Volume Title: Regulation vs. Litigation: Perspectives from Economics and Law

Volume Author/Editor: Daniel P. Kessler, editor

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-43218-1
ISBN13: 978-0-226-43218-2

Volume URL: http://www.nber.org/books/kess09-1

Conference Date: September 11-12, 2009

Publication Date: December 2010

Chapter Title: M&A Break Fees: U.S. Litigation versus UK Regulation

Chapter Authors: John C. Coates IV

Chapter URL: http://www.nber.org/chapters/c11961

Chapter pages in book: (239 - 284)

9

M&A Break Fees
U.S. Litigation versus UK Regulation

John C. Coates IV

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

Any comparison of law in two countries faces a serious omitted variable problem, and one can only generalize so far about trade-offs between litigation and regulation from one law. Still, a comparison of deal protection in the United Kingdom and the United States should yield some information.

John C. Coates IV is the John F. Cogan Jr. Professor of Law and Economics at Harvard Law School.

I extend thanks for comments and discussions to Dan Kessler, Andrei Shleifer, Luigi Zingales, Fred Schauer, Anup Malani, John Donohue, and other participants in the NBER Regulation and Litigation Conference, the Harvard Law School Law and Economics Workshop, Guhan Subramanian, Jennifer Arlen, Paul Davies, and John Armour.

The two nations have similarly active M&A markets, with a large number of bids for public companies comprising 75 percent of worldwide bid volume (Rossi and Volpin 2004). They have similar corporate governance systems (e.g., Kraakman et al. 2009), with large companies and dispersed ownership (e.g., La Porta, Lopez-de-Silanes, and Shleifer 1999), which (as discussed later) generates the need for deal protection. And they have shared political, legal, and cultural traditions (U.S. State Department 2009), including M&A practitioners that work in both nations. The topic should also be of independent value to those who study or work in the M&A markets: deal protection is used regularly in friendly M&A, which is far more prevalent and may be more economically important than hostile bids.

Section 9.1 briefly reviews relevant literatures on (a) regulation and litigation, (b) the evolution of laws over time, and (c) deal protection, including the reasons deal protection contracts are used. Section 9.1 also briefly describes the legal treatment of break fees in the United Kingdom and the United States, and conjectures why the nations have diverged in this aspect of capital markets governance. Section 9.2 summarizes data, including break fees, on large friendly control bids for nonfinancial targets drawn from Thomson, representing approximately 50 percent of total bid volume in the United States and United Kingdom over the past twenty years. Trends in the size of break fees in the United States and the United Kingdom are depicted against the backdrop of changes in regulation of break fees. Section 9.3 then relates break fee size to rates of deal competition and deal completion, two deal outcome variables that break fees are intended to affect. Univariate and multivariate results are presented, and the robustness of the findings is tested with alternative specifications. Section 9.4 concludes with observations on trade-offs between litigation and regulation and the evolution of law more generally.

9.1 Prior Literature

9.1.1 Regulation and Litigation

A growing literature in economics and law recognizes and explores trade-offs in different modes of political governance of economic activity.[1] One mode, associated with classical liberalism, is for the state to assign clear property rights ex ante, permit private parties to write their own legal rules through contracts, enforce those contracts through privately initiated lawsuits heard by independent courts, and otherwise refrain from interfering with production or trade. Because this mode of governance relies on court

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

enforcement of property and contract rights, it is often identified as "*litigation.*" A second mode, associated with political reactions to industrialization in the late nineteenth and twentieth centuries, is for the state to establish expert regulatory agencies, subject to political control, which "regulate" economic activity through explicit ex ante controls, enforce those controls directly with criminal or civil penalties imposed by state-controlled enforcement agencies, subject to judicial oversight and override, and forbid or control private contracts. This mode is often identified as "*regulation.*"

Ex ante Rules versus Ex Post Standards

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

Given rational expectations, the timing of lawmaking matters because agents can better estimate their entitlements under regulation than under litigation. If they could perfectly foresee how courts would apply law to given facts, or if their ability to predict application of law to their behavior was invariant as between regulation and litigation, there would be no difference between litigation and regulation as a result of the timing of lawmaking and enforcement.[2] Research on litigation and regulation conceived

2. Other differences between the two general modes of lawmaking, such as expertise or political control of lawmakers or law enforcers, might still matter. If judges are generalists, and regulatory agencies specialists, for example, the latter may have expertise that may be beneficial (Landis 1938; Glaeser, Johnson, and Shleifer 2001). But courts can be (and often are) specialized (e.g., Revesz [1990], who discusses twelve specialized Federal courts in the United States, and Dreyfuss [1995], who discusses the Delaware Chancery Court, which specializes in business litigation). If regulatory agencies are subject to more and courts less political control, the latter could more optimally address harms imposed by politically powerful agents on politically

this way is related to a separate line of legal research that also describes trade-offs between ex ante specification of law ("rules") and ex post application of general laws to specific facts ("standards") (von Jhering 1883; Ehrlich and Posner 1974). That literature recognizes that courts sometimes develop "rules" that function much as do regulations (e.g., contracts cannot be enforced against persons under the age of eighteen), and emphasizes that such rules specified ex ante—whether by courts *or* regulatory agencies—increase certainty and reduce the costs of legal advice and adjudication ex post, but are more costly to enact (Kaplow 1992) and more frequently lead to specific case outcomes that reduce welfare, by being both over- and under-inclusive (Kennedy 1976), particularly when they will apply over a broad range of behaviors over a long period of time, or where lawmakers' information is limited (Sunstein 1995).

