Are You Paying Too much? Large Termination Fees and Merger Outcomes

Jordan Neyland*
University of Melbourne and
Financial Research Network (FIRN)
jordan.neyland@unimelb.edu.au

Chander Shekhar
University of Melbourne and
Financial Research Network (FIRN)
c.shekhar@unimelb.edu.au

Mengchen Yang
University of Melbourne
m.yang11@student.unimelb.edu.au

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Abstract

We investigate the impact of large target termination fees in acquisitions. Bidders pay lower premiums in deals with large termination fees. Large termination fees are also associated with more post-bid competition and lower completion rates, suggesting that large fees are ineffective at locking-in gains from acquisitions. Large termination fees are more common in smaller deals and deals with larger advisory fees, consistent with acquirers using fees to recoup transaction costs if a competing bidder acquires the target. We also find that target managers are not more likely to receive severance packages or employment offers with the acquirer in deals with high fees. Overall, our evidence suggests that high termination fees do not result from self-interested managers contracting with friendly bidders. Rather, high fees help overcome contracting problems related to transaction costs.

1 Introduction

Bidders often secure merger agreements with contractual provisions and devices that protect the deal from competing bidders. The inclusion of such provisions may stem from both firms' desire to protect the deal from "undesirable" second bidders, inducing higher premiums and recovery of transaction costs in the event of deal failure among others. Although earlier literature has examined the motivation for target termination fees, its size and consequences – for both bidder and the target – have been not yet been studied extensively.[1] The courts have highlighted some concerns regarding the size – for instance in the Phelps Dodge Corp. v. CyprusAmax Minerals Co. (1999), Delaware Chancery Court held that a termination fee of "6.3% stretches the definition of reasonableness beyond its breaking point". A higher termination fee also might not survive judicial scrutiny because the courts might view it as a defensive measure designed to preclude competing bids (Block, 2007). Generally, the courts conclude that termination fees ranging from 1% to 5% are reasonable and the fees above that might subject to legal challenges.

In this paper we are primarily interested in investigating what target managers hope to gain by agreeing to pay an abnormally high termination fee to the bidder, and in particular whether the use of high fees is beneficial or detrimental to shareholder wealth. We first hypothesize that target managers grant high termination fee provisions to encourage bidders to incur the costs of gathering information and to improve the likelihood of making a bid. If the information collecting process is inefficient or there is greater information asymmetry between the bidder and target, targets' granting of high fees may lead to (higher) offers that encapsulate the bidders' (favorable) private information about the transaction. On the other hand, target managers may agree to high termination fees simply because of agency conflicts between them and their shareholders – a high fee may secure friendly bidders, and may also provide them with side benefits such as continuing employment with the acquiring firm. To

[1] Officer (2003) and Bates and Lemmon (2003) examine the provision of termination fee in merger transactions. Their results generally results suggest that target termination fees are used to solve contractual problems and hence enhance value for target shareholders. Jeon and Ligon (2011) suggest that only low fees allow for efficient contracting between buyer and the seller. We discuss these papers (and other related literature) in greater detail in Section 2 of the paper.

examine the veracity of either proposition, we empirically examine the determinants of low versus high termination fees. We also examine whether high fees deter competing bidders, affect the likelihood of deal completion, and influence the premiums (and returns) received by target shareholders. We also test for contemporaneous effects on returns garnered by acquiring companies' shareholders.

Our results suggest that the determinants of high target termination fees—termination fees above 6% of deal value—are fundamentally the same as those for low fees. High fees are negatively correlated with target firm size and positively correlated with target advisory and bidding costs. These observations are consistent with the idea that high termination fees are a means of offsetting higher contracting and information costs associated with smaller targets (Bates and Lemmon, 2003). Our results, however, also indicate that agency costs do not lead to high termination fees. CEOs and senior managers of high-fee targets are no more likely to obtain employment with the acquirer after the merger than those that with low-fee targets. Further, the proportion of target CEOs that receive severance payments and have vesting options is also identical for the low- and high-fee samples, suggesting that senior managers do not trade personal benefits in exchange for locking in a favoured bidder by agreeing to high fee provisions.

We also analyse the performance of acquirers and targets in transactions with low and high fees. Targets with high termination fees receive lower premiums and experience lower abnormal announcement period returns. Additionally, higher termination fees are associated with a lower likelihood of deal completion and higher number of competing bidders, suggesting that agreeing to high fees does little to "lock in" a specific bidder or to ensure consummation of the merger. Taken together, our results do not support the idea that agency problems drive the existence of high termination fee. Our results are also inconsistent with the idea that higher termination fees induce bidders to pay higher premiums (Coates and Subramanian, 2000). Our results do suggest that high fees represent an efficient contracting device employed by acquirer and target managers to facilitate deals involving small targets, which are more likely subject to high information asymmetry (hence higher information gathering costs).

The paper proceeds as follows. In Section 2, we discuss related literature and develop the hypotheses, followed by data selection and sample description in Section 3. Section 4 provides the multivariate results. Section 5 concludes the paper.

2 Prior literature and Hypotheses

2.1 Target termination fee provisions

Managers negotiate termination fees to increase the probability that a merger agreement will eventually result in a completed deal. Bates and Lemmon (2003) find that premiums and completion rates are higher in deals with target termination fees, suggesting that termination fees are an efficient contracting device. They posit that termination fees compensate bidders for the costs of determining the value of the target and the synergies of a completed merger. If competing bidders observe the initial bid, they receive information on the quality of the target firm. Competing bidders can free-ride on the information produced by the initial bidder without bearing the information-gathering costs faced by the initial bidder. Termination fees reduce this free-rider problem by increasing the cost of bidding for the competing bidders. Any competing bidder must pay at least the initial premium plus the value of the termination fee to the target to entice the target to break the initial agreement.

Target managers can also use termination fees to secure deals with friendly bidders and curb the bidding activity of competing, but potentially higher-value, third parties. Hartzell, Ofek, and Yermack (2004) study the personal benefits obtained by CEOs whose firms are acquired. They find that target managers are likely to negotiate special cash bonuses or receive favourable employment contracts with the acquirer. Moreover, target premiums are lower when target CEOs negotiate increased cash payments, suggesting managerial self-interest impacts merger negotiations. If self-interested target managers set termination fees sufficiently high, they could secure friendly bids and receive personal benefits while locking out rival bidders that place a higher value on the target firm.

Evidence on termination fees suggests that managers use termination fees to overcome incentive problems, rather than to promote self-interest. Officer (2003) provides evidence that termination fees do not harm target shareholder wealth on average, and are not the result of target agency problems.

Moreover, Boone and Mulherin (2007) report a positive relation between the use of termination fees and pre-bid competition. They analyze the private takeover process, which suggests that targets shop the company before implementing termination provisions. Andre, Khalil, and Magnan (2007) also suggest that termination fees are an efficient contracting mechanism, as fees are relatively higher in deals with higher bidding costs.

