

TERMINATION FEES IN MERGERS AND ACQUISITIONS: Protecting investors or managers?

Abstract:

Unknown less than 20 years ago, termination fees (otherwise called break up fees or kill fees) are now a commonplace component of friendly merger and takeover agreements. Such fees typically require target firms to pay a monetary consideration to bidders if a merger or takeover agreement is broken. In recent large transactions, institutional investors and shareholder groups have expressed strong reservations about the magnitude of such termination fees. We argue that the magnitude of termination fees reflects either potential agency problems or economic efficiency considerations. We evaluate the determinants of the magnitude of termination fees and investigate the market's response. We focus on a sample of mergers and acquisitions involving Canadian targets during the 1997-2004 period. In contrast to the US or the UK, Canada is characterised by highly concentrated ownership, many large companies still being controlled by their founders or families, but exhibits the typical corporate governance mechanisms and minority shareholder protections found in most English origin countries. The Canadian context is also interesting since little regulation exists on the legal treatment of termination fees and very few cases have been brought to court.

Our findings are summarized as follows. First, we show that the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* underestimates the true extent of termination fees. Break fees are present in all but the few hostile or high toehold deals. Second, results are consistent with termination fees being an efficient mechanism. Relative termination fees are found to be higher in transactions where the bidder incurs extensive merger costs, the deal includes a cash component and operating synergies are expected. In contrast, we do not find strong support for termination fees being a sign of agency problems. While there is weak evidence that relative termination fees are positively related CEO retention in the acquiring firm, they are not related to large golden parachutes or to separation of ownership and control in the target firm often cited as poor governance. While termination fees are greater in the presence of family block holdings, this likely denotes their crucial role in deal success. Outside board directors have a moderating effect on break fees. Break fees and premiums levels are not related which can suggest that they are jointly determined in an efficient manner during the negotiation process. As such, market participants do not appear to react differently to the level of relative termination fees in deals.

JEL classification: G34, K22

Keywords: Kill fees, Break fees, Termination fees, Mergers and acquisitions

Data availability: All data employed are commercially available from the sources described in the text

“Once considered an obscure insurance policy, fat deal termination fees have become the rage” (The Globe and Mail, February 5, 1998, p. B13)

I. INTRODUCTION

Mergers and acquisitions (M&A) are under the spot light again; the number and value of transactions has considerably increased since the low peak of 2002-03 and continue to rise (Crosbie & Co. 2006). From an investor’s perspective, there are continued concerns regarding the premium paid to acquire target firms and the post acquisition performance of the combined entity (André et al., 2004; Ghosh, 2001; Andrade et al., 2001; Loughran and Vijh, 1997; Healy et al., 1992). In recent years, another concern has emerged. More specifically, institutional investors and analysts worry about how much deal protection must be granted to a proposed acquirer or merger partner without curtailing competitive bidding and hindering an open auction process (Girvan and Boucher, 2003; Officer, 2003; Bates and Lemmon, 2003; Coates and Subramanian, 2000).

Termination fees – also known as break or break up fees, non completion fees or kill fees – are a relatively recent deal protection instrument in friendly M&A both in Canada and elsewhere (Bugeaud, 1996; *The Globe and Mail*, Feb. 5, 1998, p. B13). Termination fee provisions require the target to pay the bidder a certain amount in case it violates specific clauses resulting in the failure of the deal (Tarbert, 2003). The triggering events mostly include shareholders rejecting the merger or accepting a superior bid from a third-party. In a takeover contest, the presence of a termination fee raises the ante for any successful second bidder as it lowers its reservation price given the ultimate disbursement by the target to the first bidder.¹

Relying on an efficiency perspective, some observers argue that termination fees provided by target firms promote shareholder wealth and create shareholder value. They suggest that termination fees promote competitive bidding by compensating bidders for their time, research and opportunity cost in case a deal fails (Tarbert, 2003; Levy 2003; Brantley, 2002). An incentive is provided to a first bidder to reveal the private information necessary to convince target shareholders about the benefits of the proposed deal (Officer, 2003). The courts and institutional investors have sanctioned reasonable termination fees (Braithwaite and Ciardullo, 2004; Ontario Municipal Employee Retirement System – OMERS; Ontario Teachers’ Pension Plan – OTPP).

¹ Certain deals, generally mergers of equals, will also include a bidder termination fee.

Adopting an agency perspective, it can be argued that termination fees represent a tool that deters competitive bidding by hindering an open and fair market for corporate control (Levy, 2003). Braithwaite and Ciardullo (2004) and Bagdasarian (2003) suggest that exorbitant termination fees might inhibit a fair auction process. Brantley (2002) notes that self-dealing managers grant excessive termination fees preferentially and pre-maturely to selected bidders to the detriment of the shareholders. McMurdy (1998) suggests that the inclusion of a termination fee is similar to the payment of a fine for accepting a higher bid. Stephen Jarislowsky, from Jarislowsky Fraser Ltd, suggests that termination fees sometimes block shareholders from getting the best price (*National Post*, Feb. 18, 2003, p. FP 4; Mar. 4, 2002, p. FP 3). He proposes that an acceptable termination fee should only cover a bidder's out of pocket expenses.

Recent transactions illustrate how termination fees have emerged as a contentious issue in M&A. For instance, the Caisse de Dépôt et Placement du Québec (CDP) opposed the merger between Alberta Energy Company and Pan-Canadian Petroleum on the basis that the \$350 million termination fee was too high (*National Post*, Feb. 18, 2003, p. FP 4). Similar opposition by some institutional investors surfaced regarding the \$350 million termination fee included in the takeover agreement between Sun Life Financial Services and Clarica Life Insurance Co and in the recent \$320 million break fee in the Inco-Falconbridge deal². The magnitude of these fees was considered to be excessive, especially in light of evidence that there was inadequate consideration of alternative transactions (Girvan and Boucher, 2003; Brieger, 2005).

Limited empirical evidence shows that incorporating a termination fee in a friendly business combination has economic and rational basis, and is seemingly beneficial to target shareholders (Bates and Lemmon, 2003; Officer, 2003). Bates and Lemmon (2003) document that termination fees are more frequent when bidding is costly and there is a high potential for information expropriation by competing bidders. In addition, Bates and Lemmon (2003) and Officer (2003) find that target firms with termination fee clauses have higher deal completion rates and larger transaction premiums. Boone and Mulherin (2006) show that termination provisions are positively related to takeover competition.

To the best of our knowledge, there is no research that investigates the factors that determine the magnitude of target termination fees in friendly M&A apart from Coates and

² The Ontario Municipal Employees Retirement System (OMERS) generally opposes termination fees, especially those that are at or above 2.5 percent of deal value, while the Ontario Teachers Pension Plan (OTPP) supports shareholder' rights plans that incorporate a modest limit on granting termination fees.

Subramanian (2000). Relying on agency and stewardship theory, we examine whether efficiency or agency proxies determine the magnitude of termination fees. Specifically, we assess whether an association exists between termination fee' magnitude and proxies for expected benefits from the transaction as well as proxies for the corporate governance structure of Canadian firms involved in friendly M&A over the period 1997-2004.

Our results are consistent with termination fees being an efficient mechanism. Relative termination fees are found to be higher in transactions where the bidder incurs extensive merger costs, the deal includes a large cash component and operating synergies are expected. In contrast, we do not find strong support for termination fees being a sign of agency problems. While there is weak evidence that relative termination fees are positively related CEO retention in the acquiring firm, they are not related to large golden parachutes or to separation of ownership and control in the target firm, firms often criticized for poor governance. Termination fees are greater in the presence of family block holdings, but this likely denotes their crucial role in deal success. Outside board directors have a moderating effect on break fees. Break fees and premiums levels are not related which can suggest that they are jointly determined in an efficient manner during the negotiation process. As such, market participants do not appear to react differently to the level of relative termination fees in deals.

The paper contributes to the literature in the following ways. The factors that determine the magnitude of termination fees in friendly M&A are largely unknown despite the controversy surrounding them. Apart from Coates and Subramanian (2000), the scant empirical evidence at hand focuses on the determinants and implications resulting from the inclusion of a termination fee in friendly M&A (Bates and Lemmon, 2003; Officer, 2003) but not their magnitude³.

The paper extends the work of Coates and Subramanian (2000) in various ways. First, we integrate two conflicting theoretical perspectives, efficiency (stewardship) and agency, to investigate the determinants of target termination fees in friendly business combinations. This contrasts with Coates and Subramanian (2000) which mainly focuses on acquiring firm and deal characteristics. Second, we use the takeover proxy circular to validate the termination fee data in the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* and obtain data for the expected benefits from the business combination, the estimated merger costs, target managers' severance packages and retention

³ Recent papers examine the trade-offs between toeholds and termination fees (see Betton et al. 2005), a different research question.

in the combined entity. We show that the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* underestimates the true extent of termination fees; only rare cases of hostile takeovers or large toeholds do not have break fees. We also examine the market's reaction to the magnitude of target kill fees.