Regulation of M&A: Mandatory versus Default Law

Another use of "regulation" is relevant in the context of corporate and securities laws governing M&A. Legal scholars have long argued over whether those bodies of law are or should be mandatory ("regulatory") or optional ("default" rules) (e.g., Bebchuk 1989). Should use of the corporate form—or the raising of capital from dispersed investors—trigger laws that can be freely tailored through the corporate charter or bylaws or contract, or should they be binding? And if binding, should they be binding with respect to issues other than fraud? Laws that are "regulatory" in this sense are not necessarily clear ex ante rules, and they may require ex post litigation to clarify their meaning as well as for enforcement; in effect, the content of key M&A contracts, including the risk of litigation, may be imposed by regulation.

Legal scholars tend to classify laws as mandatory or default formally, based on whether they expressly permit companies to "opt out" of their provisions. But many laws relevant to M&A that are, on their face, "regulatory" in this sense can, with some ingenuity and effort, be "contracted around."[3] But "opt outs" of such core elements of corporate law are rare in the United

weak agents (Pace et al. 2007; Cook and Ludwig 2002). But in the United States, at least, many regulatory agencies (e.g., the Federal Reserve Board) are arguably subject to weaker political control than judges, who are elected in most states Rottman (2000), and precisely the opposite argument has been made in favor of regulation on the ground that judges or law enforcers required to impose large ex post fines may be more vulnerable to persuasion or bribery (Becker and Stigler 1974; Glaeser and Shleifer 2003).

3. For example, every U.S. state provides that, with board approval, a majority of shareholders may approve a merger with another corporation, and in the merger dissenting shareholders will have a choice of accepting the merger consideration or cash at a "fair value" set ex post by a court. In effect, shareholders can have their shares converted into cash by majority vote through merger. Coates (1999) shows that the risk of such ex post litigation can be eliminated by contract. Further, the ability of a majority of shareholders to force through a merger could be eliminated by contract—a corporate charter could, for example, require unanimous shareholder approval of a merger.

States, possibly because of transaction costs exacerbated by network effects (Coates 1999). In practice, laws that are formally mandatory may not bind, and laws that are formally default rules may bind. Key aspects of M&A law are, in practice, "regulatory" in the sense specified earlier—there are clear ex ante rules that typically structure the deal process. They are not "regulatory" in a formal sense, in that they can be contracted around. But in practice, they rarely are.

An important set of examples for U.S. M&A practice arises from the "fiduciary duties" applicable to corporate directors and officers. Fiduciary duty law is widely thought to represent an attempt to supplement private contract—not for any of the reasons just summarized for regulation, but because detailed specification of contracts ex ante is too expensive or in some cases impossible, whether because of imperfect information, collective action problems, or both. Fiduciary duty law is "regulatory" in the sense that, in general terms, private parties cannot opt out of it—it is binding on them whether they include it in their contracts or not, and often has a moral flavor similar to criminal laws. But it is enforced through private litigation ex post in courts; it remains relatively unspecified in detailed content until applied to specific facts (is a set of "standards"); and, in some particulars, it may be contracted around (e.g., Coates 1999). An overly strong distinction between litigation and regulation as modes of lawmaking may obscure the fact that many laws partake of both.

9.1.2 Evolution of Laws Over Time

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

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

Other conjectures about the evolution of law can be found in the aforementioned literatures. Sunstein (1995) claims that a system of rules entails "no rapid changes in the content of law," consistent with a common view that civil law is less flexible or adaptable than common law, and that regulation tends toward sclerosis. Rajan and Zingales (2003) argue that civil law countries (i.e., countries that rely on regulatory agencies subject to political controls as their primary means of lawmaking) can undergo more rapid and transformative legal changes in response to changes in private interests, than can the common law. This claim could be consistent with claims about regulatory sclerosis if, over periods of time, private interests remain stable, producing little change in a regulatory system, but occasionally, in response to factor, technological, or unrelated political shocks, private interests shift suddenly, leading to regulatory change that is more rapid and significant than could occur through litigation in a common law system. Kennedy (1986) suggests reasons (and offers some qualitative evidence) that rules and standards may cycle, evolving into the other over time: rules evolve into standards as the welfare loss commanded by a rule in a given case will induce a court to invent an exception, with the exceptions eventually swallowing the rule; conversely, standards induce rules, as private parties lobby for (or persuade courts to adopt) rules to assist them in planning.

Niblett, Posner, and Shleifer 2009 provide one of the few empirical tests of some of these claims by tracking the evolution of one aspect of U.S. tort law (the economic loss rule) from 1970 to 2005 and find that while the law did appear to converge toward one version of the rule in the first twenty-five years of their sample period, courts have begun to deviate and splinter in their approach to the rule—that is, the law did not converge to any stable resting point. This chapter attempts to provide another empirical test of theories of how common law evolves over time, in a different domain.