2.2 Abnormally large fee provisions

Prior literature focuses primarily on the average effects of termination fees, but the average effect can mask results related to the largest termination fees, which may result from managerial self-interest. The Delaware courts have scrutinized high termination fees for their potential to harm target shareholders. In *Phelps*, the court stated that a 6.3 percent termination fee pushed the definition of reasonableness beyond its breaking point.[2] The Delaware Chancery Court reaffirmed its position in *Toys "R" Us*, condemning the termination fee in the Phelps case, as "a more than reasonably explicable barrier to a second bidder".[3]

Little research has been done on large termination fees. Bates and Lemmon (2003) find a significant negative relation between termination fees above ten per cent and bid premiums. Jeon and Ligon (2011) confirm that high termination fees are negatively related to deal premiums. This negative relation is consistent with self-interested managers locking in friendly bids – and thus agency problems – albeit at the expense of target shareholders. However neither of these papers test directly for the relation between the fee and proxies for such issues. Berkovitch and Khanna (1990) show that defensive strategies which make bidding more difficult for some bidders can lead to higher target price. Termination fees inhibit competition from follow-on bidders. However, Fishman (1989) and French and McKormick (1984) predict that the costs of bidding deter potential acquirers from making a bid. Initial bidders are more willing to undertake the information gathering costs associated with bidding if they are granted a termination fee, because the termination fee will effectively compensate bidders for the costs associated with bidding. The initial bidder recoups bidding costs even if the

[2] Phelps Dodge Corp. v. Cyprus Amax Minerals Co., 1999 WL 1054255 (Del.Ch. Sept.27, 1999)
[3] In re Toys "R" Us, Inc. Shareholder Litigation, 877 A.2d 975 (Del.Ch. Jun 22, 2005)

target is eventually purchased by another bidder. Because termination fees make initial bids more attractive, targets have increased ability to receive higher premiums.

If bidders use termination fees to overcome bidding costs, high fees could result from high information gathering costs, rather than agency problems. Servaes and Zenner (1996) argue that information asymmetry between the bidder and target positively influences the use of costly investment banking services in acquisitions. McLaughlin (1992) shows that investment bank fee contracts contain fixed and variable components that depend on the size of the acquisition. Jeon and Ligon (2011) suggest that search costs and information gathering costs incurred by bidders are largely fixed and independent of target size. If there are high fixed costs or greater information asymmetries, the bidding costs can be high as a percentage of deal value, especially for smaller targets. Hence, we expect high termination fees to be associated with smaller targets, if managers use termination fees as a tool for facilitating bidding.

We also expect that legal uncertainty related to termination fees impacts the use of large termination fees. Coates and Subramanian (2000) document an increasing trend in the use and magnitude of termination fees. They attribute much of the increase in the magnitude of termination fees to the Delaware court's willingness "to cast a generous eye toward lockups in general and breakup fees in particular," but they also suggest that "breakup fees above 3% of deal value should be given a particularly hard look". The criticism of high termination fees remains potent given the renewed criticism in *Phelps* and *Toys "R" Us*. Managers could reduce the size of large fees to "reasonable" levels, in spite of higher bidding costs. If managers artificially lower high fees to avoid judicial scrutiny, then the fees would be abnormally low, compared to the level of fee needed to effectively deter bid competition and recoup information-gathering costs. Because bidders cannot reduce competition or recoup the search costs when a competing bidder makes an offer for the target firm, an initial bidder will not value the merger agreement as highly. That is, if court opinions act as bounds on the maximum level of termination fees, we expect large termination fees to be associated with lower completion rates and lower deal premiums.

3 Data and Summary Statistics

3.1 Data

Thomson Securities Data Corporation's (SDC) merger and acquisition database provides the sample of transactions announced between January 1989 and December 2011. We restrict our sample to deals after 1989, because Officer (2003) reports that termination fee data is limited before 1988 in SDC. We restrict the SDC sample to bids with the following restrictions. (1) The target is a U.S. public target. (2) The form of the deal is defined as a "merger" or "acquisition" by SDC. (3) The status of the deal is either "completed" or "withdrawn". (4) The deal value must be equal to or greater than one million dollars to ensure the deal is economically meaningful. (5) The percentage of shares held by a bidder 6 months prior to the announcement is less than 50%. We also drop deals in which SDC identifies the acquirer as an "Investor", "Investor Group", "Shareholders", or "Creditors", as well as deals in which the acquirer and the target share the same parent.

These restrictions leave a sample of 8,742 bids. We require target firms to have non-missing returns data from CRSP for the year preceding the merger and data for book assets from Compustat for the fiscal year preceding the year of the merger announcement. These data restrictions reduce the final sample to 6,816 deals.[4]

3.2 Descriptive Statistics - Termination Fees

Table 1, Panel A reports the percentage of bids with high, low, and no termination fees by industry and by year. About 59.02% (4,023 bids) of the total observations (6,816 bids) include target termination fee provisions. Coates and Subramanian (2000) show a growing incidence of termination provisions from 1988 to 1998. Officer (2003) reports that termination fees were almost never used in the 1980s, but nearly 60% of bids included a termination fee in 1998.

[4] The actual sample size in regressions is reduced by data availability. In particular, missing observations for target free cash flow and acquirer returns reduce the sample size.

Coates and Subramanian (2000) point out two judicial decisions—*Paramount* in 1994 and *Brazen* in 1997—that generally support the use of termination fees in merger agreements.[5] As shown in Table 1, Panel A, the proportion of deals using target termination fees roughly doubles between the four-year period from 1994 to 1997 and the use of target termination fees increases from 15.42% in 1989 to nearly 91% in 2011.[6]

Table 1, Panel B provides the descriptive statistics for the size of termination fee provisions. Although Delaware courts generally hold that termination fees do not breach directors' fiduciary duties to their shareholders, these courts are critical of "excessive" termination fees. In *Toys "R" Us*, the court upheld the use of a termination fee of 3.75%, but the court in *Phelps* criticized a termination fee of 6.3%. Because of the courts' criticism of fees above 6%, we define high termination fees as fees above 6%. This threshold is admittedly arbitrary, so in multivariate analysis we also define high fees as fees above 5% and 10%, which roughly correspond to the 95th and 99th percentile of the distribution of termination fees in the sample.[7] The mean low (high) target termination fees in dollar terms is $44.30 ($14.83) million. The mean low (high) proportional fee (target termination fees scaled by deal value) is 3.09% (12.25%).

The maximum termination fee grant for targets in our sample is $2.5 billion payable by Sprint Nextel to MCI Worldcom in a $115 billion proposed merger announced in October of 1999. The maximum target termination fee in relative terms is the $2.5 million (215%) fee payable by Envirosource Inc. to Greenwich Street Capital in a $1.16 million merger announced in June of 2001.This maximum is an extreme outlier with the next highest termination fee equal to 48% of deal value.

