procedures leave a total of 2,579 bids. Of those, Thomson reports stock price and premium data for only 1,346, consisting of 209 bids for UK companies and 1136 bids for US companies. This subsample is the focus of the remaining analysis.[5]

II.B. Summary Data and Simple Comparisons of Large Bids in the US and the UK

[4] There are, in fact, more hostile bids in the UK (7% of the broader sample of large bids) than in the US (3%, p-value < .01). But as noted at the outset, there are vastly more friendly deals in each country.

[5] More UK bids lack premium data (58%) than US bids (51%), but the basic results discussed below regarding incidence and size of break fees, and their relationships with bid completion and bid competition, are not qualitatively affected by retaining all large non-pending friendly control bids for non-bank targets.

Of the bids in the remaining large bid sample, pooling both US and UK bids, 88% were completed, and 12% were withdrawn. Average (median) bid size was $4.9 billion ($2.1 billion). The mean (median) duration of a completed bid was 145 (114) days. Bids were at an average (median) premium over the prior day's target stock price of 30% (26%). Break fees – again, pooling across US and UK bids – were used in 70% of bids,[6] and were an average (median) of 2.6% (2.7%) of deal size.

Bid size between the two nations was similar: $4.7 billion in the UK, on average, versus $5.0 billion in the US. Bids using stock consideration were larger than cash bids, but this was true in both nations. Yet, as reflected in Table 1, break fees were used significantly less often and were significantly smaller in the UK than in the US. Table 2 shows that these differences persist in cash bids.

Table 1.

Summary Statistics, All Bids and US vs. UK Bids, 9th Decile of Bid Size, 1989-2008

	Mean for all bids (n=1346)	Mean for UK bids (n=209)	Mean for US bids (n=1137)	p-value (US vs. UK)
% sought in bid	98.5	97.3%	98.7%	0.01
Bid value ($mm)	4.9	4.7	5.0	0.72
% bid premium over 1-day prior market price	29.8	30.0	29.8	0.91
% with break fees[6]	70.4	18.7	70.3	0.00
Break fee as % of bid value	2.6	0.9	2.6	0.00
% using tender offer	26.9	72.2	18.6	0.00
% cash bids	56.7	65.1	55.1	0.01
% stock bids	28.0	5.3	32.1	0.00
% completed	87.9	82.8	88.8	0.01
% with litigation	4.2	0.0	5.0	0.00
% with public bid competition	9.8	19.6	8.0	0.00
% cross-border	19.9	36.8	16.9	0.00
Duration of completed bids in days	145	128	148	0.02

Table 2.

Summary Statistics, Cash Bids in US vs. Cash Bids in UK, 1989-2008

	Mean for UK cash bids (n=209)	Mean for US cash bids (n=1137)	p-value (US vs. UK cash bids)
% sought in bid	96.4%	98.4%	0.00
Bid value ($mm)	4.1	4.2	0.93

[6] But see Boone & Mulherin 2006 on underreporting of break fees in Thomson's database.

% bid premium over 1-day prior market price	29.8	29.9	0.96
% with break fees[6]	26.4	80.3	0.00
Break fee as % of bid value	0.9	2.7	0.00
% using tender offer	72.1	28.6	0.00
% completed	79.4	88.5	0.00
% with litigation	0.0	3.9	0.02
% with public bid competition	22.8	10.0	0.00
% cross-border	35.3	21.3	0.00
Duration of completed bids in days	126	133	0.44

Given these differences, it is perhaps not surprising that significantly more bids for US targets were completed (89%) than was true for UK bids (83%, p-value <.01) – that is the goal of deal protection, to deter competition and increase completion rates.

Yet US bids took longer to complete than UK bids. The reason for the timing difference has to do with the interaction of law – stock deals require a more lengthy regulatory clearance process – and bid financing, which is weighted more towards cash in the UK than in the US. Specifically, UK bids are most frequently for all cash (65%) than for all stock (5%) or for other securities or a blend of deal currencies (30%). While large US bids are also most commonly for all cash (55%), they are more frequently for stock (32%) than in the UK, with the rest for other securities or a blend of deal currencies (13%). Each of those pairwise differences is statistically significant at a p-value of <.01. As shown in Table 2, cash bids close more rapidly than other bids in either nation, but cash bids take roughly the same amount of time in either country.

The differences in bid consideration and bid duration thus only make the contrast between bid completion rates in the US and the UK even more striking. One of the primary reasons bids are not completed is competition [cite], and bid competition increases with bid duration [cites]. Yet in the UK – where bids take less time because they are more commonly for all cash – close less frequently than in the US, where they take more time, because they are more for all stock. In fact, as reflected in Table 2, the difference in closing rates spans choice of consideration: all-cash bids in the US remain more likely to be completed (89%) than all-cash bids in the UK (79%, p-value < .01).