9.1.3 Deal Protection and Break Fees

In both the United Kingdom and the United States, M&A involving public company targets face a law-derived risk of noncompletion: (a) the law requires target shareholders to approve or accept a bid, either by tendering or voting; (b) compliance with disclosure and other laws governing the process of obtaining target shareholder tenders or votes entails delay, ranging from a minimum of thirty days up to six months in some situations;

and (c) target shareholders may decide not to accept or approve a bid for any reason, including a third-party bid that emerges after agreements for an initial bid are signed. In effect, an M&A agreement or bid gives shareholders of a public target an option to accept the bid, and does not effectively bind the target or its shareholders to the bid, even if approved by the target's ordinary agents (i.e., its board or officers).

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

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

Empirical research on break fees was initiated by Coates and Subramanian (2000), who studied break fees and other forms of deal protection granted by U.S. targets in friendly bids for control greater than $50 million in value in the period 1988 to 1999. They found that break fee size was dispersed and grew nonmonotonically throughout that period, ranging from 1 percent (twenty-fifth percentile) to 3 percent (seventy-fifth percentile) in 1988 and from 2 percent (twenty-fifth) to 4 percent (seventy-fifth) in 1999, consistent with a potential "Lake Woebegone effect," in which bidders sought a fee that was slightly larger than the average fee in a recent period sample, producing ever-increasing fees.[4] They also found that fee size correlated with court decisions, including 1994 and 1997 Delaware Supreme Court decisions in *Paramount* and *Brazen,* and with other bid characteristics, including larger bid size and the use of a tender offer by the bidder. They found, finally, in both univariate and multivariate tests, that the fact and size of break fees correlated with completion rates, both in general and conditional on publicly reported bid competition.

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

9.1.4 Legal Treatment of Break Fees

Why is deal protection regulated (or the subject of a special type of litigation)? There are three justifications for having special laws for break fees, one from antitrust theory, one from agency theory, and one from contract theory. First, they can deter bids, reduce competition, and reduce welfare

4. Boone and Mulherin (2007) find (and André, Khalil, and Magnan [2007] confirm) that Thomson's data on break fee *incidence* is biased in several respects: first, there is a general underreporting of fees and other forms of deal protection, relative to what is revealed by a careful review of SEC filings; second, there is a greater underreporting earlier in time, creating the spurious impression of time trends in fee incidence; and third, there is greater underreporting for smaller bids, creating the spurious impression of a relationship between toeholds and break fees. Since these biases emerge from underreporting by Thomson, they should not affect data on fee *size,* since such data is only available where Thomson reports fee data. They also confirm the finding, reported in Coates and Subramanian (2000), that fee incidence increased significantly after the 1994 Delaware Supreme Court decision in *Paramount.*

by allowing the target to be transferred to a lower-valuing bidder. In the presence of market power, contracts between a bidder and target (such as break fees) can impose externalities on other bidders and reduce social welfare because they both deter breach and reduce the benefits of search (see Diamond and Maskin 1979; Aghion and Bolton 1987). Second, for public targets, the "owners" of the target are dispersed shareholders, who cannot effectively represent themselves in the sales process. Target managers effectively choose among bidders in the first instance, subject to shareholder approval. Target manager preferences over bidders, moreover, can be expected to systematically differ from those of target shareholders. Traditional fiduciary duty law would thus constrain, to some extent, target managers' ability to use break fees to favor one bidder over another, absent a justification, particularly if the target managers had some evident tangible interest in the choice, such as a better job or severance package. Third and finally, there is a broader justification rooted in the basic structure of corporate law common to the United Kingdom and its former colonies, which is that a fee cannot be so large as to essentially eliminate the option target shareholders have to accept or reject the bid. Put differently, even if there is no specific concern about target managers in the context of a particular bid, a law permitting any and all break fees to be enforced would crucially undermine more generally laws requiring shareholder consent for sale of the company. One can view limits on break fees as reflecting an implicit term in the underlying contract between a target and its investors. Those more general laws can be justified on contract grounds—they were part of the bargain by virtue of being part of corporate law at the time investors purchased stock in a company—and on efficiency grounds—shareholder approval or consent requirements constrain agency costs in general, even if they are unnecessary or even inefficiently costly for a given company with given managers in the context of a given bid. For any or all of these reasons, the law in both the United States and the United Kingdom constrains break fees. But it does so differently in each nation.

UK Regulation of Break Fees

In the UK, break fees are constrained in theory by three sets of laws, but in practice only two are binding, and both have identical effects (Davies and Palmer 2004; Montgomery, Davies, and Palmer 2005). The Takeover Code limits break fees to 1 percent of the value of the bid.[5] That Code was originally a set of rules self-imposed by major institutional participants in the city, including representatives of the Bank of England, the London Stock Exchange (LSE), leading merchant banks, and organizations representing institutional investors, and is now statutorily binding on all tender offers

5. The Panel on Takeovers and Mergers, the Takeover Code § 21.2.

for public companies in the United Kingdom, by virtue of the UK's implementation of the EU-wide Takeover Directive.[6] Prior to 2006, the Takeover Code did not formally have the force of law, but was practically binding (Armour and Skeel 2007; Tarbert 2003), in part because UK courts deferred to its judgments because they recognized that the United Kingdom's formal regulatory bodies (the Department of Trade and Industry and the Bank of England) had sponsored its formation.[7] The direct sanction for flouting its requirements was expulsion from the LSE and trade organizations representing institutional investors, disinvestment by the British institutional investor community (who were required by the terms of the Code to divest from anyone breaking the Code), and an inability to obtain services or other assistance from others subject to the Code. In essence, Code enforcement piggy-backed on private organizations and relationships that would be considered essential for ongoing business activities in the United Kingdom.