Further, the paper provides the first empirical evidence within a different ownership and legal environment. In contrast to the US or the UK, Canada is characterised by highly concentrated ownership, many large companies still being controlled by their founders or their families. However, Canada exhibits the typical corporate governance mechanisms and minority shareholder protections found in most English origin countries. The Canadian context is interesting since little regulation exists on the legal treatment of termination fees. Contrary to the US, most Canadian public companies are incorporated under the Federal charter, not state or provincial charters. In addition, few cases have been brought to court or appealed since the practice started in Canada (Bugeaud, 1996) although more numerous procedures have been undertaken in the US including the recent Toys 'R' Us transaction with a 3.75% break fee upheld by the Delaware court in 2005. The leading Canadian case, *CW Shareholdings Inc. v. WIC Western International Communications Ltd. et al* in 1998 established that break fees are valid if their purpose is to compensate a bidder for its time, effort, direct costs and lost of opportunity (Osler 2005). Many legal experts (e.g., Talbert, 2003, 711), however, believe that termination fees pose immense challenges to Anglo-American corporate law.⁴

The paper is structured as follows. The next section presents the theoretical frameworks and hypotheses. Section III includes the definition for the variables of interest, while section V presents the key findings.

II. THEORY

Ayres (1990) developed the first theoretical framework to investigate the economic implications of lockup provisions. He concludes that absolute lockups which allow managerial entrenchment are extremely rare. Fraidin and Hanson (1994) expand Ayres' (1990) model by including boards fiduciary responsibilities and the possibility of trade between bidders and conclude that courts should have little concerns about lockups. Altogether, they conclude that foreclosing lockups do not affect bid outcomes or allocational efficiency.

⁴ Since July 2001, British companies must comply with Rule 21.2 of the *City Code on Takeovers and Mergers* which limit break up fees to one percent of the offer value (Talbert, 2003, p. 676-77)

Kahan and Klausner (1996) argue that first bidder lockups enhance the market for corporate control and allocational efficiency by rewarding first bidders for search costs and for the informational externality a bid creates. In contrast, lockups granted to second bidders do not promote competitive bidding. The efficiencies a second bidder lockup creates are outweighed by the side payments that target managers extract from second bidders. Leshem (2006) suggest that targets may use break fees as a signal of their potential value to obtain better deals.

Coates and Subramanian (2000) develop a new theoretical model of lockups. They criticize existing theoretical frameworks for failing to incorporate the buy side distortions that influence the behaviour of bidding firms' managers. For instance, bidding firm managers might not necessarily take actions that are in the best interest of the bidding firm shareholders. In addition, bidding firm managers might be reluctant to switch among corporate strategies if switching is costly. Finally, bidding firm managers might want to build a "tough-bidder" reputation that leads to future benefits in the takeover market. The authors conclude that such distortions provide the opportunity for lockups to affect allocational efficiency in the market for corporate control.

More recently, Officer (2003) and Bates and Lemmon (2003) rely on both agency and efficiency perspectives to examine the antecedents and consequences of including a termination fee in friendly business combinations.⁵ The entrenchment hypothesis posits that termination fees deter competing bids for the target firm, and allow entrenched target managers to selectively deal with one particular bidder to obtain private benefits such as employment in the merged firm, and/or compensation and severance package (Bates and Lemmon, 2003). The shareholders' interest hypothesis stipulates that target termination fees serve a less exploitative role and represent a contractual device that efficiently solve contracting problems between bidder and target firms (Officer, 2003). Boone and Mulherin (2006) show that termination provisions are positively related to takeover competition in the US.

Agency theory

The agency problem arising from the relationship between shareholders and professional managers in publicly held corporations is well established in finance and economics. In an M&A context, self-interested target managers not only bargain over the acquisition price, but also over who will manage the combined entity and the identity of the board members

⁵ Burch (2001) examines lockup options, a fairly contested form of deal protection which has more or less disappeared from the corporate landscape.

(Hartzell et al., 2004). Further, press reports suggest that target firm CEOs negotiate personal financial packages before submitting a deal for board and shareholder approval (*The New York Times*, Apr. 7, 2002, p. 1). They attribute the failure of many merger discussions to management's inability to reach a compromise regarding these personal benefits (*The New York Times*, Jun. 3, 1999, p. C1). In return for continued tenure and/or severance packages, self interested target managers could use termination fees to protect the deal proposed by a white knight bidder (Officer, 2003; Hartzell et al., 2004; Bates and Lemmon, 2003). Although target termination fee grants represent a small fraction of deal value, they account for a substantial percentage of the total wealth gains to mergers. Hence, while termination fees typically vary between 1-5 percent of deal value, wealth gains to the combined business entity around the announcement period is only 1-3 percent (Andrade et al., 2001). We propose the following:

H1: The magnitude of a termination fee is positively correlated to the agency problem faced by the target firm.

CEO ownership, the presence of large shareholders and the presence of outsiders on the board are believed to reduce the agency problems in the firm. However, the relationship between block holdings and termination fees may be ambiguous giving the determining role block holders play in insuring a successful merger or acquisition. While agreement to higher termination fees may demonstrate greater commitment, acquirers often negotiate specific contractual commitments from very large shareholders reducing the need for high termination fees (Boone and Mulherin, 2006 and Betton et. al, 2005). We also control for the separation of ownership and control via dual class voting shares which are present in many Canadian public companies still in the hands of their founding families (Ben Amar and André, 2006). Dual class voting shares are thought to introduce particular agency issues between large and minority shareholders.

Stewardship theory

Stewardship theory defines a situation in which managers are not driven by individual goals but rather have their interests aligned with the shareholders' objectives (Davis and Schoorman, 1997). Based on that premise, target and bidder firm managers negotiating a business combination are inclined to act in the shareholders' best interests. They use termination fees as an efficient contracting tool that protects the deal-related investment made

by the bidder and increases the willingness of the bidder to make such an investment (Officer, 2003). They mutually set termination fees magnitude to compensate bidders for negotiation costs and information externalities, thereby improving the incentives for bidding and encouraging bidders to reveal their private information (Bates and Lemmon, 2003).

Under this efficiency perspective, the magnitude of a termination fee will be increasing in the costs associated with bidding and with the value of private information revealed during the bidding process (Bates and Lemmon, 2003). Leshem (2006) suggest that target management agree to termination fees as a signal of their private information as to the value of the firm. The magnitude of the termination fee might also be associated with the benefits that are expected from the business combination. The M&A literature mostly refers to operating and financial synergies as potential benefits derived from business combinations (Weston et al., 2001; Berkovitch and Narayanan, 1993). Operating synergies arise from combining firms that have unequal managerial capabilities and integrating the production and investment infrastructure of the acquirer and target firms. Financial synergies arise when firms that have large internal cash flows and small investment opportunities combine with firms having low internal fund generation and large growth opportunities providing the latter with lower cost internal funds. It is likely that the disclosure of operating synergies provides some private information to the market. We propose the following:

H2: The magnitude of a termination fee is positively correlated to the fees and expenses incurred to conclude the transaction.

H3: The magnitude of a termination fee is positively correlated to the value of the private information disclosed in the information circular.

H4: The magnitude of a termination fee is positively correlated to the expected post-merger operating synergies arising from the transaction.

The premium over the target firm share price represents another benefit arising to the target firm shareholders. Coates and Subramanian (2000) suggest that takeover premium and termination fee magnitude are potential complements. For instance, Walkling (1985) documents a positive relation between takeover premium and deal success. Along the same line, Jennings and Mazeo (1993) show that higher bid premiums deter competing bids and reduce resistance. Officer (2003) concludes that break fees lead to a greater bid premium. However, Bates and Lemmon (2003) suggest that premium and break fees are set jointly and

efficiently, thus neither drives the other. Neither they nor Coates and Subramaniam find a relationship between break fees and premium. Thus, the following null hypothesis:

H5: The magnitude of a termination fee is not correlated to the premium paid.

The mode of payment also provides a signal about a deal's expected benefits. Research findings show that the stock market reacts positively to a cash offer, while responding unfavourably to a stock exchange (Loughran and Vihj, 1997). First, according to the asymmetric information hypothesis, acquiring firms prefer to use cash when their stock is undervalued by the stock market (Branch and Yang, 2003). Second, in equity based transactions, the value of the consideration offered largely depends on how successful the combined entity is in realizing the deal's projected synergies (Bates and Lemmon, 2003). Further, cash payments require bidding firms to entail real costs to set up financing facilities. We propose the following:

H6: The magnitude of a termination fee is higher for cash deals.