II.C. Trends in Break Fee Size

Trends in the size of break fees in the US and the UK are depicted in Table 1. As previously reported in Coates & Subramanian 2001 (but for a sample including smaller deals than the one reported on in this paper), break fees (as a percentage of bid value) increased over the course of the 1990s in the US. However, any trend in US break fees in large deals appears to have moderated in the 2000s. As a more formal test, break fee size as a percent of bid value is regressed against the bid announcement date (not reported), and against bid announcement date, a dummy indicating that the year of announcement is

after 1999, and the interaction of announcement date and the year 1999. In both regressions, bid announcement date correlates strongly with break fee size, but the signs on the post-1999 and the date*1999 interactions are negative and statistically insignificant.

By comparison, there is no marked trend in break fees in the UK. Admittedly, Thomson only reports break fees in UK bids starting in 1999, but break fees already are clustering near the legal cap of 1% as early as 2000, and remain there throughout the sample period. (In only one year – 2005 – are there any reported break fees in excess of 1.0%, and that one outlier is an erroneous datum in Thomson, which lists PetroKhazakhstan as a UK target, when it fact it was Canadian.) Of the break fees reported in the UK, over 60% fall between 0.9% and 1.0% of bid value; in the US, only 2% fall in that range. In unreported regressions, there is no relationship of break fee size on bid announcement date over any part of the sample period.

Table 3. Trends in Break Fee Size, US vs. UK, 1989-2008

	UK		US	
	Mean	Median	Mean	Median
1989	--	--	1.5%	1.0%
1990	--	--	2.6%	2.6%
1991	--	--	3.0%	3.0%
1992	--	--	1.6%	1.2%
1993	--	--	2.1%	2.1%
1994	--	--	2.3%	2.2%
1995	--	--	2.2%	2.4%
1996	--	--	2.5%	2.5%
1997	--	--	2.5%	2.5%
1998	--	--	2.4%	2.5%
1999	0.7%	0.7%	2.4%	2.6%
2000	0.9%	0.9%	3.0%	2.8%
2001	--	--	2.7%	2.7%
2002	0.4%	0.4%	2.8%	2.8%
2003	--	--	3.0%	3.2%
2004	1.0%	1.0%	2.8%	3.0%
2005	1.5% (0.8%)	1.0% (0.8%)	2.6%	2.8%
2006	0.7%	0.8%	2.8%	2.9%
2007	1.0%	1.0%	2.7%	2.9%
2008	1.0%	1.0%	2.9%	2.8%

-- = no observed break fees; for 2005, the UK fee statistics are listed as derived directly from Thomson, and in parentheses as corrected after dropping a misclassified target (see text)

Table 4 depicts trends in variation of break fee size in the UK and in the US in available years. Two measures are shown: the annual standard deviation in break fee size, as a percentage of bid value, and the residuals from the best fitting multivariate regression models predicting break fee size presented in Column X of Table Y below, which

removes variation in stable predictors of break fee size from the cross-country comparisons. In all years but 2005, the standard deviation of break fees in the US is more than double, and sometimes much larger, than its counterpart in the UK, and after dropping the misclassified deal discussed above, the same is true for 2005. [Discuss residuals] There do not seem to be any trends in the variation in the US data: despite years of experience, thousands of deals, and hundreds of lawsuits (discussed below), there remains as much variation in observed break fee size in the early 1990s as there is in the late 2000s.

Table 4. Trends in Variation in Break Fee Size, US vs. UK, 1989-2008

	UK		US	
	Standard Deviation of Break Fee Size	Residual from the model of break fee size in column (X) of Table Y below	Standard Deviation of Break Fee Size	Residual from the model of break fee size in column (X) of Table Y below
1989	--		0.00752	
1990	--		--	
1991	--		0.01525	
1992	--		0.01563	
1993	--		0.00820	
1994	--		0.00895	
1995	--		0.00736	
1996	--		0.00846	
1997	--		0.00938	
1998	--		0.00877	
1999	--		0.00932	
2000	--		0.01194	
2001	--		0.00931	
2002	--		0.00756	
2003	--		0.01179	
2004	0.00048		0.00809	
2005	0.01325 (0.00393)		0.00766	
2006	0.00314		0.00699	
2007	0.00247		0.00812	
2008	0.00087		0.00850	

-- = insufficient observed break fees; for 2005, the UK fee statistics are listed as derived directly from Thomson, and in parentheses as corrected after dropping a misclassified target (see text)

Part III

III.A. Outcomes: Deal Competition and Deal Completion

Part III relates break fee incidence and size to rates of deal competition and deal completion, deal outcome variables that break fees are intended by M&A practitioners to affect.

III.B. Univariate Results

Univariate and multivariate results are presented, and the robustness of the findings is tested with alternative specifications.

III.C. Multivariate Results

III.D. Robustness

IV. Lessons

Part IV then concludes with some observations about potential lessons from the data on trade-offs between litigation and regulation more generally.

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