Currently, the Takeover Panel, responsible for interpreting and resolving disputes under the Takeover Code, includes members nominated by trade organizations of insurance companies, investment companies, investment managers and brokers, commercial and investment bankers, industrial companies, accountants, and pension funds, and those members also constitute a majority of the members of the Hearing Committee, which hears disputes and imposes sanctions under the Code.[8] It is thus an "expert" regulatory body. But as long as it retains its public, bright-line character and is backed by the threat of significant sanctions, UK law on break fees functions as a self-enforcing bright-line rule that requires no ongoing expertise. In principle, the Takeover Panel could raise or lower the cap over time, in response to changing market conditions or evidence regarding the welfare or other effects of break fees, but they have not done so in the ten years since the rule was first formally adopted.[9] Few if any disputes concerning the rule's

6. European Parliament and Council Directive 2004/05, 2004 O.J. (L142) 12 (EC), art. 4 (supervisory authorities may include private bodies recognized by national law, such as the Takeover Panel), 9 (target board obligations include not taking frustrating actions, including limits on break fees); the Takeovers Directive (Interim Implementation) Regulations 2006, 2006 S.I. 2006/1183 (Eng.), available at www.opsi.gov.uk/SI/si2006/20061183.htm (transitional provisions); Companies Act, 2006, c. 46, §§942-65 (Eng.), statute giving Takeover Panel authority to write Takeover Code, and its Hearing Committee authority to give binding rulings on its application.

7. Regina v. Panel on Take-overs and Mergers, Ex parte Datafin Plc., 1987 Q.B. 815, 838-39 (C.A.). (The Panel's "source of power is only partly based upon moral persuasion and the assent of institutions and their members, the bottom line being the statutory powers exercised by the Department of Trade and Industry and the Bank of England. In this context I should be very disappointed if the courts could not recognize the realities of executive power and allowed their vision to be clouded by the subtlety and sometimes complexity of the way in which it can be exerted.")

8. See http://www.thetakeoverpanel.org.uk/structure/panel-membership.

9. Takeover Panel, Inducement Fees, Panel Statement 1999/10 (7/16/1999), available at http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1999-10.pdf. See also Takeover Panel, Practice Statement No. 23, Rule 21.2—Inducement Fee Agreements and Other Agreements Between an Offeror and the Offeree Company (7/10/2008).

application to conventional break fees, and the rule can only be deviated from with advance permission of that same body, which reportedly they rarely grant. (These statements are consistent with the data discussed in Section 9.2.)

A second law—the Companies Act—has long forbidden public companies in the United Kingdom from providing "financial assistance" to anyone purchasing their shares, including in the context of a takeover bid.[10] "Financial assistance" for this purpose includes any contingent payment to the bidder by the target, with certain exceptions. Break fees are covered, unless they are less than 1 percent of the bid value. Violations of the law could result in civil and even criminal penalties for any officer or director of the target that approved the violation. Thus, even if a bidder would be prepared to endure expulsion from the UK financial community in order to obtain a break fee larger than 1 percent, targets risk significant sanctions if they agree. Agreements for such fees would also be unenforceable in UK courts, making it risky for a bidder to rely on an agreement for such a fee, even if a target were willing to risk sanctions. Unlike the Takeover Code, the Companies Act was adopted as a general statute by Parliament, and to that degree differs from the modal form of regulation described earlier. But as with the Takeover Code, the Companies Act provisions as applied to break fees appear to function in practice as a set of rules, with the ex ante character of regulation, and generate few disputes and little litigation (Davies and Palmer 2004).

Third, and unimportantly in the United Kingdom, there are general fiduciary duty obligations, enforced in a common law fashion by the UK courts. Because the aforementioned Takeover Code and Companies Act provisions effectively rule out legally controversial break fees, no competing bidders have sought an injunction or other judicial remedy as a result of a break fee on fiduciary duty grounds. In short, ex ante bright-line UK regulation of break fees by an expert body, supplemented by a statute establishing the legal authority of that body, has crowded out break fee litigation and the use of ex post standards in practice, even if they remain formally available.

U.S. Law on Break Fees

In the United States, there is no equivalent to the UK Takeover Code or the statutory UK ban on "financial assistance." Nor are break fees constrained by Federal law. Instead, the only legal constraints are the general fiduciary duties imposed on target directors and officers by state corporate law enforced through litigation (Coates and Subramanian 2000). Target shareholders—including a competing bidder that purchases a single share of the target—have standing to sue in court on the ground that the agreement to pay a break fee was disloyal, grossly negligent, or both. While courts