Within an efficiency perspective based on information signalling, the termination fee should be lower for second bidders. The cost of information acquisition and the value of the private information disclosed by a second bidder can be argued to be lower than those for the first bidder.⁶ Bates and Lemmon (2003) show that termination fees are less likely to occur when the acquiring firm is a second bidder. Similarly, bidders that have large toeholds in the target have a higher likelihood of concluding the deal. Others argue that termination fees and toeholds act as complements (Betton et al., 2005). Finally, tender offers are riskier than mergers which are decided at a special shareholder meeting with generally a lower voting threshold and more easily controlled by management. Thus, we propose the following:

H7: The magnitude of a termination fee is lower for deals involving a second bidder.

H8: The magnitude of a termination fee is lower for deals where the bidder has a toehold.

H9: The magnitude of a termination fee is higher for tender offers.

⁶ Alternatively, if the second bidder acts as a white knight for the target's management, we could expect higher termination fees.

IV. RESEARCH METHODOLOGY

Sample

We search the Thomson database for both completed and uncompleted mergers and acquisitions involving Canadian public firms as targets over the period 1997 to 2004. The year 1997 was chosen as a starting point because it coincides with the start of the last merger wave in Canada (see André et al., 2004). It is also chosen because takeover circulars are freely and easily available electronically on SEDAR (sedar.com) starting in 1997.

Our sample is presented in table 1. Our initial search for completed and uncompleted deals between 1997-2004 involving a public Canadian target and worth more than 15 million CAN (10 million US) and for which we had a complete set of data (proxy in SEDAR and financial and stock data in Compustat or Datastream) gave us 262 deals (by 185 acquirers). The Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* initially suggested that 43.9% (115 of the 262 deals) had termination fees. This was similar to Bates and Lemmon (2003) and Officer (2003) with 37% and 42.1%, respectively. However, when examining the takeover circulars on SEDAR, we found that the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* largely understates the presence of termination fees. In fact, 103 of the 147 deals (70%) coded in the database as not having kill fees had such fees. Recent concurrent work by Boone and Mulherin (2006) also shows how severely the Thomson SDC database underestimates termination fees in US deals.⁷

[Table 1]

When analyzing in detail the no kill fee sample (44 transactions), we find that these transactions include 21 hostile deals (15 were unsuccessful with 11 being won by another

⁷ Harvard Law School Professor Subramaniam (of Coates and Subramaniam 2000) also recognized the deficiencies of the current databases in an affidavit presented in the recent Toys 'R' US (2005) shareholder litigation which once more upheld the right to reasonable termination fees in M&A contracts. Delaware Court of the Chancery Vice Chancellor Leo Strine's response was most striking: 'In his most recent affidavit, Subramanian claimed that he and other scholars had been relying on inconsistent calculations from a leading source of data. There is no way for me, or the defendants, to stop the injunction clock and conduct a rational exploration of this midnight-hour contention. The reality that even distinguished scholars often have to refine their initially published arguments and policy recommendations, even though they have a more leisurely period of time to come up with them in the first place, might suggest that more empathy is due to fiduciaries who must, by business necessity, make difficult choices in the faster-moving context of real world commerce. This is not to say that scholarly work should not inform a fiduciary's, or the judiciary's, thinking. It should, but in a measured way that recognizes the necessarily imprecise and arguable nature of most "social science" research.' (*In RE Toys 'R' Us shareholder litigation*, Delaware Court of the Chancery, 2005, p.72)

bidder)⁸ and 13 transactions having high toehold equity investments by the bidder (toeholds are less than 1% on average for the kill fee sample, only 18 cases, whereas all 13 no kill fee cases have toeholds greater than 15%, i.e., “inside bids” under Canadian securities law⁹). Of the 10 others deals, 3 involve lock-ups with controlling shareholders (one is a sale in the context of bankruptcy proceedings), 3 involve lock-ups with dominant shareholders (more than 20% holdings) and 3 are restructurings in regulated industries (telecommunication and airlines), leaving only one unexplained case. Since our sample follows the precedent setting Delaware 1997 *Brazen* court case (see Talbert 2003 for a detailed discussion) upholding termination fees and the apparent deficiencies of the SDC database, examining the presence of kill fees as does the prior literature is of little consequence (Officer, 2003; Bates and Lemmon, 2003). Thus, we focus on the determinants of relative non-zero kill fees (218 cases).¹⁰

Variable Definition

Agency Variables

Academic researchers, institutional investors and shareholder interest groups identify a variety of factors that impact the agency problem. These include ownership by management and large shareholders, the proportion of outsiders on board, and benefits obtained by target firm’s managers (golden parachutes and employment in the acquiring firm).

Managerial equity ownership alleviates the agency problem by better aligning managerial interests with those of the shareholders (Core et al., 1999). A continuous variable captures the percentage of shares owned by the chief executive officer (who are not a large shareholder or a family member of the large shareholder) as disclosed in a firm’s proxy circular in the year preceding the business combination (NONFAMCEOBLK%) and a dummy captures the presence of such block holdings (NONFAMCEOBLK). We also control for potential nonlinearity by adding a square term (NONFAMCEOBLK%²).

⁸ Given the highly concentrated ownership structure of Canadian firms, mergers and acquisitions are rarely hostile, see also Ben-Amar and André (2006). Only one deal with kill fees is coded as hostile but following the initial bid and after opening their data room to other bidders, management finally came to an agreement with the initial bidder.

⁹ This is also consistent with Betton et al. (2005) who suggest that kill fee and toeholds are substitutes.

¹⁰ It could be argued that this constitutes ‘Incidental truncation’ (see Wooldridge 2003 587-591), so we did perform the Heckitt 2 step-procedure. The selection equation explaining the presence of kill fees was estimated with all the independent variables of our model plus a variable for ‘Hostility’. As expected, hostility and toeholds reduce the probability of kill fees while second bids and large bids increase the probability. The usual t test on Mills Lambda coefficient is not significant suggesting we don’t have a selection bias. Further, results from the estimated regression model are similar to those from our OLS regression in Table 6.

Large equity holders also have incentives to monitor a firm's top management (Denis, 2001). Their significant equity holdings provide them with the incentive to expend significant resources to monitor management and influence decision making within the firm to maximise their shareholding (Daily et al., 2003; Denis and McConnell, 2003; Huson et al., 2001). Conversely, large shareholdings create a new agency problem. Many authors suggest that large shareholders may use their power to extract benefits at the expense of minority shareholders (Ben Amar and André, 2006; Faccio and Lang, 2005). Large equity holders are segregated in two groups: individual/family large shareholders and financial/institutional large shareholders. Large shareholders own more than 10 percent of the target's outstanding shares (limit at which ownership stakes must be disclosed in the information circular under Canadian securities regulations). A dummy variable captures the presence of such large family shareholders (FAMBLK) or institutional/financial block holders (FINBLK) while a continuous variable captures the percentage of ownership by large external equity holders (FAMBLK% and FINBLK%) as disclosed in the deal document or the firm's proxy circular in the year preceding the business combination. We also control for the potential non linearity of such a relationship by taking the squared percentage of ownership (FAMBLK%² and FINBLK%²). In most takeover bids that involve large target shareholders, these shareholders also commit to voting for the deal or to tender their shares.¹¹

Further, ownership and control rights can differ because corporations issue different classes of shares that provide different voting rights for given cash-flow rights or use pyramid structures (Ben Amar and André, 2006; Faccio and Lang, 2002). Separation of ownership and control rights means that controlling shareholders do not bear the full costs of their decisions. Separation has generally been shown to have a significant negative effect on firm performance (Claessens et al. 2000; La Porta et al. 2002; Faccio and Lang 2002; Cronqvist and Nilsson 2003; André and Schiehl, 2004) and merger performance (Yen and André, 2006). We control for the presence of separation of control and ownership rights (SEPARATION) and its level (SEPARATION%) measured as the ratio of control and ownership rights.

Independent outside directors also play an important role in monitoring top management (Officer, 2003). Unrelated outside directors are motivated by their desire to maintain their reputation and their fear of dissident stockholder lawsuits (Weisbach, 1988; Hermalin and Weisbach, 2003). We obtain the percentage of unrelated directors from proxy

¹¹ This contrasts with the view expressed by Barger (2006) that shareholder tender agreements differ from termination fees.

statement disclosures based on the Toronto Stock Exchange definition (OUTSIDERS). When not disclosed, we calculate the proportion of unrelated directors on board by dividing the number of directors that are not current or past employees of the firm and those that have no business with the firm or family ties with its owners by board size. We calculate this ratio for the year preceding the business combination.