Panel B of Table 1 also indicates that for about 94.5% of observations with termination fees, the fee is between zero and 6% of deal value. 222 deals (5.5%) have termination fees at or above 6% of transaction value, but only 76 observations involve fees in excess of 10% of transaction value. We

[5] Paramount Communications Inc. v. QVC Network Inc, 637 A.2d34, 51 (1993); Brazen v. Bell Atlantic 695 A.2d 43 (1997)

[6] By contrast, Boone and Mulherin (2007) report a high and steady incidence of termination fee provisions in the 1989-1999 period using hand collected SEC data on a subsample of 400 bids, suggesting that time trends may result from data error from SDC data. We recognize that data errors may impact our results. However, we have no reason to expect that SDC under-reports low target termination fees relative to high target termination fees.

[7] Bates and Lemmon (2003) examine fees above 10% of deal value.

also observe that the average firm with a large termination fee is smaller than the average firm with a lower termination fee. In fact, the average firm size almost monotonically decreases within termination fees size quintiles, excluding firms without termination fees (results untabulated). This observation is consistent with the idea that bidding costs do not scale directly with target size, and target firms have higher bidding costs as a percentage of deal value.

3.3 Descriptive Statistics - Deal and Target Characteristics

We now examine the data for any differences in the deal characteristics between no, low and high termination fee deals, followed by similar univariate analysis for target characteristics. Table 2 provides a comparison of deal characteristics and provides two primary insights. One, deals without termination fees are typically different from deals that do include them - for instance no termination fee deals have higher pre-bid ownership (by acquirer), are more hostile, and are more likely to be financed by stock. Two, although there are also differences between low and high termination fee deals, they are also remarkably similar across several variables of interest. Lockups and toeholds provide initial bidders with gains in the event of a higher competing bid, allowing the initial bidder to capture much of the deal gains in the event of a second bid. Because lockups and termination fees similarly protect deals from follow on bidders, we expect toeholds and lockups are negatively related to the use of termination fees and termination fee size. However, there is no significant difference between the use of lockups or toeholds between deals with low and high fees, suggesting high termination fees are no more likely to protect a merger than low termination fees. High termination fees deals are not significantly less likely to be hostile, be diversifying, include bidder termination fee, or be subject to litigation. Panel B, Table 2 summarizes the target firm characteristics. We also find that deals with high fees are associated with smaller deals. The difference in mean deal value between deals with high fees and deals with low fees (1,479.25 vs. 231.6) is significantly different from zero. That is, deals with high termination fees are more likely to be smaller, consistent with the idea that high fixed transaction costs could drive the use of high termination fees for smaller deals.

Target size is often regarded as a proxy for the level of deal complexity (Bates and Lemmon, 2003). However, Jeon and Ligon (2011), suggest that termination fee size is not monotonically related to deal size. We expect that smaller firms have relatively large information gathering costs during the bidding process, and induce the target managers to grant a high termination fee to secure the deal. We also find the average market-to-book ratio is higher in deals with low termination fees, suggesting information asymmetry about growth opportunities (Smith and Watts, 1992) is negatively related to termination fee size. Consistent with this observation is the mean 1 year return prior to the takeover – low termination fee targets exhibit a significantly lower (negative) return than high fee targets. Finally the free cash flow is also higher for low fee targets, which is consistent with the view that the use of termination fees (and especially high termination fees) may be driven be agency conflicts at target firms.

In order to examine the relation between agency costs and termination fee directly, we examine the post-merger employment and compensation arrangements for target CEOs and senior executives in deals with high termination fees and a matched sample of deals. Hartzell, Ofek, and Yermack (2004) present results suggesting that there is a negative relation between premiums paid and benefits (such as financial bonuses and appointments in the acquiring firm) accorded to the CEOs of target firms. We gather compensation and post-acquisition employment data for the 222 high termination fee bids. We obtain compensation and employment data from proxy statements, tender offer statements, S-4's, and other filings available through the SEC's EDGAR database. Due to a lack of electronic filings before 1995 and other data constraints, we are not able to find employment and compensation data for each target firm. However, we are able to confirm employment and compensation data for 190 of the deals with high termination fees (above 6%).

We form a matched sample of bids for comparison. We categorize each bid by its one-digit SIC code, year of announcement, and size tercile. For each high termination fee bid, we randomly draw a sample

bid from the same industry, year, and size tercile with replacement.[8] We find compensation and employment data on 174 of the matched bids.

Table 3 presents descriptive statistics for the high termination fee and matched samples. The data indicate that there is no significant difference in the probability that a target CEO receives employment with the acquirer between the high fee deals and the matched sample. Additionally, other non-CEO executives in high fee deals are no more likely to receive a position with the acquirer than the matched sample non-CEO executives. CEOs' compensation incentives are also not significantly different in high fee deals. Target CEOs in high termination fee deals are just as likely to receive a severance or to have options that will vest in the event of a merger. Overall, these results suggest that CEOs and other executives' personal incentives are not related to the decision to negotiate a higher termination fee. Rather, the univariate evidence supports the idea that termination fees are related to contracting costs.

4 Results

We examine the determinants of the use of termination fees, the choice between low and high fees, and the effect of fees on both acquirer and target on deal outcomes. We model the choice between high, low, and no termination fees with logits and multinomial logits. We define low termination fees as fees below 6%, and high termination fees as fees above or equal to 6%. We choose 6% as the boundary between low and high fees, because this number is explicitly mentioned in court cases (*Phelps*), but results are generally robust to different cut-off points (e.g., 5% and 10%).

4.1 Choosing Termination Fees

The first set of results of logit regressions for choice models are presented in Table 4. We use use basic logit regressions to compare the determinants of high and low termination fees in a simplified framework that is comparable to prior studies. The dependent variable in Model 1 equals one if the bid includes a high or low termination fee, zero if there is no termination fee. Model 1indicates that including a termination fee, either low or high, is positively related to bidder termination fees, deal

[8] Only 8 bids are duplicate observations in the matched sample.

size, tender offer status, and an indicator for a same-industry deal. All three legal judgments pertaining to litigation related to termination fee also increase the likelihood that it is included in the merger agreements. On the other hand, bidder toeholds have a significant negative impact on the inclusion of termination fees they are likely substitutes for each other. Finally, existence of prior bids (indicating multiple bidders) also decreases the likelihood of including termination fee, perhaps as it would suggest explicit favoritism for one bidder over other.

In models 2 and 3, we analyze the likelihood of high fees versus no and low fees, and low fees versus high fees only, dropping deals without termination fees. As both models are intended to highlight factors that lead firms to favor high fees, we discuss the results concurrently. Results indicate that inclusion of high fee termination fee is positively influenced by bidder termination fee. This is consistent with the idea that bidder fees represent a type of "insurance" for targets. That is, they negotiate the inclusion of such fees when the expected costs of incomplete bids are high (Bates and Lemmon, 2003). Our results are consistent with Bates and Lemmon (2003) but include the additional insight that the presence of such fees significantly increases the likelihood of high target termination fee as well. Both deal size and target market-to-book ratio decrease the likelihood of high termination fee, and the passage of legal rulings do not exhibit any relation with presence of high fee in transactions.