10. Companies Act 2006 (c. 46), Part 18, Chapter 2; Companies Act 1985 §§ 151–158.

typically defer to the "business judgment" of a company's board in such cases, if the bidder can plausibly argue that the fee was designed to favor incumbent managers, it will often be able to get a court to scrutinize the facts surrounding the fee agreement. The standard directly applicable to "deal protection" in the leading U.S. jurisdiction (Delaware)—a break fee is permissible if it induces a bid and impermissible if it forecloses bidding[11]—but nearly all fees have the potential to do both, that formal standard provides little guidance to practitioners, and courts review many other facts in reviewing fees. One relevant consideration, but only one, will be the size of the fee. Other factors, such as the target board's plausible interests in favoring a particular bidder, the information they had at the time they granted the fee, the process that preceded the grant of the fee provision, and the size of comparable fees in comparable transactions, will all generally be considered by the reviewing court, in a typically fact-intensive fiduciary duty case.[12]

Because there is no bright-line rule setting a maximum amount for break fees in the United States, bidders or target shareholders unhappy with a given fee must seek to attack it ex post, in court, without any assurance as to the outcome. Bidders that want break fees must negotiate for them without knowing precisely how large the fee can be without risking a court finding that it represents a breach of the target's fiduciary's duties. (Courts view a bidder as participating in any violation represented by an agreed-upon fee, so a bidder may not claim an entitlement arising from a breach by the target's directors.[13])

The courts reviewing the claims can be state (judges typically elected for terms) or federal (appointed judges with life tenure), and typically have "general jurisdiction"—they do not specialize in M&A. In the leading U.S. jurisdiction for M&A law (Delaware), however, the reviewing court will be the Court of Chancery, which specializes to a large extent in corporate law cases, including M&A and deal protection. While there is no requirement that plaintiffs sue in Delaware when a Delaware target's directors are alleged to have breached their fiduciary duties, the data presented in figure 9.2 show that specialized Delaware courts retains a "market share" roughly in line with Delaware's share of public companies generally. On mode of regulation, then, the United States thus uses a part-hybrid model: ex post review through litigation in courts which, more than half of the time, have specialized knowledge.

11. QVC Network, Inc. v. Paramount Communications, Inc., *Del. Ch., 635 A.2d 1245 (1993),* aff'd, *Del. Supr., 637 A.2d 34, 50 (1994)* (citing Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., *Del. Supr. 506 A.2d 173, 179 (1986)* and Mills Acquisition Co. v. Macmillan, Inc., *559 A.2d 1261 (1988)*).

12. For example, Louisiana Municipal Police Employees' Retirement System v. Crawford, 918 A.2d 1172, Del. Ch. (Chandler, C.), February 23, 2007 (No. Civ. A. 2635-N, Civ. A. 2663-N) (listing a number of factors to be considered in evaluating break fees).

13. For example, Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 55 (Del. 1994).

Why the Divergence?

Why have the United States and the United Kingdom diverged in their treatment of break fees? In both countries, law on break fees emerges from the law on hostile takeovers, despite the relatively minor role that hostile takeovers now play in the United States. In the United Kingdom, break fees were attacked in the mid-1980s as a type of "frustrating action" by a target that was prohibited in general terms by the Takeover Code in force then and now. In the United States, break fees were attacked as violations of the target's fiduciary duties, which are given heightened scrutiny by courts in the takeover context. Both countries adapted their preexisting systems for governing hostile takeovers and target responses to the growth in the use of break fees, despite the fact that most break fees are not used primarily in the context of hostile takeovers.

That explanation, of course, only begs the question: why do the United Kingdom and the United States approach hostile takeovers differently? Part of that history has been told by Armour and Skeel (2007), drawing on interviews and newspaper accounts. Here is a summary: when hostile bids emerged in the 1950s, they received negative press, but opinion was insufficient to result in legislation or regulation, leaving them to the courts. Targets began to use defenses that were controversial for interfering with what were perceived as shareholder rights, but not so extreme as to lead courts to set aside their traditional reluctance to interfere with the business judgment of corporate boards. In the United Kingdom, institutional shareholders were more significant than in the United States, and more organized, facing lower costs for collective political action (Olson 1965). Legislative intervention posed political risks extending beyond M&A to economic regulation generally, so institutions and the financial community preempted Parliament by developing a self-regulatory body, with the implicit backing of the UK government. In the United States, by contrast, corporate managers were more politically powerful than shareholders, and the only Federal legislation to be proposed (the Williams Act) was intended to restrict takeovers, not takeover defenses. Although a preexisting regulatory agency (the Securities and Exchange Commission [SEC]) was able to lobby for a more neutral, disclosure-oriented takeover statute, defenses were largely left to the states to govern with ex post litigation.

This capsule comparative history of takeover governance suggests that the contrast between the United Kingdom's regulatory approach and the United States litigation approach is less stark than in the narrow case of break fees. That is because the UK Code, while bright-line with respect to break fees, is full of standards as applied to takeovers generally, and has generated a substantial body of litigation. But most of this "litigation" is of a different character than is true in U.S. courts, in three respects. First, it does not involve lawyers. Second, partly due to not involving lawyers, it is faster. Third, partly due to being faster, it takes place ex ante, before a given action that might create a conflict occurs—bidders and targets go to the Panel to ask permission for a given action, and the Panel decides whether they can. In essence, the United Kingdom has in general formalized a means to combine the benefits of certainty that come from ex ante regulation with the benefits of tailoring that come from ex post standards. But as applied to break fees, they have chosen a much starker form of ex ante regulation.