Finally, recent evidence shows that target managers may trade premium against special payments, better golden parachutes or employment in the acquiring firms (Hartzell et al. 2004). Such managers may have incentives to agree to larger termination fees in order to preclude a second bidder from endangering such side payments. We include dummy variables to capture these two possibilities (GOLDPARACHUTE+ and CEORETENTION). We measure GOLDPARACHUTE+ as 1 when the CEO has a severance package greater than twice his current compensation, the industry norm, and CEORETENTION as 1 if there is any form of retention (COB, CEO, director, consultant).

Efficiency perspective

Actual costs, benefits of the transaction and private information acquisition

The proxy for the level of expenses to be incurred by the bidder is the estimate of expenses disclosed in the takeover proxy circular, scaled by deal value (EXPVAL). The proxy for the level of information asymmetry between the target and outside investors is the target firms' market to book value (Bates and Lemmon, 2003). The market to book ratio for target firms are obtained from *Compustat* at the end of the year preceding the deal (MBRATIO). Further, second bidders should have benefited from the initial information generated from the initial bid and should have lower informational costs (SECONDBIDDER).

We include two dummy variables to proxy for the operational and financial synergies derived from the business combination. The first variable takes a value of 1 if the board discloses that operational synergies are expected benefit from the transaction, and 0 otherwise (OPSYN). The second variable takes a value of 1 if the board considers financial synergies as an expected benefit from the deal, and 0 otherwise (FINSYN). These two types of benefits can be clearly identified from the disclosure provided in the takeover proxy circular. We also include a dummy variable to capture relatedness (RELATED) when target and acquirer have the same SIC codes.

We include a continuous variable for the premium paid to target shareholders (PREMIUM). In most cases, the premium is supplied by the Thomson SDC database and is

disclosed in the takeover proxy circular. Nevertheless, we recalculate the premium as the consideration paid to target shareholders minus the target firm share price the day prior to the announcement (or first announcement in the case of second bids) and divided by this share price.¹² We also use a dummy variable that takes the value of 1 for cash deals (CASH), a dummy that takes 1 if the deal is a tender offer (TENDER) and a dummy that takes 1 if we have a toehold (TOEHOLD), and 0 otherwise. We also measure continuous variable for cash used and level of toehold (CASH% and TOEHOLD%).

Control variables

Coates and Subramanian (2000) suggest that the relative deal size can influence the presence or absence of a termination fee. We measure this by the log of the ratio of acquiring firm total assets to target firm total assets (LNRELSIZE). We also control for market timing, similar to Boone and Mulherin (2006), by having a dummy variable which takes to value of 1 if the deal is announced in 1997-2000 and zero if announced in 2001-2004 (BOOMBUST). Further, the Canadian economy is dominated by energy firms (96 cases or 44% of sample) so we control for this by including a dummy variable labelled ENERGY.

V. RESULTS

Descriptive Statistics

Our final sample includes 218 transactions with kill fees. Figure 1 presents the distribution of termination fee as a percentage of deal value (TFVAL). Most termination fees to deal value are in the 2 to 6 percent range (over 80% of cases). The distribution is comparable to that of Coates and Subramanian (2000) showing that the ratio of the termination fee to deal value mostly varies between 1 to 5 percent of deal value. Table 2a presents the top 20 highest termination fees, while table 2b and 2c shows the incidence and relative value of target termination fees by year and industry.

[Table 2a, b and c]

The highest termination fee ever registered in a Canadian deal was 1.17 billion dollars in the Seagram-Vivendi deal. Termination fees in the other top 20 deals range from 120 to 548 million. The relative termination fees vary from 1% to 5% of deal value. Table 2b shows

¹² We also considered other measures such as the difference in days +1 and -1, days -20 and +1 and days -20 and +20. Results, not reported, were qualitatively similar.

that the transactions are evenly spread across the period 1997-2004. The number of transactions in the overall sample peaked at 52 in the year 2000, the end of the second mergers and acquisitions wave in Canada. This trend is in line with that depicted by Officer (2003), Bates and Lemmon (2003) and Coates and Subramanian (2000) in the US. Slightly more than half the deals (111 deals) are in the 1997-2000 M&A wave that coincided with the boom market. Table 2c present results by industry. Excluding the two smallest sectors, relative fees range between 3.2% and 3.9%.

The data in tables 3 provides descriptive statistics for deal value (VAL), in addition to termination fee and fees and expenses as a percentage of deal value.

[Table 3]

Average (median) deal value is 700.39 million Canadian (102.17) and bidders are between 3 to 4 times larger than targets. The relative termination fees vary between 0.39% and 8.49% of deal value with an average (median) of 3.55% (3.50%). These percentages are somewhat comparable to those documented by Coates and Subramanian (2000) and Bates and Lemmon (2003), though they are considered to be large as per guidelines set by institutional investors. Merger costs are on average 1.68% (median of 1.30%) of deal value. This suggests that the rationale for termination fees extends beyond fair reimbursement of out-of-pocket expenses by unsuccessful bidders.

Table 3 and table 4 present descriptive data on the other explanatory variables. Examining the efficiency variables, we note that more than 32% of transactions are cash deals and more than 59% of deal documents suggest operational synergies while 53.2% suggest financial synergies. Acquiring firms are second bidders in 11% of deals. The average (median) premium is 31.6% (24.1%). Target's market-to-book ratio is on average 2.05 (median 1.66).

Looking at agency type variables, we see that 38.1% of targets have a large family shareholder with an average holding of 32.8% (median of 27.5%). Targets have financial block holders in 38.5% of cases with an average (median) holding of 19.5% (14.7%). Targets also have non family CEO block holdings in 74.8% of cases with an average (median) holding of 2.0% (1.2%). The target's boards include 70.6% of outsiders (median of 70.5%). Further, 45.9% of target CEOs have golden parachutes paying more than 2 times salaries (the norm) and only 11.9% retain a position in the acquiring firm.

[Table 4]

Univariate analysis

Table 4 provides further analysis of the difference in the relative level of termination fees for the dummy variables. Examining the efficiency variables, we note that cash deals have higher termination fees (4.164% vs. 3.258%) as expected. Termination fees do not differ whether operational synergies (OPSYN) are expected or not, but they are lower when financial synergies (FINSYN) are said to be an objective of the deal. Break fees are also higher when we have tender offers but are not significantly different for first or second bidders or for related or unrelated deals. While kill fees are higher for firms where bidders have a toehold (4.119% vs. 3.497%), the difference is not significant using a Kruskal-Wallis non parametric test.

When analyzing the agency dichotomy variables, we see that relative termination fees are greater when we have a family block holding (3.975% vs. 3.288%) but they do not differ when we have a financial block holder or non family CEO block holdings, when we have separation of control and ownership, when CEOs retain a position in the acquiring firm or when CEOs have high golden parachutes in the year preceding the deal.

Table 5 shows a partial correlation matrix of TFVAL with the variables used in the analysis. Key relations emerge. The ratio of termination fee to deal value (TFVAL) is positively and significantly correlated with the fees and expenses as a percentage of deal value (EXPVAL) as suggested above (H2). Thus, and in line with the efficiency perspective, target firms management and directors set termination fees in a way that allows the recovery of the fees and expenses incurred by acquiring firms. Termination fee as a percentage of deal value is also positively correlated with another set of efficiency proxy, cash and level of cash consideration (H6). The correlation coefficient is negative and significant with suggested financial synergies. TFVAL is also statistically positively correlated with tender offers (H9). Contrary to H8, TFVAL is negatively correlated with both the level and presence of toeholds. Further examination of the 18 cases with such toeholds show that many are large financial block holders attempting to gain control of the firms: going-private type deals.

[Table 5]

The correlation matrix shows that TFVAL is negatively correlated with the percentage of unrelated directors serving on target firms' boards of directors, outsiders appear

to moderate the level of break fees. On the other hand, the presence and level of family block holding is positively correlated with relative termination fees. It seems to reflect an offer/demand for a lock up from this crucial player in the decision process. TFVAL is not significantly correlated with financial block holdings or the presence of separation of control and ownership rights. Overall, univariate tests support the link between some efficiency variables and termination fees (relative expenses and cash deals) and lower fees when outsiders are present.

Multivariate analysis: OLS

To examine the determinants of relative level of termination fees (TFVAL), we run three models. The first model uses dummy variables for cash, ownership measures and toehold whereas the second model includes the level of cash used and of the toeholds and introduces ownership percentages. The third model controls for potential non linearities in the ownership variables. The results for the OLS regressions are shown in table 6 with clustered robust standard error estimates to control for multiple acquirers. The models are significant (F statistics of 4.26, 4.08 and 4.87) and explain 27-29 percent of the variation in the termination fee to deal value.