In Table 5, we explicitly compare the relative importance of factors that influence a target firm's decision to choose low or high fee against the alternative of no fee. In multinomial logit regressions, we model the use of termination fees as a choice between high, low, and no termination fees. We test whether the determinants of termination fees are different between high and low termination fees by comparing the coefficients of these determinants for high and low termination fees. The base case is the subsample with no target termination fee. In Model 1, the Wald test identifies statistically significant differential effect of bidder termination fee, deal size, and target market-to-book ratio on low versus high fees. Put differently, these three variables have a significantly different impact on the choice of high or low termination fees. Additionally, neither target's prior return nor its free cash flow are significant, suggesting that in as much these factors capture agency costs (Officer 2003, Bates and

Lemmon 2003), such costs are not relatively more influential for choosing high fees than low fees. For instance, a target's pre-bid market adjusted return could signal agency problems, increasing the likelihood that target managers would use termination fees to secure a friendly bid, possibly at the expense of target shareholders. Our results however, when coupled with the earlier observation that the post-merger employment and compensation arrangements for CEOs and managers do not differ across fee types, strongly suggest that agency costs are not the drivers of large termination fee provisions in mergers and acquisitions.

Models 2 and 3 in Table 5 include target and bidder advisory fees, respectively. We expect small firms and firms with higher advisory fees are more likely to grant high termination fees as their transaction costs are relatively large. Target size, proxied by deal value, is positively related to low termination fees, but negatively related to high termination fees, and the difference is statistically significant. Both target and bidder advisory fees are positively related to large termination fees, but negatively related to low termination fees. This difference is consistent with the fixed component of contracting and advisory fees being larger for the smallest firms, while deal complexity drives the use of lower termination fees for larger firms. We note that the agency cost variables—target's prior return and free cash flow—continue to be insignificant. Overall, the results are consistent with transaction costs driving the use of high termination fees.

4.2 Firm Performance

In this sub-section, we examine whether target termination fees significantly affect the returns to both acquirer and target shareholders in a multivariate framework. If the target information gathering costs dominate the choice of termination fee size, the management team should be more willing to grant relatively high termination fees, and we would not expect adverse consequences for the target shareholders. Concurrently, acquirer shareholders should also not obtain abnormal benefits from such a situation. To address these issues we begin by regressing acquirer and target announcement abnormal returns on target and bid characteristics. CARs are measured as cumulative net-of-market return where the market return is the CRSP value-weighted index and the estimation period from 250

days to 30 days prior to the bid announcement date. All models contain a target termination fee dummy as well as an indicator variable that captures whether the fee is above 5%, 6%, and 10% respectively. Controlling for a common set of characteristics these specifications allow us to isolate and highlight the effect of fee on shareholders' wealth.

Results for acquirer announcement cumulative abnormal returns (ACAR) are presented in the first sets of regressions in Table 6. The estimated coefficients on high termination fees are positive and statistically significant, suggesting that acquirers obtain much higher announcement returns when deals include target termination fee. When the fee becomes excessive (≥10%) however, the correlation disappears. The signs and statistical significance of other control variables is both consistent across the three specifications and with results in earlier studies (e.g. Bates and Lemmon, 2003). When we estimate the same models but with target announcement abnormal returns (TCAR) as the dependent variable, the effect of high termination fee is negative and significant – in other words target returns are negatively correlated with fee provisions. Additionally some of the control variables also significantly impact target's abnormal announcement return - they are lower in stock offers, and are higher for tender offers and for hostile deals. Taken together, the results for ACARs and TCARs suggest that the market reaction is opposite for the two types of firms, which in turn suggests that high termination fee are ineffective for targets.

In the third set of analyses in Table 6, premiums paid are regressed on the same set of independent variables as before. Consistent with TCAR results, premiums exhibit a negative correlation with different levels of fee provisions – the higher the targets' termination fee, the lower the premium paid. The signs and significance of remaining control variables are generally consistent with previous studies as well as with estimates for CAR models presented earlier. Premiums are significantly higher if the deal is a tender offer or a stock offer during the acquisition process, but significantly lower when the bidder has a toehold of more than 5% of the target's outstanding equity. Pre-bid stock returns and free cash flow however are negatively related to premiums.

Overall, our results do not support the efficient transaction hypothesis. The observed positive (negative) outcome for acquirers (targets) seem to suggest that high termination fees not only compensate acquirers for more than the transaction costs, but also represent an inefficient contractual device from the target management perspective.

4.3 Deal completion

To examine the effectiveness of high termination fee provisions, we use logit regressions to examine whether the presence of large target termination fee provisions affects the likelihood of deal completion and least-squares regressions to model the presence of competing bidders. The dependent variable in Panel A of Table 7 is an indicator equal to one if a bid is eventually completed, zero otherwise. In Panel B of Table 7, the dependent variable is the number of competing bidders in an auction. An auction for a target includes an initial bid and all sequential bids that fall within 365 days of the prior bid for that target. The independent variable of interest is *High Termination Fee*, which is an indicator equal to one if the bid includes a high termination fee, zero otherwise. We include three different proxies for high termination fees to show that results are robust to different specifications. We define high termination fees as fees above 5%, 6%, and 10%, respectively.

The results in Panel A, Table 7 indicate that the inclusion of high and very high target termination fee provisions in merger agreements is associated with a significantly lower probability of deal success. The signs and statistical significance of the control variables are consistent and as expected – deals are less likely to be consummated if they are hostile and involve litigation. On the other hand, target lockups, tender offers and stock offers are all associated with a higher likelihood of completion. In Panel B, we re-estimate these models but with number of bidders as the dependent variable. Results suggest that higher the termination fee, higher the number of bidders. Note that merely the presence of termination fee exhibits a negative correlation with number of bidders; it is the existence of high termination fee that seems to induce additional (potential) buyers to join the auction. This result is inconsistent with the notion that target managers agree to high termination fee as a means of favoring a bidder (which may also indicate agency problems). To the contrary, our results suggest that high

termination fee in fact spurs competition, significantly decreasing the likelihood that target managers use high termination fee to mete out preferential treatment to a particular acquirer.

5 Conclusion

We examine why target firms agree to include high termination fees in merger agreements. In this paper, we first examine what affects the choice of fee size and whether high fee provisions alter the probability of deal completion, followed by testing whether high fees affect the deal premiums and the returns realized by shareholders. Although previous research suggests that the use of termination fee provisions in general is more consistent with efficient contracting than agency costs, this literature and court opinions suggest that high termination fees could result from agency problems and harm shareholder wealth. However, we present evidence that high termination fees cluster in smaller deals, which are more likely to have higher advisory and transaction costs relative to the size of the deal. High termination fees may be necessary to cover the costs of bidding in these transactions. Moreover, high termination fees are not associated with lower bid competition, suggesting that self-interested target managers do not grant an abnormally high termination fees to lock-in "friendly" bidders. We find that target managers are not more likely to be employed at the acquiring firm after the acquisition nor are they more likely to receive a larger compensation payout following the merger. Altogether, evidence that agency costs drive the use of large termination fees is weak.