9.2 Hypotheses and Data on Break Fees in the United States and the United Kingdom

9.2.1 Hypotheses

The following hypotheses, drawn from the literatures just reviewed, can be tested against the subsequent samples. First, if break fee law binds in the United States and the United Kingdom, then one would expect:

HYPOTHESIS 1 *UK break fees will not exceed 1 percent of bid value.*

HYPOTHESIS 2 *U.S. break fees will vary more than UK break fees.*

HYPOTHESIS 3 *UK bids will encounter little if any break fee litigation.*

HYPOTHESIS 4 *U.S. bids will encounter more break fee litigation.*

Further, if break fee law binds, if the demand for break fees varies from bid to bid, if the modal demand for a break fee would result (but for law) in a fee greater than 1 percent being agreed between a bidder and target, then one would expect:

HYPOTHESIS 5 *UK break fees will cluster at 1 percent.*

HYPOTHESIS 6 *U.S. break fees will typically exceed 1 percent.*

Turning to time trends, if "common law" courts in the United States develop rules out of standards over time, and improve law with repeated disputes, then one would expect:

HYPOTHESIS 7 *U.S. break fee litigation would diminish over time.*

HYPOTHESIS 8 *U.S. break fees themselves would exhibit less variation over time, as applicable law became more certain and practitioners conformed to legal norms.*

Finally, if U.S. fees exceed 1 percent on average, as predicted by hypothesis 6, then one would also expect:

HYPOTHESIS 9 *Post-bid competition will be higher in the United Kingdom than in the United States.*

HYPOTHESIS 10 *Bid completion rates will be lower in the United Kingdom than in the United States.*

HYPOTHESIS 11 *Bid incidence will be lower in the United Kingdom than in the United States.*

9.2.2 Descriptions of Samples

The foregoing hypotheses are tested using four samples. The first sample—on break fees and bid activity—is drawn from Thomson Financial's M&A Database. All bids for UK or U.S. targets in the time period 1989 through 2008 are initially sampled (n = 17,977). Because bid techniques (including deal protection) vary by deal size (see Coates and Subramanian 2000), because deal size may vary between the United Kingdom and the United States, and because bid size has varied over time, the sample is then constrained to consist of bids over $1 billion, which is roughly the ninetieth percentile of bid size in 1989—this chapter refers to these bids as "large bids" for convenience. (None of the qualitative findings reported following depend on the precise size cut-off.) This produces a total of 5,171 bids.

Bids that are reported by Thomson as still pending—that is, bids with no effective date or withdrawal date—are dropped, leaving 4,404 bids. Of those, Thomson classifies 865 as "hostile," meaning the target publicly resisted the bid. Because a target's consent is required to obtain standard deal protection, deal protection is less likely to be found in hostile bids, and they are dropped.[14] Of the remaining bids, 194 bids sought less than a controlling interest, and are accordingly dropped. Because banks and other financial institutions are generally cash- and capital-constrained, making conventional cash break fees difficult or impossible to pay (see Coates and Subramanian [2000] for a discussion and evidence in the U.S. context), while economic substitutes are available (e.g., stock or asset options), they are regulated differently than break fees, at least in the United States. Bids for targets with Standard Industrial Classification (SIC) codes 6000-6999 (n = 766) are dropped. These procedures leave a total of 2,579 bids. Of those, Thomson reports stock price and premium data for only 1,346, consisting of 209 bids for UK companies and 1,136 bids for U.S. companies. This subsample is the focus of the remaining analysis,[15] and represents approxi-

14. There are, in fact, more hostile bids as a share of large bids in the United Kingdom (7 percent of the broader sample of large bids) than in the United States (3 percent, p-value $< .01$). But as noted at the outset, there are many more friendly deals in each country. Break fees are also much less common in the dropped hostile bids (13 percent) than in the retained friendly bids (37 percent). Rossi and Volpin (2004) report fewer hostile bids in the United Kingdom (4.4 percent of listed firms versus 6.4 percent in the United States) for a sample that includes smaller bids.

15. More UK bids lack premium data (58 percent) than U.S. bids (51 percent), but the basic results discussed later regarding incidence and size of break fees, and their relationships with bid completion and bid competition, are not qualitatively affected by retaining all large nonpending friendly control bids for nonbank targets.

mately 50 percent of the total friendly control bid volume for nonfinancial targets in the United States and United Kingdom over the past twenty years.

A second "placebo" sample used to test the robustness of the findings from the main M&A sample consists of resolved bids dropped from Thomson because they sought less than a control interest (including noncontrol bids for financial institutions). This sample is by construction not likely to be affected by break fee law, since the reason for break fees is to constrain competition in control bids.

The third sample consists of all control bids (i.e., all bids for more than 50 percent of the target) for companies listed on the main stock exchanges in the United States (Amex, NYSE, and Nasdaq) and the United Kingdom (London). This sample is used to estimate annual bid incidence in each nation, normalized by the annual numbers of firms listed on each nation's stock exchanges, which are taken from the World Federation of Exchanges, which reports that data for the years 1990 to 2008.