Results support most of our efficiency hypotheses. Relative termination fees are significantly and positively related to the relative merger costs (H2: 0.216 in model 1, 0.246 in model 2 and 0.244 in model 3; $p < 0.01$) which is consistent with proponents arguing that break fees are to cover costs related to the deal. TFVAL is also positively related to deals suggesting operational synergies (H4: 0.265, 0.301 and 0.318; $p < 0.10$) which is consistent with termination fees being related to the benefits from the deal but also real and opportunity costs. Disclosing operating synergies supplies the market with new information that others could free ride upon and losing the deals entails switching costs such as strategic reorientation and abandoning restructuring in process. RELATED is also positively related to fees in Model 2 and 3. Inversely, financially motivated deals command lower kill fees. Cash deals, as measured by CASH and CASH%, also have a positive impact on break fees (H6: 0.265, 0.006 and 0.006; $p < 0.01$) which is consistent the positive signalling aspect of the consideration used but also real costs that come from setting up the financing facilities to execute such a deal.

There is no significant relation between the extent of private information (as proxied by the market to book ratio, H3)¹³, relatedness of the deal or tender offers (H9) or the fee being negotiated with a second bidder (H7), although the latter three have the expected sign. Surprisingly, toehold% is positively related to break fees (contrary to H8) but, as discussed above, it appears that many of the 18 toehold cases are financial block holders taking the firms private.

[Table 6]

In line with our agency related hypothesis (H1), the coefficient for the percentage of outside directors (-1.042, -1.079 and -1.048; $p > 0.05$) is negative and significant. This suggests that outside directors' monitoring role moderate the relative level of termination fees. Analysis of the ownership variables reveals a consistent pattern. The presence of block holdings is positively related to relative termination fees, although, only significant in the case of family blocks. When we introduce the actual percentage of ownership and ownership squared to account for potential non linearities, we again find that family ownership is positively related to relative termination fees. However, break fees start decreasing at a certain point for larger block holdings but it is not significant. We calculate the break point for family block holdings around 65.7% (only eight cases above this threshold). This could be viewed as an effect of greater monitoring. However, this is also consistent with evidence (Boone and Mulherin 2006) showing that bidders obtain binding commitments from large shareholders to vote in favour of the deal or to tender their shares. Such agreements with a very large controlling block holder reduce the risks that deals will not be completed.

There is weak evidence that managers may trade off retention against higher break fees (models 2 and 3). However, high CEO golden parachute provisions (greater than twice compensation which is the generally the norm in executive contracts in Canada) or SECONBIDDER (the white knight scenario) are not significantly related to the relative termination fee.

Multivariate analysis: Premium and the endogeneity issue

Premium is not significantly related to relative termination fees. One possible explanation is that break fees and premiums are unrelated. Another explanation is that both

¹³ We also used two other proxies suggested in the literature, a dummy for firms in high tech industries and the standard error of the market model estimation over days -159 to -40 prior to the announcement but results remain similar.

are optimally established during the negotiation process, leading to no relationship in the regression model. As suggested by certain authors (e.g., Bates and Lemmon 2003, Officer 2003, Leshem 2006), if break fees and the premium paid are determined jointly during the negotiation process leading to a proposed deal, then the models in table 6 are potentially misspecified. These authors set out to model a simultaneous equation system with relative break fees and premium and estimate these equations using 2SLS. Recent work by Larcker and Rusticus (2005) raise doubts as to the appropriateness of this technique in many accounting and finance settings. Given the difficulty in finding theoretically and empirically adequate instruments, 2SLS may not be superior to OLS. For example, Bates and Lemmon (2003) and Officer (2003) exclude the hostility variable from the premium regression (the order condition) but this is highly debatable. Further, they exclude pre-deal target characteristics (performance, leverage, volatility) from the break fee regression but these are only weakly significant in the premium regression (the rank condition).

We replicate this approach (excluding EXPVAL from the premium equation and pre-deal target characteristics from the relative break fee equation). Similarly, the pre-deal target instruments are only weakly significant. Results from the break fee regression are qualitatively similar to those from the OLS regression. Further, a Hausman test rejects differences between coefficients of the OLS and 2SLS regressions. Lacking any theoretical justification for any other instruments, we conclude that the 2SLS procedure does not provide better estimates than our OLS results in table 6. We are unable to differentiate between the two competing explanations for the lack of relationship between break fees and premium.¹⁴

Market reaction

In this final section of the study, we examine the market reaction to the deals analyses and examine whether markets participants discriminate based on the magnitude of break fees. If market participants view that break fees are hindering the auction process and potentially not generating the best deal or that they are opportunistically used by managers to appropriate some of the value of the firm, they should react negatively to these deals. It is impossible to fully test this assertion by comparing deals with and without break fees since we have demonstrated that the few deals without such fees are of a different nature: hostile, thus precluding break fees or deals where the bidder is a large industrial block holder (large toehold). We therefore examine the market's reaction to deals with varying levels of break

¹⁴ In both the OLS and 2SLS regressions, premiums are higher in larger deals and in second bids but lower in energy sector deals.

fees by splitting up the sample based on the median break fee level (3.39%) and by comparing the first quartile (lower than 1.88%) and 4th quartile (greater than 4.23%)¹⁵. Figure 2 graphically presents the cumulative abnormal returns (CAR) over the period ranging from 20 days prior to the deal announcement to 20 days. We present the CAR for the entire break fee sample and for these sub samples. Table 8 presents statistical tests of the CAR over the 3-day period (-1, +1) and the 41-day period (-20, +20) and tests of mean differences across sub-samples.

[Figure 2 and Table 7]

On average, Canadian target shareholders get 14.7% abnormal returns¹⁶¹⁷ over the 3-day period (-1, +1) around the announcement and 21.7% over the 41-day period (-20, +20) around the announcement. Results comparing break fees by sub-samples, above or below median TFVAL groups and 1st and 4th quartile groups, suggest that markets do not differentiate between deals having varying levels of break fees, *ceteris paribus*. There is weak evidence that the CAR(-20,+20) are greater for larger break fee deals. Overall, these results are also consistent with market participants viewing break fees as efficiently set in the negotiation period.

VI. CONCLUSION

Mergers and acquisitions have attracted considerable attention over the past two decades. Researchers in finance and economics have long examined various facets of business combinations including the method of payment, premiums paid, and the performance of the combined entity. Our paper contributes to this stream of research by examining termination fees in takeover deals, a recent development in friendly mergers and acquisitions. While early papers examine the likelihood of deals having break fees, we show that all deals currently include such fees except for hostile deals or deals where the bidder has a large toehold. A number of important court cases in the mid-to-late 1990s confirmed to appropriateness of reasonable break fees but without setting a ‘magic number’. The purpose of our study is to examine the magnitude of such fees. Except for Coates and Subramanian

¹⁵ We also looked at deals over 5%, a threshold often cited in the business press as being the upper limit for reasonable fees, although no regulation or court rulings set a magical number. Results are similar.

¹⁶ Announcement period abnormal returns are cumulated over (-1, +1) using the market model parameters estimated between -159 and -40 days.

¹⁷ As a sensitivity test, we also used raw returns and market adjusted returns (not tabulated) and found similar results.

(2000) examining an earlier US sample of deals with incomplete data, there are no other papers that examine the factors that determine the level of termination fees in friendly business transactions.

We integrate two theoretical frameworks to examine the association between agency and efficiency proxies and the magnitude of termination fees in Canadian friendly business combinations. Consistent with Officer (2003) and Bates and Lemmon (2003), our results provide support for the efficiency perspective. We find that termination fees are used as an efficient contractual device, where their magnitude is set rationally to account for the expenses incurred to conclude the transaction, the expected benefits from the proposed business combination and potential opportunity costs.

Our findings do not generally provide strong support for termination fees being a sign of agency problems; opportunistic managers trading higher break fees in exchange for side payments. Relative termination fees are not related to higher golden parachute or second bids and only weakly with CEO retention in the acquiring firm. They are not related to firms using dual class voting shares or pyramid structures to separate control and ownership rights, firms often criticized for poor governance. Termination fees are greater in the presence of family block holdings, likely denoting their crucial role in deal success. Also, outside board directors appear to moderate the level of fees.

While many shareholder groups have decried the increasing levels of termination fees, relative termination fees have not increased significantly in the 1997-2004 period, absolute termination fees may simply reflect the larger mergers and acquisitions experienced during this period and efficiency consideration remain important determinants of these fees. Break fees and premiums levels are not related which can suggest that they are jointly determined in an efficient manor during the negotiation process. As such, market participants do not appear to react differently to the level of relative termination fees in deals.