Three important conclusions can be gleaned from our findings regarding high target termination fees in merger agreements. First, high fees have a negative association with deal success. High fees may actually be less effective at securing deals with acquirers, possibly due to the lower dollar-value of the termination fees, as large fees are found more in smaller deals. Second, the use of high target fees in a merger agreement is associated with a lower deal premium when compared with deals with low fees. While this result may be consistent with managers locking-in deals with friendly bidders, it is also consistent with efficient contracting. Bidders would not pay a higher premium for a termination fee, if the termination fee is ineffective at securing the bid. This interpretation is also consistent with results related to lower (higher) target (acquirer) abnormal returns in deals with large target termination fees.

Overall, we find little evidence that high termination fees are detrimental to shareholder wealth, and, in fact, limitations on the size of termination fees may prevent contracting that would otherwise lead to an efficient outcome.

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Variable Appendix

Variable	Description
Bidder Abnormal Returns	The cumulative abnormal returns to bidders for the three days surrounding the announcement of a bid, (-1, 1). Abnormal returns come from a market model of returns with an estimation window of 200 days starting 260 days before the announcement of a bid.
Bidder Advisory Fees	Fees paid by the bidder to financial advisors for advisory services, in millions of dollars.
Bidder Termination Fee	An indicator equal to one if the deal includes a bidder-payable termination fee.
Brazen Indicator	An indicator equal to one if the bid was announced in or after 1997, the year of the *Brazen* case.
Completed	An indicator variable equal to one if the bid is eventually completed, zero otherwise.
Deal Value	The value of the transaction in millions of dollars.
High Termination Fee (5%/6%/10%)	High fees are termination fees that are greater than or equal to six percent of the deal value, unless otherwise designated at 5% or 10%.
Hostile Deal	An indicator equal to one if the deal attitude is hostile, as defined by SDC.
Litigation	An indicator equal to one if there is litigation associated with the bid.
Low Fee	Unless otherwise specified, low fees are termination fees that are less than six percent of the deal value.
Number of Bidders	A count variable of the number of bidders for an individual bid.
Paramount Indicator	An indicator equal to one if the bid was announced in or after 1994, the year of the *Paramount* case.
Phelps Indicator	An indicator equal to one if the bid was announced in or after 1999, the year of the *Phelps* case.
Premium	Premiums are defined as the total value of consideration offered to the target divided by the market capitalization of the target 42 days before the announcement of the bid less one. Similar to Officer (2003), we adjust for outliers below zero or above two (200%). If the premium is above (below) 2 (0), we calculate premium as the price offered per share as provided by SDC divided by the price of target stock 42 days prior to the bid announcement less one. If this per share measure is also above two or below zero, premium is coded as missing.
Prior Bid	An indicator equal to one if there was a preceding bid for the target firm within 365 days of the announcement of the current bid.
Prior Return (1 year)	The stock return of the target firm, net of market returns, for the 252 trading days beginning 312 days before bid announcement and ending 61 days before bid announcement.
Same SIC	An indicator equal to one if the target and acquirer share the same two-digit SIC code.
Stock Deal	An indicator equal to one if the consideration offered is all stock or a mix of cash and stock.
Target Abnormal Returns	The cumulative abnormal returns to targets for the three days surrounding the announcement of a bid, (-1, 1). Abnormal returns come from a market model of returns with an estimation window of 200 days starting 260 days before the announcement of a bid.
Target Advisory Fees	Fees paid by the target to financial advisors for advisory services, in millions.

Variable Appendix (continued)

Variable	Description
Target Book Assets	The book value of the target's assets.
Target Debt-to-Assets	The sum of long-term and short-term debt of the target divided by the book value of target assets.
Target Free Cash Flow	Operating income before depreciation less interest expense, income taxes, and capital expenditure, scaled by the book value of assets.
Target Lockup	An indicator equal to one if the bidder has a lockup provision, an option to purchase target shares, in the merger agreement.
Target Market-to-Book	The market value of the target divided by the book value of target assets, as defined by Compustat.
Tender Offer	An indicator equal to one if the bid is structured as a tender offer for the target's shares.
Termination Fee Size ($mil)	The size of the termination fee in millions of dollars.
Termination Fee Size (% of Deal Value)	The ratio of the value of the termination fee divided by the value of the transaction, expressed as a percentage.
Toehold Indicator	An indicator equal to one if the bidder owns shares in the target firm prior to the announcement of the bid.

Table 1

The Distribution of Termination Fees

This table presents the distribution of 6,816 sample bids from the SDC database for the years 1989 to 2011. High termination fees are greater than or equal to 6% of deal value. Panel A presents the distribution of low and high termination fees by dollar value and the value of the termination fee relative to the size of the deal. Panel B shows the percentage of deals with no, low, and high termination fees by one-digit SIC industry. Panel C shows the percentage of deals with no, low, and high termination fees by year.

Panel A – Termination Fees by Fee Size

Low Termination Fees - Below 6% of Deal Value					
Variable	**N**	**Mean**	**Std. Dev.**	**Min**	**Max**
Termination Fee Size ($mil)	3,801	44.30	138.54	0.03	2,500.00
Termination Fee Size (% of Deal Value)	3,801	3.09	1.08	0. 00[a]	5.99
High Termination Fees - At Least 6% of Deal Value					
Variable	**N**	**Mean**	**Std. Dev.**	**Min**	**Max**
Termination Fee Size ($mil)	222	14.83	65.65	0.24	787.93
Termination Fee Size (% of Deal Value)	222	12.25	19.05	6.00	214.96

[a] The actual minimum is slightly above zero, but rounded down.

Panel B – Termination Fees by Industry and Fee Size

One-Digit SIC	**N**	**No Termination Fees**	**Low Termination Fees**	**High Termination Fees**
0 (Agriculture)	14	71.43%	28.57%	0.00%
1 (Mining)	303	43.89%	53.47%	2.64%
2 (Construction)	710	35.49%	61.27%	3.24%
3 (Manufacturing)	1,530	36.80%	59.93%	3.27%
4 (Transportation)	590	41.36%	55.25%	3.39%
5 (Trade)	529	49.53%	47.45%	3.02%
6 (Finance)	1,574	51.72%	46.12%	2.16%
7 (Services)	1,194	31.74%	63.48%	4.77%
8 (Services)	372	36.56%	59.68%	3.76%

Panel C – Termination Fees by Year and Fee Size

Year	N	No Termination Fees	Low Termination Fees	High Termination Fees
1989	266	84.59%	14.29%	1.13%
1990	131	88.55%	10.69%	0.76%
1991	114	82.46%	15.79%	1.75%
1992	108	73.15%	24.07%	2.78%
1993	132	71.97%	25.76%	2.27%
1994	294	64.97%	32.31%	2.72%
1995	391	67.52%	30.95%	1.53%
1996	385	69.09%	29.09%	1.82%
1997	514	36.77%	58.95%	4.28%
1998	568	37.50%	59.68%	2.82%
1999	587	38.16%	59.11%	2.73%
2000	490	34.90%	60.41%	4.69%
2001	363	23.42%	69.97%	6.61%
2002	219	37.90%	57.53%	4.57%
2003	258	49.22%	48.06%	2.71%
2004	232	15.09%	81.47%	3.45%
2005	261	19.16%	78.93%	1.92%
2006	312	18.59%	80.13%	1.28%
2007	334	15.57%	82.63%	1.80%
2008	238	26.05%	69.33%	4.62%
2009	181	28.73%	61.88%	9.39%
2010	247	17.81%	77.33%	4.86%
2011	191	9.42%	86.39%	4.19%