The fourth sample, on break fee litigation, is drawn from a search of the Westlaw "all cases" database for reported judicial opinions on fiduciary duty disputes involving break fees in the period 1989 to 2009. The search returned 225 reported case decisions that mention both mergers or tender offers and "break fee" or synonymous phrases.[16] A review of those decisions shows that a third—the sixty-one cases listed in the appendix—were in cases concerned with the legitimacy of M&A break fees, either on their own or in combination with other claimed facts supporting a claim for breach of the target fiduciaries' duties.[17] Grossed up to account for cases not generating reported decisions, a rough estimate of break fee litigation in the United States in that period would be approximately ninety-five cases.[18]

16. A search of Westlaw's all cases database (including both Federal and state courts), using the search phrase "(merger or 'tender offer')" and "('break fee' or "bust-up fee' or 'break-up fee' or 'termination fee') and 'fiduciary duty'" returned 224 cases.

17. The sixty-one cases concerned with break fees are listed in the appendix. The rest consist of cases in bankruptcy courts, which govern break fees differently than in normal bids; reverse termination fee cases, which involve fees payable by bidders rather than targets; disclosure cases; cases involving "termination fees" in unrelated contexts that happen to mention "merger" or "tender offer"; cases in which break fees are mentioned in passing; and cases not involving fiduciary duty claims. Of those cases, thirty-four were reported by Delaware courts, roughly 67 percent of the sample over the whole period, in line with Delaware's market share of U.S. public companies (Coates 2001). However, as illustrated in figure 9.1, Delaware's "market share" of break fee cases has declined in recent years, from an average of 95 percent from 1989 through 1998, to 57 percent from 1999 to 2008.

18. While reported decisions do not represent all cases filed, the multiple of complaints-to-reported-decisions is not as large as one might think: Thomas and Thompson (2004) report 348 fiduciary duty cases were filed in Delaware Chancery Court in 1999 and 2000; a search for "fiduciary duty" in the Westlaw Delaware cases database returns 224 reported decisions for the same time period.

Table 9.1 **Summary statistics, all bids and United States vs. United Kingdom bids over $1 billion, 1989–2008**

	Mean (standard deviation) for all bids (n = 1,346)	Mean (standard deviation) for UK bids (n = 209)	Mean (standard deviation) for U.S. bids (n = 1,137)	p-value of t-test of means (U.S. vs. UK)
% sought in bid	98.5 (6.4)	97.3 (7.6)	98.7 (6.2)	0.01
Bid value ($mm)	4.9 (9.9)	4.7 (8.6)	5.0 (10.2)	0.72
% bid premium over 1-day prior market price	29.8 (28.0)	30.0 (29.2)	29.8 (27.8)	0.91
% with break fees[a]	70.4 (45.7)	18.7 (38.7)	70.3 (40.1)	0.00
Break fee as % of bid value	2.6 (1.0)	0.9 (0.3)	2.6 (1.0)	0.00
% using tender offer	26.9 (44.4)	72.2 (44.7)	18.6 (38.9)	0.00
% cash bids	56.7 (49.6)	65.1 (47.8)	55.1 (49.8)	0.01
% stock bids	28.0 (44.9)	5.3 (22.4)	32.1 (46.7)	0.00
% cross-border	19.9 (39.9)	36.8 (48.3)	16.9 (37.4)	0.00
% bidder and target in same industry (one-digit SIC)	63.4 (48.1)	52.4 (50.1)	65.4 (47.6)	0.00
Duration of completed bids, in days	145 (107)	128 (82)	148 (111)	0.02

[a]But see Boone and Mulherin (2007) on underreporting of break fees in Thomson's database.

9.2.3 Summary Data and Simple Comparisons of Large Bids in the United States and the United Kingdom

As shown in table 9.1, 88 percent of large U.S. and UK bids were completed, the rest withdrawn. Average (median) bid size was $4.9 billion ($2.1 billion). Mean (median) duration of a completed bid was 145 (114) days. Bids were at an average (median) premium over the prior day's target stock price of 30 percent (26 percent). Break fees—again, including U.S. and UK bids—were used in 70 percent of bids,[19] and were an average (median) of 2.6 percent (2.7 percent) of deal value.[20] In nominal dollars, the average break fee was $124 million; the largest was $3.9 billion. While these fees may seem small relative to bid size, it should be remembered that the best evidence

19. But see Boone and Mulherin (2007) on underreporting of break fees in Thomson's database.

20. Thomson reports "deal value," defined to include the "total consideration paid," including liabilities assumed if disclosed, excluding fees and expenses. Thomson also reports "enterprise value" and "rank value," which attempt to reflect debt and other claims against the target or the acquiror after the bid differently, as well as "equity value," which is simply the prebid equity market capitalization of the target. The qualitative findings presented following persist regardless of whether break fees are calculated as a percentage of deal value, equity value, enterprise value, or rank value. The remainder of this chapter uses "deal value" as the basis for the calculation of break fees, but uses the term "bid value" to reflect the fact that not all bids in the data set are completed.

about the expected effect of M&A bids on bidder share prices is that they are close to zero, often negative, and at most increase bidder share prices by 0 to 2 percent (Andrade, Mitchell, and Stafford 2001). While buyers are typically larger than targets, moving from a 1 percent to a 3 percent fee could substantially erode or even wipe out the expected net benefit of a bid for a typical prospective competing bidder.