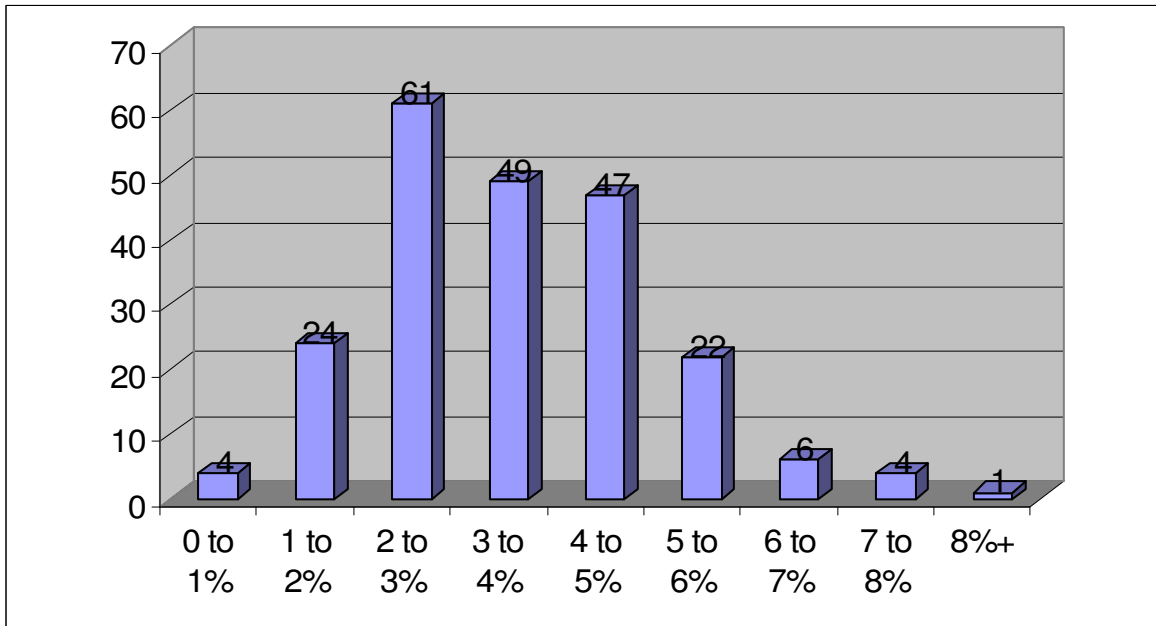
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Figure 1
Relative termination fee (TFVAL) distribution



TF/VAL Class	Number (%)
0% To 1%	4 (1.8%)
1% To 2%	24(11.0%)
2% To 3%	61 (28.0%)
3% To 4%	49 (22.5%)
4% To 5%	47 (21.6%)
5% To 6%	22 (10.1%)
6% To 7%	6 (2.8%)
7% To 8%	4 (1.8%)
More than 8%	1 (0.5%)
Total	218 (100%)

Figure 2
Cumulative abnormal returns by termination fee sub-samples

Sample of 218 M&A deals involving Canadian target firms with deal value over \$15 million and positive termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*. Announcement period abnormal returns are cumulated over (-1, +1) using the market model parameters estimated between -240 and -40 days. Sample split based on TFVAL median and quartiles.

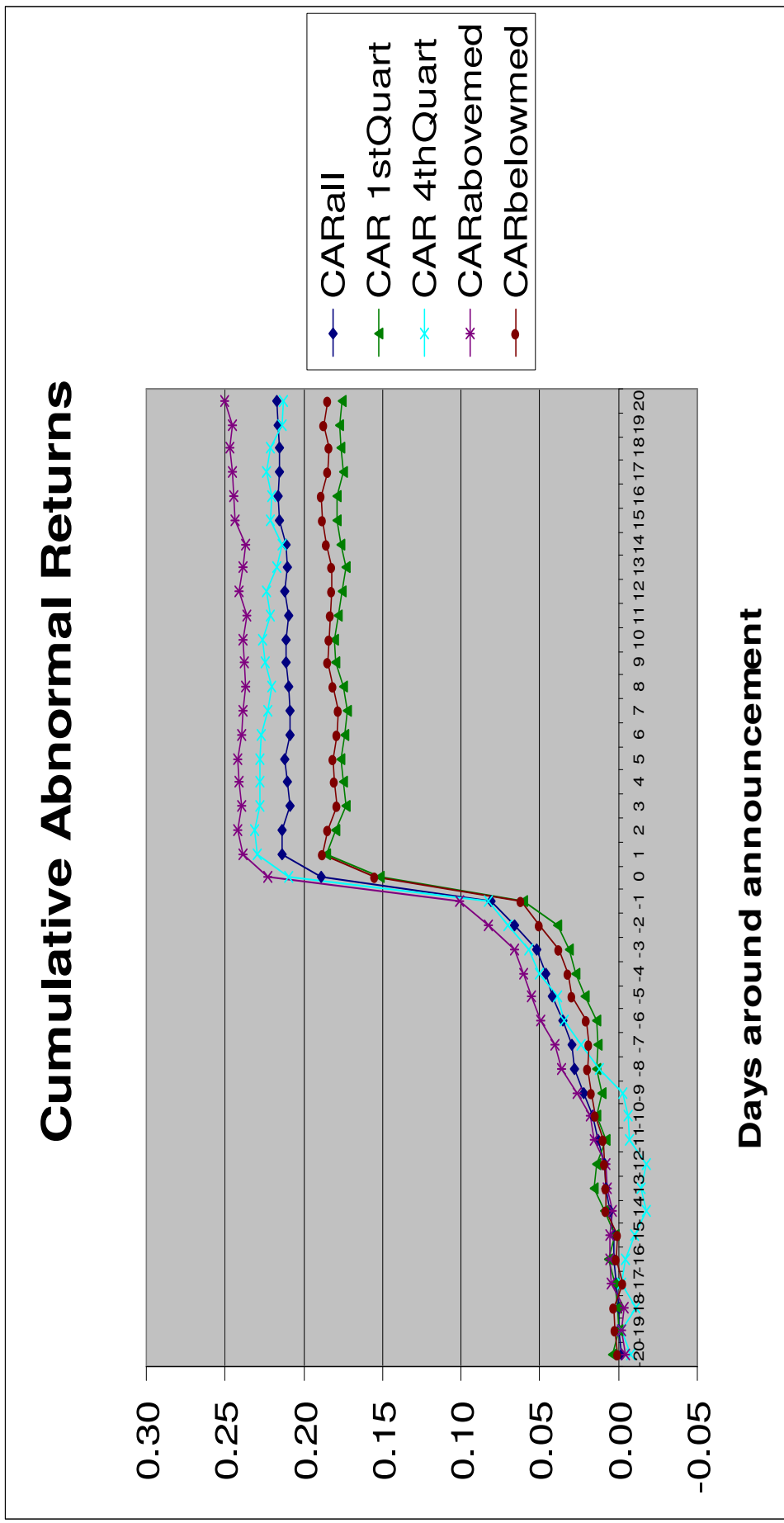


Table 1
Sample

	With Kill Fees	Without Kill Fees	Total
Initial Sample (Completed and uncompleted takeover deals involving a public Canadian target, worth over 15 million CAN, announced between 1997-2004 and with complete information set)	115 43.9%	147 56.1%	262 100%
Transactions coded in the Thomson Financial Securities Data's SDC Platinum TM <i>Worldwide Mergers & Acquisitions Database</i> as not having a kill fee but which were found to have a kill fee when proxy documents were analyzed	103	(103)	
Final sample	218 83.2%	44 16.8%	262 100%

Table 2a

Highest 20 termination fees in M&A deals involving Canadian target firms with a deal value over \$15million for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ Worldwide Mergers & Acquisitions Database