Table 2

Descriptive Statistics

This table presents sample statistics for the 6,816 sample bids from the SDC database for the years 1989 to 2011. High termination fees are greater than or equal to 6% of deal value. Panel A shows means of deal characteristics by fee type. Panel B shows means of deal characteristics by fee type. The sample size is reduced in Panel B from missing target data. Targets must have debt, free cash flow, and market-to-book ratio data to be included in the sample. T-tests provide tests of significant differences between the low termination fee and high termination fee deals. Variables are winsorized at the 1% level, except indicator variables. Variable definitions are in the Variable Appendix.

Panel A - Deal Characteristics

	No Termination Fee	Low Termination Fee	High Termination Fee	T-statistic Low - High
	N = 2,793	**N = 3,801**	**N = 222**	
Bidder Termination Fee	0.026	0.261	0.315	-1.79
Target Lockup	0.124	0.083	0.068	0.81
Prior Bid	0.096	0.059	0.081	-1.35
Hostile Deal	0.076	0.008	0.005	0.60
Toehold Indicator	0.125	0.037	0.068	-2.29
Tender Offer	0.150	0.227	0.212	0.54
Stock Deal	0.613	0.589	0.473	3.41
Deal Value	701.467	1395.628	189.865	6.06
Same SIC	0.562	0.584	0.559	0.74
Litigation	0.061	0.026	0.018	0.69

Panel B - Target Characteristics

	No Termination Fee	Low Termination Fee	High Termination Fee	T-statistic Low - High
	N = 1,971	**N = 2,887**	**N = 176**	
Target Book Assets	775.306	1,479.251	231.631	3.63
Target Market to Book	0.996	1.361	0.792	5.36
Target Debt to Assets	0.264	0.234	0.288	-3.02
Prior Return (1 year)	-0.131	-0.046	-0.293	6.23
Target Free Cash Flow	-0.054	-0.025	-0.117	5.84

Table 3

Target Executive Post-merger Employment Arrangements and Compensation

This table presents mean statistics of the post-merger employment and compensation outcomes of target managers. Out of the 222 sample bids with high termination fees, 190 have employment information. A matched sample of 222 low fee bids with similar deal size is randomly drawn from the full sample of 6,816 bids, excluding high fee deals. Employment and compensation data are found for 174 of the matched sample bids. High termination fees are greater than or equal to 6% of deal value. T-statistics report the results from t-tests of differences between the high fee deals and the low fee matched sample. Z-statistics report the results from proportion tests for differences between the high fee sample and the matched sample. Because *Deal Value* is a continuous variable, the Z-statistic comes from a rank-sum test. Variable definitions are in the variable appendix.

	Matched Sample	**High Fee Sample**	**Tests of Differences**	
	N = 174	**N = 190**	**T-statistic**	**Z-statistic**
Target CEO Receives New Position	50.57%	49.47%	0.21	0.21
Other Executives Receive New Position	60.34%	55.79%	0.88	0.88
CEO Receives Severance	39.08%	41.58%	-0.48	-0.49
CEO has Vesting Options	35.06%	40.00%	-0.97	-0.97
Bidder Termination Fee	18.97%	34.21%	-3.32	-3.28
Target Lockup	7.47%	6.84%	0.23	0.23
Prior Bid	8.62%	7.89%	0.25	0.25
Hostile Deal	1.15%	0.53%	0.66	0.66
Toehold Indicator	8.05%	7.37%	0.24	0.24
Tender Offer	16.09%	22.11%	-1.45	-1.45
Stock Deal	50.00%	45.79%	0.80	0.80
Same SIC	46.55%	56.32%	-1.87	-1.86
Litigation	0.00%	1.58%	-1.67	-1.66
Deal Value	249.95	208.74	0.39	3.76

Table 4

Determinants of Termination Fees

This table presents the results of logit regressions modelling the probability that a bid includes a termination fee. The sample bids come from the SDC database for the years 1989 to 2011. The sample is split into three subsamples to examine the determinants of termination fees. In the first model, the dependent variable is equal to one if the bid includes a target termination fee, zero otherwise. In the second model, the dependent variable equals one if the bid includes a termination of at least 6% and equals zero if the bid includes a termination fee below 6% or not termination fee at all. In the third model, the dependent variable equals one if the bid includes a termination fee of at least 6% and equals zero if the bid includes a termination fee greater than zero but below 6%. One-digit SIC indicators control for industry fixed effects. Variables are winsorized at the 1% level, except indicator variables. Variable definitions are in the Variable Appendix. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively. T-statistics are reported in parentheses.

	Termination Fee vs. No Fee	**High Fee vs. Low and No Fee**	**High Fee vs. Low Fee**
	(1)	**(2)**	**(3)**
Bidder Termination Fee	2.345***	1.390***	0.720***
	(14.32)	(7.40)	(3.59)
Target Lockup	0.427***	0.722**	0.587*
	(2.60)	(2.19)	(1.69)
Prior Bid	-0.479***	0.184	0.278
	(-3.53)	(0.63)	(0.85)
Hostile Deal	-2.870***	-1.065	1.038
	(-10.26)	(-1.02)	(0.86)
Toehold Indicator	-1.145***	-0.349	0.213
	(-7.88)	(-1.01)	(0.57)
Tender Offer	0.969***	0.481**	0.001
	(9.80)	(2.50)	(0.00)
Stock Deal	0.028	-0.223	-0.265
	(0.34)	(-1.28)	(-1.35)
Log of Deal Value	0.279***	-0.713***	-0.962***
	(12.22)	(-11.61)	(-12.31)
Target Market to Book	0.090***	-0.224*	-0.286**
	(2.76)	(-1.87)	(-2.12)
Same SIC	0.154**	0.029	-0.029
	(2.05)	(0.17)	(-0.16)
Prior Return (1 year)	0.084	-0.197	-0.198
	(1.07)	(-0.99)	(-0.98)
Target Free Cash Flow	0.205	0.145	0.062
	(1.17)	(0.43)	(0.17)
Paramount Indicator	0.646***	0.557	-0.369
	(4.48)	(1.27)	(-0.74)
Brazen Indicator	1.218***	0.849**	0.118
	(9.80)	(2.55)	(0.34)
Phelps Indicator	0.262***	-0.048	-0.105
	(2.60)	(-0.21)	(-0.44)
Industry Fixed Effects	Yes	Yes	Yes
N	5,051	5,051	3,071
Pseudo R2	0.292	0.209	0.290

Table 5

Multinomial Logits of the Determinants of Low and High Termination Fees

This table presents the results of multinomial logit regressions modelling the probability that a bid includes a low termination fee, high termination fee, or no termination fee. The base outcome is no termination fee. The sample bids come from the SDC database for the years 1989 to 2011. High termination fees are termination fees equal to or greater than 6%. Variables are winsorized at the 1% level, except indicator variables. Variable definitions are in the Variable Appendix. One-digit SIC indicators control for industry fixed effects. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively. T-statistics are reported in parentheses below coefficient estimates. Chi-squared statistics are reported for Wald tests that test for the equality of coefficient estimates for determinants of termination fees.