Date Announced	Date Effective	Target Name	Acquirer Name	Host Curr. Value of Deal (mil)	Host Curr Target's termination fee (mil)	TF/VAL
20/06/2000	08/12/2000	Seagram Co Ltd	Vivendi SA	59,296.26	1,173.37	1.98%
23/02/2000	25/05/2000	Newbridge Networks Corp	Alcatel SA	10,323.65	548.48	5.31%
23/01/1998	-	Bank of Montreal, Ontario, CA	Royal Bank of Canada	18,220.68	500.00	2.74%
17/04/1998	-	Toronto-Dominion Bank	Canadian Imperial Bk Commerce	22,072.30	400.00	1.81%
27/01/2002	05/04/2002	Alberta Energy Co Ltd	PanCanadian Energy Corp	9,811.95	350.00	3.57%
17/12/2001	29/05/2002	Clarica Life Insurance	Sun Life Finl Svcs of CA Inc	7,065.77	310.00	4.39%
17/02/2003	10/07/2003	Canada Life Financial Corp	Great-West Lifeco Inc	7,139.05	287.00	4.02%
25/03/2000	24/10/2000	Groupe Videotron Ltee	Investor Group	5,209.15	241.00	4.63%
07/02/2000	-	Groupe Videotron Ltee	Rogers Communications Inc	5,161.10	241.00	4.67%
29/05/2001	16/07/2001	Gulf Canada Resources Ltd	Conoco Northern Inc	9,738.62	220.00	2.26%
04/09/2001	08/11/2001	Anderson Exploration Ltd	Devon Energy Corp	7,116.69	210.00	2.95%
11/02/2000	22/06/2000	Donohue Inc	Abitibi-Consolidated Inc	6,982.93	200.00	2.86%
21/08/2000	12/01/2001	Clearnet Communications Inc	Telus Corp	6,697.70	184.00	2.75%
29/01/2001	18/05/2001	Mackenzie Financial Corp	Investors Group Inc	3,870.00	180.00	4.65%
26/01/1998	02/07/1998	NOVA Corp of Alberta Ltd	TransCanada Pipelines Ltd	7,126.00	175.00	2.46%
11/12/2000	11/05/2001	BioChem Pharma Inc	Shire Pharmaceuticals Grp PLC	5,716.21	167.79	2.94%
20/12/1999	-	Canadian National Railway Co	Burlington Northern Santa Fe	8,898.00	150.00	1.69%
08/03/1999	15/11/1999	Newcourt Credit Group Inc	CIT Group Holdings Inc	4,018.28	135.00	3.36%
26/01/1998	03/03/1998	Norcen Energy Resources Ltd	Union Pacific Resources Group	5,009.42	125.00	2.50%
20/09/2001	14/03/2002	Westcoast Energy Inc	Duke Energy Corp	11,661.17	120.00	1.03%

Table 2b Relative termination fees (TF/VAL) by year

Sample of 218 M&A deals involving Canadian target firms with a deal value over \$15million and a termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

Year	Number (%)	TF/VAL
1997	19 (8.7%)	3.441
1998	19 (8.7%)	3.046
1999	21 (9.6%)	3.551
2000	52 (23.9%)	3.471
2001	44 (20.2%)	3.998
2002	17 (7.8%)	3.460
2003	18 (8.3%)	3.208
2004	28 (12.8%)	3.674
ALL	218 (100%)	3.553

Table 2c Relative termination fees (TF/VAL) by industry

Sample of 218 M&A deals involving Canadian target firms with a deal value over \$15million and a termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

Year	Number (%)	TF/VAL
Consumer products and services	8 (3.7%)	3.692
Energy and Power	96 (44.0%)	3.553
Financial services	14 (6.4%)	3.636
Health	4 (1.8%)	4.487
High tech	23 (10.6%)	3.507
Industrials	19 (8.7%)	3.560
Materials	23 (10.6%)	3.206
Media	10 (4.6%)	3.852
Real estate	2 (0.9%)	1.644
Retail	5 (2.3%)	3.271
Consumer staples	8 (3.6%)	3.886
Telecommunications	6 (2.6%)	3.705
ALL	218 (100%)	3.553

Table 3
Descriptive statistics

Deal, governance and financial characteristics for 218 M&A deals involving Canadian target firms with a deal value over \$15million and a termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

	Mean	Median	Std. Dev	Minimum	Maximum
TFVAL	3.55	3.50	1.38	0.39	8.49
EXPVAL	1.68	1.30	1.38	0.07	7.01
CASH%	48.51	54.97	45.47	0.00	100.00
MBRATIO	2.05	1.66	1.65	0.12	9.71
OUTSIDERS	70.55	70.50	14.86	16.70	90.90
NONFAMCEOBLK%	1.49	0.48	2.20	0.00	9.75
(163 non zero cases)	2.00	1.16	2.33	0.01	9.75
FAMBLK%	12.86	0.00	20.50	0.00	76.00
(83 non zero cases)	33.76	27.50	19.94	10.90	76.00
FINBLK%	7.50	0.00	11.83	0.00	52.15
(84 non zero cases)	19.45	14.68	11.41	10.00	52.15
PREMIUM	31.58	24.07	42.32	-14.87	514.50
TOEHOLD%	0.89	0.00	3.61	0.00	22.00
LNRELSIZE	1.69	1.54	1.62	-1.47	7.52

TFVAL: termination fees to deal value in percent; EXPVAL: acquirer merger expenses to deal value in percent; CASH%: percentage of consideration paid cash; MBRATIO: target market-to-book ratio at the end of the year preceding the deal; OUTSIDERS: Percentage of outside directors on board; LNRELSIZE: Natural log of acquirer total assets divided by target total assets at the end of the year preceding the deal; PREMIUM: merger consideration over target one day pre-announcement price in percent; FAMBLK%: ownership stake of family block holder; FINBLK%: ownership stake of financial or industrial block holder; NONFAMCEOBLK%: ownership stake of non family CEO; TOEHOLD%: Level of the toehold held.

Table 4
Relative termination fees (TF/VAL) by Transaction and Firm Characteristics

218 M&A deals involving Canadian target firms with a deal value over \$15million and a termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

	N	Mean	Std. Dev.	t-stat ^{&}
Cash deal (CASH)				
Yes	70 (32.1%)	4.164	1.344	4.736***
No	148 (67.9%)	3.258	1.307	
Operational synergies (OPSYN)				
With	129 (59.2%)	3.432	1.254	1.512
Without	89 (40.8%)	3.719	1.541	
Financial synergies (FINSYN)				
With	116 (53.2%)	3.206	1.282	4.038***
Without	102 (46.8%)	3.938	1.395	
Non family CEO blockholding (NONFAMCEOBLK)				
With	163 (74.8%)	3.388	1.387	3.020***
Without	55 (25.2%)	4.026	1.264	
Individual/Family blockholding (FAMBLK)				
With	83 (38.1%)	3.975	1.387	3.662***
Without	135 (62.4%)	3.288	1.317	
Financial blockholding (FINBLK)				
With	84 (38.5%)	3.572	1.461	0.199
Without	134 (61.5%)	3.534	1.340	
Separation of ownership and control (SEPARATION)				
Yes	19 (8.7%)	3.834	1.327	0.942
No	199 (91.3%)	3.522	1.383	
GOLDPARACHUTE+				
With	100 (45.9%)	3.468	1.384	0.792
Without	118 (54.1%)	3.617	1.382	
CEORETENTION				
Yes	26 (11.9%)	3.533	1.586	0.065
No	192 (88.1%)	3.551	1.3574	
SECONDBIDDER				
Yes	24 (11.0%)	3.760	1.833	0.794
No	194 (89.0%)	3.523	1.320	
BOOMBUST				
Boom period (1997-2000)	111 (50.9%)	3.408	1.487	1.535
Bust period (2001-2004)	107 (49.1%)	3.695	1.255	

Table 4 (cont'd)
Relative termination fees (TF/VAL) by Transaction and Firm Characteristics

218 M&A deals involving Canadian target firms with a deal value over \$15million and a termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

	N	Mean	Std. Dev.	t-stat ^{&}
RELATED				
Yes	114 (52.3%)	3.609	1.254	0.681
No	104 (47.7%)	3.482	1.513	
TENDER				
Yes	106 (48.6%)	3.762	1.370	2.526***
No	112 (51.4%)	3.347	1.369	
TOEHOLD				
Yes	18 (8.3%)	4.119	2.049	1.836*
No	200 (93.6%)	3.497	1.301	
ENERGY				
Yes	96 (42.1%)	3.502	1.288	0.440
No	122 (57.9%)	3.585	1.458	

*** significant at the 1% level, ** significant at the 5% level, * significant at the 10% level. [&] A Krustal-Wallis non parametric test was also performed and gives similar inference except for BOOMBUST (significant at 5% level) and TOEHOLD (not significant).

CASH: Dummy equal 1 if the consideration paid involves cash; FINSYN: Dummy equals 1 if financial synergy is reported in the takeover circular as a deal benefit; OPSYN: Dummy equals 1 if operating synergy is reported in the takeover circular as a deal benefit; FAMBLK: Dummy equals 1 if a family block holder owns more than 10 % of the shares outstanding; FINBLK: Dummy equals 1 if a financial or industrial block holder owns more than 10 % of the shares outstanding; NONFAMCEOBLK: Dummy equals 1 if non family CEO owns a block of shares; SEPARATION: Dummy equal 1 if presence of dual class voting shares or pyramid structure leading to separation of control and ownership rights; GOLDPARACHUTE+: Dummy equals 1 if CEO has a change in control severance provision in the year preceding the deal; CEORETENTION: Dummy equals 1 if CEO retains a position in the acquiring firm; SECONDBIDDER: Dummy equal 1 if bidder is second bidder; BOOMBUST: Dummy equals 1 if deal announced in years 1997-2000 (boom years) and 0 if announced in years 2001-2004; TENDER: Dummy equals one if tender offer; RELATED: Dummy equal 1 if both target and acquirer have same SIC industry code; TOEHOLD: Dummy equals 1 if toehold; ENERGY: Dummy equals 1 if firm is in the energy sector.