	Base Case = No Termination Fee								
	Model 1			Model 2			Model 3		
	Low Fee	High Fee	Wald Test (Chi-squared)	Low Fee	High Fee	Wald Test (Chi-squared)	Low Fee	High Fee	Wald Test (Chi-squared)
Bidder Termination Fee	2.274***	3.016***	15.749***	1.749***	2.574***	11.901***	2.733***	2.796***	0.016
	(13.81)	(12.73)		(7.79)	(8.10)		(7.29)	(4.63)	
Target Lockup	0.391**	0.949***	2.823*	-0.067	-0.066	0.000	-0.093	0.468	0.762
	(2.33)	(2.71)		(-0.35)	(-0.14)		(-0.31)	(0.69)	
Prior Bid	-0.502***	-0.146	1.387	0.313	0.361	0.013	0.895**	1.822*	1.135
	(-3.57)	(-0.49)		(1.17)	(0.77)		(2.25)	(1.95)	
Hostile Deal	-2.948***	-2.032**	0.715	-2.747***	-15.591***	917.599***	-3.175***	-14.689***	179.075***
	(-9.93)	(-2.02)		(-7.51)	(-38.90)		(-6.50)	(-18.52)	
Toehold Indicator	-1.162***	-0.945***	0.365	-1.149***	-0.736	0.810	-1.049***	-1.392	0.039
	(-7.67)	(-2.67)		(-5.38)	(-1.58)		(-3.25)	(-0.82)	
Tender Offer	0.978***	1.038***	0.094	0.162	0.051	0.232	0.633**	0.566	0.022
	(9.71)	(5.03)		(1.14)	(0.20)		(2.50)	(1.19)	
Stock Deal	0.039	-0.185	1.593	-0.085	-0.571**	4.225**	0.185	0.796	0.818
	(0.47)	(-1.01)		(-0.65)	(-2.21)		(0.70)	(1.16)	
Log of Deal Value	0.340***	-0.509***	178.525***	0.203***	-0.818***	99.058***	0.229***	-1.110***	31.261***
	(14.09)	(-7.93)		(3.93)	(-7.48)		(2.92)	(-4.50)	
Target Market to Book	0.103***	-0.155	4.688**	0.052	-0.145	2.204	0.101	0.116	0.006
	(3.07)	(-1.29)		(1.07)	(-1.07)		(1.26)	(0.57)	
Same SIC	0.160**	0.128	0.037	0.225**	0.176	0.053	0.047	0.606	1.492
	(2.11)	(0.73)		(1.98)	(0.76)		(0.25)	(1.26)	
Prior Return (1 year)	0.109	-0.114	1.218	0.180	-0.186	2.450	-0.164	-0.184	0.002
	(1.38)	(-0.55)		(1.42)	(-0.72)		(-0.79)	(-0.40)	
Target Free Cash Flow	0.219	0.274	0.025	0.228	0.119	0.061	-0.190	2.609*	4.566**
	(1.23)	(0.77)		(0.83)	(0.24)		(-0.42)	(1.93)	
Paramount Indicator	0.672***	0.527	0.109	0.741***	0.535*	0.564	1.016***	0.926	0.013
	(4.52)	(1.21)		(4.79)	(1.79)		(3.88)	(1.17)	
Brazen Indicator	1.206***	1.404***	0.361	0.978***	0.810	0.104	0.814***	0.855	0.005
	(9.53)	(4.18)		(5.31)	(1.53)		(3.25)	(1.44)	
Phelps Indicator	0.247**	0.125	0.283	0.960***	1.055**	0.060	0.479*	0.735	0.220
	(2.42)	(0.53)		(5.62)	(2.55)		(1.76)	(1.24)	
Target Advisory Fees				-0.015	0.058**	9.046***			
				(-1.27)	(2.20)				
Bidder Advisory Fees							-0.042**	0.053	7.096***
							(-2.35)	(1.38)	
Industry Fixed Effects	Yes	Yes		Yes	Yes		Yes	Yes	
N		5,051			2,932			1,037	
Pseudo R2		0.288			0.267			0.347	

Table 6

High Termination Fees and Firm Performance

This table presents the results of regressions of deal outcomes on indicators of termination fees, high termination fees, and control variables. The sample bids come from the SDC database for the years 1989 to 2011. *Bidder Abnormal Return* is the cumulative abnormal return to the bidder for the three days surrounding bid announcement, (-1,1). Abnormal returns are estimated from a market model of returns. *Target Abnormal Returns* are similarly defined. *Premium* is the price paid offered by the bidder divided by the target's value forty-two days prior to the bid announcement, minus one. Further details on variables are available in the Variable Appendix. *Termination Fee Indicator* is equal to one if the merger agreement includes a target termination fee. *High Termination Fee (5%, 6%, and 10%)* are indicators equal to one if the target termination fee are above 5%, 6%, and 10%, respectively. Variables are winsorized at the 1% level, except indicator variables. Year and one-digit SIC indicators control for industry and year fixed effects. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively. T-statistics are reported in parentheses below coefficient estimates.

	Bidder Abnormal Return			Target Abnormal Return			Premium		
Termination Fee Indicator	-0.004	-0.004	-0.003	0.062***	0.065***	0.063***	0.044***	0.044***	0.039**
	(-1.07)	(-1.08)	(-0.82)	(7.18)	(7.60)	(7.47)	(2.68)	(2.63)	(2.38)
High Termination Fee (5%)	0.014**			-0.008			-0.076**		
	(2.08)			(-0.43)			(-2.27)		
High Termination Fee (6%)		0.024**			-0.055**			-0.120***	
		(2.49)			(-2.43)			(-2.67)	
High Termination Fee (10%)			0.029			-0.077*			-0.172*
			(1.55)			(-1.90)			(-1.92)
Bidder Termination Fee	-0.010**	-0.010**	-0.010**	-0.063***	-0.062***	-0.064***	-0.059***	-0.057***	-0.061***
	(-2.43)	(-2.52)	(-2.37)	(-7.03)	(-6.89)	(-7.09)	(-3.29)	(-3.19)	(-3.39)
Target Lockup	-0.006	-0.006	-0.005	0.021	0.021	0.021	0.007	0.006	0.005
	(-1.14)	(-1.14)	(-1.07)	(1.41)	(1.44)	(1.41)	(0.25)	(0.24)	(0.19)
Prior Bid	-0.006	-0.006	-0.006	-0.092***	-0.091***	-0.092***	-0.012	-0.011	-0.011
	(-1.27)	(-1.29)	(-1.27)	(-10.68)	(-10.59)	(-10.62)	(-0.51)	(-0.48)	(-0.49)
Hostile Deal	-0.012**	-0.012**	-0.011*	0.026*	0.028*	0.027*	0.033	0.033	0.032
	(-1.98)	(-2.02)	(-1.92)	(1.70)	(1.79)	(1.75)	(1.09)	(1.10)	(1.05)
Toehold Indicator	-0.001	-0.001	-0.000	0.011	0.011	0.010	-0.175***	-0.175***	-0.175***
	(-0.15)	(-0.16)	(-0.08)	(0.88)	(0.89)	(0.86)	(-7.73)	(-7.70)	(-7.73)
Tender Offer	0.011***	0.011***	0.011***	0.079***	0.079***	0.078***	0.093***	0.093***	0.093***
	(3.53)	(3.50)	(3.52)	(8.45)	(8.41)	(8.37)	(5.51)	(5.52)	(5.50)
Stock Deal	-0.016***	-0.016***	-0.016***	-0.044***	-0.045***	-0.045***	0.127***	0.127***	0.128***
	(-5.20)	(-5.15)	(-5.23)	(-5.47)	(-5.56)	(-5.50)	(8.28)	(8.25)	(8.31)
Log of Deal Value	-0.004***	-0.003***	-0.004***	0.007***	0.006***	0.007***	0.006	0.006	0.007
	(-3.84)	(-3.76)	(-4.13)	(3.22)	(2.76)	(3.07)	(1.27)	(1.25)	(1.59)
Target Market to Book	-0.003***	-0.003***	-0.003***	-0.016***	-0.016***	-0.016***	-0.032***	-0.032***	-0.033***
	(-2.96)	(-2.93)	(-2.94)	(-5.42)	(-5.45)	(-5.44)	(-5.45)	(-5.46)	(-5.47)
Target Debt to Assets	0.010	0.010	0.010	-0.045***	-0.043**	-0.044**	0.230***	0.231***	0.229***
	(1.48)	(1.42)	(1.56)	(-2.61)	(-2.49)	(-2.53)	(7.26)	(7.31)	(7.20)
Same SIC	-0.005	-0.005*	-0.005	0.010	0.010	0.010	0.018	0.018	0.018
	(-1.64)	(-1.66)	(-1.64)	(1.31)	(1.31)	(1.30)	(1.32)	(1.34)	(1.31)
Prior Return (1 year)	-0.003	-0.003	-0.003	-0.036***	-0.036***	-0.036***	-0.064***	-0.065***	-0.063***
	(-1.06)	(-1.07)	(-1.10)	(-4.72)	(-4.79)	(-4.73)	(-4.02)	(-4.02)	(-3.95)
Target Free Cash Flow	0.003	0.003	0.003	0.001	0.001	0.000	-0.205***	-0.204***	-0.207***
	(0.37)	(0.37)	(0.42)	(0.04)	(0.04)	(0.01)	(-4.44)	(-4.42)	(-4.49)
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	3,199	3,199	3,199	5,013	5,013	5,013	4,410	4,410	4,410
R2	0.072	0.074	0.072	0.114	0.115	0.115	0.131	0.132	0.131
Adjusted R2	0.059	0.060	0.059	0.106	0.107	0.107	0.122	0.123	0.122

Table 7

High Termination Fees, Bid Competition, and Bid Completion

This table presents the results of regressions of bid completion and bid competition on indicators of termination fees, high termination fees, and control variables. The sample bids come from the SDC database for the years 1989 to 2011. In Panel A, logit regressions model the probability of deal completion. *Completed* is an indicator variable equal to one if a bid is completed, zero otherwise. Panel B presents least-squares regressions of bid competition on termination fees and high termination fees. *Number of Bidder*s is a count variable for the number of bidders associated with a bid. Only the first bid in an auction is used. An auction is defined as all bids on a target within a 365 day rolling window. *Termination Fee Indicator* is equal to one if the merger agreement includes a target termination fee. *High Termination Fee (5%, 6%, and 10%)* are indicators equal to one if the target termination fee are above 5%, 6%, and 10%, respectively. Variables are winsorized at the 1% level, except indicator variables. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively. T-statistics are reported in parentheses below coefficient estimates.

Panel A – Large Termination Fees and Deal Completion

	Completed	**Completed**	**Completed**
Termination Fee Indicator	1.945***	1.920***	1.931***
	(20.92)	(21.00)	(21.26)
High Termination Fee (5%)	-0.334*		
	(-1.76)		
High Termination Fee (6%)		-0.259	
		(-1.03)	
High Termination Fee (10%)			-0.810**
			(-2.36)
Bidder Termination Fee	-0.199*	-0.198	-0.208*
	(-1.65)	(-1.64)	(-1.72)
Target Lockup	1.796***	1.794***	1.795***
	(9.30)	(9.27)	(9.29)
Hostile Deal	-2.265***	-2.268***	-2.267***
	(-13.70)	(-13.71)	(-13.69)
Tender Offer	1.216***	1.215***	1.213***
	(9.54)	(9.54)	(9.51)
Stock Deal	0.222***	0.221***	0.220***
	(2.96)	(2.95)	(2.94)
Litigation	-0.349*	-0.350*	-0.348*
	(-1.80)	(-1.81)	(-1.80)
Log of Deal Value	-0.035*	-0.031	-0.034
	(-1.66)	(-1.49)	(-1.61)
N	6,816	6,816	6,816
Pseudo R2	0.197	0.197	0.198

Panel B – Large Termination Fees and the Number of Bidders

	Number of Bidders	Number of Bidders	Number of Bidders
Termination Fee Indicator	-0.044***	-0.044***	-0.044***
	(-4.88)	(-5.01)	(-5.05)
High Termination Fee (5%)	0.015		
	(1.15)		
High Termination Fee (6%)		0.032*	
		(1.87)	
High Termination Fee (10%)			0.081**
			(2.24)
Bidder Termination Fee	0.021**	0.021*	0.021**
	(2.00)	(1.96)	(2.04)
Target Lockup	-0.026**	-0.026**	-0.026**
	(-2.26)	(-2.26)	(-2.25)
Hostile Deal	0.148***	0.147***	0.147***
	(3.97)	(3.97)	(3.97)
Tender Offer	-0.001	-0.001	-0.001
	(-0.10)	(-0.09)	(-0.05)
Stock Deal	-0.019**	-0.019**	-0.019**
	(-2.05)	(-2.04)	(-2.03)
Litigation	0.149***	0.149***	0.148***
	(4.46)	(4.45)	(4.44)
Log of Deal Value	0.010***	0.010***	0.010***
	(4.30)	(4.45)	(4.54)
N	6,307	6,307	6,307
R2	0.033	0.033	0.033
Adjusted R2	0.031	0.032	0.032