Table 5
Partial Correlation matrix

Sample of 218 M&A deals involving Canadian target firms with deal value over \$15 million and a termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

	TFVAL
CASH	0.306***
CASH%	0.284***
MBRATIO	-0.045
FINSYN	-0.265***
OPSYN	-0.102
EXPVAL	0.295***
SECONDBIDDER	0.054
PREMIUM	0.035
TENDER	0.151**
RELATED	0.046
TOEHOLD	0.124*
TOEHOLD%	0.171**
FAMBLK	0.242***
FAMBLK%	0.264***
FINBLK	0.014
FINBLK%	-0.020
NONFAMCEOBLK	-0.201***
NONFAMCEOBLK%	-0.031
SEPARATION	0.064
SEPARATION%	0.053
OUTSIDERS	-0.178***
GOLDPARACHUTE+	-0.054
CEORETENTION	-0.004
LNRELSIZE	0.154**
ENERGY	-0.029
BOOMBUST	-0.104

Pearson correlations. *** Correlation is significant at the 0.01, 0.05 level (2-tailed). ** Correlation is significant at the 0.05 level (2-tailed).

TFVAL: Termination fees to deal value in percent; CASH: Dummy equal 1 if cash deal; CASH%: percentage of consideration paid cash; MBRATIO: Target market-to-book ratio at the end of the year preceding the deal; FINSYN: Dummy equals 1 if financial synergy is reported in the takeover circular as a deal benefit; OPSYN: Dummy equals 1 if operating synergy is reported in the takeover circular as a deal benefit; EXPVAL: Acquirer merger expenses to deal value in percent; SECONDBIDDER: Dummy equal 1 if bidder is second bidder; PREMIUM: Merger consideration over target one day pre-announcement price in percent; TENDER: Dummy equals 1 if tender offer; RELATED: Dummy equals 1 if both target and acquirer are from the same industry; TOEHOLD: Dummy equals 1 if acquirers has a toehold in the target; TOEHOLD%: Level of the toehold held; FAMBLK: Dummy equals 1 if a family block holder owns more than 10 % of the shares outstanding; FAMBLK%: Ownership stake of family block holder; FINBLK: Dummy equals 1 if a financial or industrial block holder owns more than 10 % of the shares outstanding; FINBLK%: Ownership stake of financial or industrial block holders; NONFAMCEOBLK: Dummy equals 1 if non family CEO owns a block of shares; NONFAMCEOBLK%: ownership stake of non family CEO; SEPARATION equals 1 if there is presence of dual class voting shares or pyramid structure leading to separation of control and ownership rights; SEPARATION%: Control rights divided by ownership rights; OUTSIDERS: Percentage of outside directors on board; GOLDPARACHUTE+: Dummy equals 1 if CEO has a high severance provision (more than twice compensation) in the year preceding the deal; CEORETENTION: Dummy equals 1 if CEO retains a position in the acquiring firm; LNRELSIZE: Natural log of acquirer total assets divided by target total assets at the end of the year preceding the deal; ENERGY: Dummy equals 1 if firm is in energy sector; BOOMBUST: Dummy equals 1 if deal announced in years 1997-2000 (boom years) and 0 if announced in years 2001-2004.

Table 6
Multivariable Regression Analysis of the determinants of relative termination fees for all deals

Dependent variable: TFVAL

Sample of 228 M&A deals involving Canadian target firms with deal value over \$15 million and positive termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*

		Model 1	Model 2	Model 3
CASH	+	0.792***		
CASH%	+		0.006***	0.006***
MBRATIO	+	-0.018	-0.036	-0.032
FINSYN	?	-0.544***	-0.475***	-0.494***
OPSYN	+	0.265*	0.301*	0.318*
EXPVAL	+	0.216***	0.246***	0.244***
SECONDBIDDER	-	0.267	0.056	0.082
PREMIUM	?	0.012	0.006	-0.002
TENDER	+	0.022	0.026	-0.004
RELATED	+	0.195	0.227*	0.228*
TOEHOLD	-	0.467		
TOEHOLD%	-		0.057*	0.055*
FAMBLK		0.404*		
FAMBLK%			1.014**	2.003*
FAMBLK% ²				-1.524
FINBLK		0.087		
FINBLK%			0.497	1.518
FINBLK% ²				-2.748
NONFAMCEOBLK		-0.260		
NONFAMCEOBLK%			0.143	9.031
NONFAMCEOBLK% ²				-11.122
SEPARATION		0.156		
SEPARATION%			0.078	0.079
OUTSIDERS	-	-1.042**	-1.079**	-1.048**
GOLDPARACHUTE+	+	0.143	0.112	0.109
CEORETENTION	+	0.378	0.396*	0.394*
LNRELSIZE		0.039	0.045	0.040
ENERGY	-	0.282	0.171	0.156
BOOMBUST		-0.323*	-0.349*	-0.328*
INTERCEPT		3.525***	3.218***	3.101***
F Statistic		4.26***	4.08***	4.87***
R ²		29.3	27.8	28.3

* p<0.10, ** p<0.05, *** p<0.01 significance, clustered robust standard errors (185 acquirers), one tail when signed

TFVAL: Termination fees to deal value in percent; CASH: Dummy equal 1 if cash deal; CASH%: percentage of consideration paid cash; MBRATIO: Target market-to-book ratio at the end of the year preceding the deal; FINSYN: Dummy equals 1 if financial synergy is reported in the takeover circular as a deal benefit; OPSYN: Dummy equals 1 if operating synergy is reported in the takeover circular as a deal benefit; EXPVAL: Acquirer merger expenses to deal value in percent; SECONDBIDDER: Dummy equal 1 if bidder is second bidder; PREMIUM: Merger consideration over target one day pre-announcement price in percent; TENDER: Dummy equals 1 if tender offer; RELATED: Dummy equals 1 if both target and acquirer are from the same industry; TOEHOLD: Dummy equals 1 if acquirers has a toehold in the target;

TOEHOLD%: Level of the toehold held; FAMBLK: Dummy equals 1 if a family block holder owns more than 10 % of the shares outstanding; FAMBLK%: Ownership stake of family block holder; FAMBLK%²: ownership stake of family block holder squared; FINBLK: Dummy equals 1 if a financial or industrial block holder owns more than 10 % of the shares outstanding; FINBLK%: Ownership stake of financial or industrial block holders; FINBLK%²: Ownership stake of financial or industrial block holders squared; NONFAMCEOBLK: Dummy equals 1 if non family CEO owns a block of shares; NONFAMCEOBLK%: ownership stake of non family CEO; NONFAMCEOBLK%²: Ownership stake of non family CEO squared; SEPARATION equals 1 if there is presence of dual class voting shares or pyramid structure leading to separation of control and ownership rights; SEPARATION%: Control rights divided by ownership rights; OUTSIDERS: Percentage of outside directors on board; GOLDPARACHUTE+: Dummy equals 1 if CEO has a high severance provision (more than twice compensation) in the year preceding the deal; CEORETENTION: Dummy equals 1 if CEO retains a position in the acquiring firm; LNRELSIZE: Natural log of acquirer total assets divided by target total assets at the end of the year preceding the deal; ENERGY: Dummy equals 1 if firm is in energy sector; BOOMBUST: Dummy equals 1 if deal announced in years 1997-2000 (boom years) and 0 if announced in years 2001-2004.

Table 7
Cumulative abnormal returns by termination fee sub-samples

Sample of 218 M&A deals involving Canadian target firms with deal value over \$15 million and positive termination fee for the period 1997-2004 obtained from the Thomson Financial Securities Data's SDC PlatinumTM *Worldwide Mergers & Acquisitions Database* having deal documents on *SEDAR.ca* and stock data on *Datastream*. Announcement period abnormal returns are cumulated over (-1, +1) using the market model parameters estimated between -159 and -40 days. Sample split based on TFVAL median and quartiles. *** significant at the 1% level, ** significant at the 5% level, * significant at the 10% level.

	N	CAR (-1,+1)	t stat	t test of differences	CAR (-20,+20)	t stat	t test of differences
All	218	0.1470	32.38***			0.2173	
Below median	109	0.1382	18.87***	0.806	0.1845	6.82***	1.697*
Above median	109	0.1557	21.73***		0.2501	9.44***	
Top quartile	53	0.1590	15.72***	-0.403	0.2127	5.69***	-0.665
Bottom quartile	54	0.1473	15.85***		0.1752	5.10***	