Bid size between the two nations was similar: $4.7 billion in the United Kingdom, on average, versus $5.0 billion in the United States. Bids using stock consideration were larger than cash bids, but this was true in both nations. Yet, as reflected in table 9.1, break fees were significantly smaller and vary less in the United Kingdom than in the United States. In the United States, 95 percent of break fees were greater than 1 percent, the maximum for the United Kingdom. Over 60 percent of the UK fees fall between 0.9 percent and 1.1 percent; less than 2 percent of fees in the United States fall in that range. The standard deviation of UK break fee size is less than a third of that in the United States. Consistent with hypothesis 5, UK break fees are left skewed (–1.7), and less peaked (kurtosis = 5.0), whereas U.S. break fees are much less skewed (0.6), and are more peaked (kurtosis = 8.9). In short, at all moments of the distribution, UK and U.S. break fees differ as predicted, as reflected on figure 9.1.

In nominal dollars, the average agreed-upon UK fee was $41 million, a third the size of the average U.S. break fee, at $128 million; the largest agreed-upon fee in the United Kingdom was $212 million, in the 2007 buy-

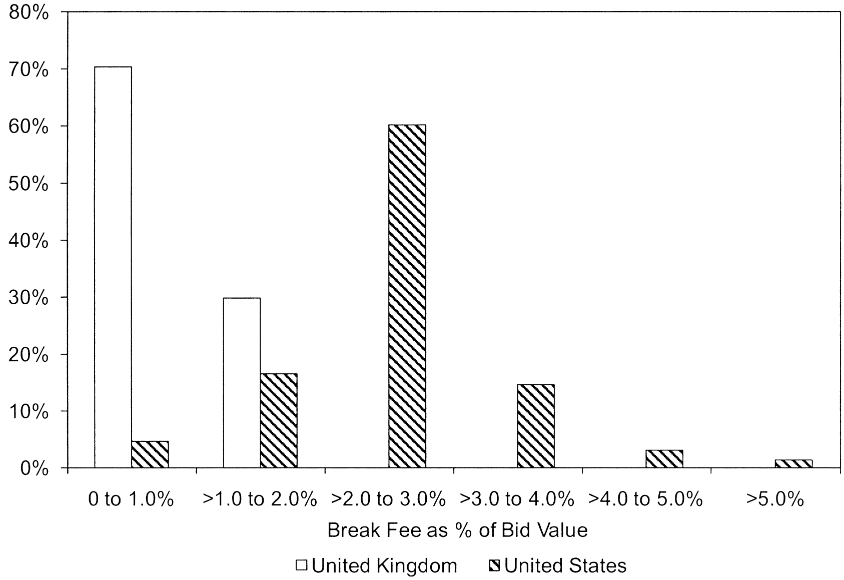

Fig. 9.1 Break fees distribution, United States versus United Kingdom

out of Alliance Boots, compared to the largest U.S. fee, the $3.9 billion fee agreed to in the 2000 stock merger of Time-Warner and AOL. Among withdrawn bids, where the fee would typically have been required to be paid, the average fee in the United Kingdom was $25 million, 15 percent of the size of the average triggered in the United States ($184 million). The largest paid triggered in the United Kingdom was a mere $35 million, in the 2000 acquisition of Lasmo by Amerada Hess, compared to the largest fee triggered in the United States, the $1.8 billion paid in the 2000 acquisition of Warner-Lambert by Pfizer.

The U.S. bids took longer to complete than UK bids. The reason for the timing difference has to do with the interaction of law—stock deals require a more lengthy regulatory process in both nations, due to disclosure and registration requirements—and bid financing, which is weighted more toward cash in the United Kingdom than in the United States. Specifically, UK bids are most frequently for all cash (65 percent) than for all stock (5 percent) or for other securities or a blend of deal currencies (30 percent). While large U.S. bids are also most commonly for all cash (55 percent), they are more frequently for stock (32 percent) than in the United Kingdom, with the rest for other securities or a blend of deal currencies (13 percent). Each pairwise difference is statistically significant at a p-value of $< .01$. As shown in table 9.2, cash bids take roughly the same amount of time in both countries. The UK bids were also more likely to involve an overlap between a bidder's and a target's one-digit SIC code, even in cash bids.

9.2.4 Trends in Break Fee Size

Trends in the size of break fees in the United States and the United Kingdom are presented in table 9.3. As previously reported in Coates and Subramanian (2000) (for a sample including smaller deals than reported on in this chapter), break fees increased over the course of the 1990s in the United States. However, any trend in U.S. break fees in large deals appears to have moderated in the 2000s. As a more formal test, break fee size as a percent of bid value is regressed against the bid announcement date; and against bid announcement date; a dummy indicating that the year of announcement is after 1999, and the interaction of announcement date and the year 1999. In both regressions (unreported), bid announcement date correlates strongly with break fee size, but the signs on post-1999 and date*1999 interaction are negative and statistically insignificant.

By comparison, there is no marked time trend in break fees in the United Kingdom—other than the initial jump from no fees to 1 percent fees in 1999, the same year that the Takeover Panel approved 1 percent fees through rule-making. While break fees were used on occasion in the United Kingdom prior to the 2000s, they were sufficiently suspect—viewed as potentially a type of "frustrating action" barred by the UK Takeover Code—that they did not occur frequently in the 1990s, and only began to appear

Table 9.2 **Summary statistics, cash bids in United States vs. cash bids in United Kingdom, 1989–2008**

	Mean for UK cash bids (n = 209)	Mean for U.S. cash bids (n = 1,137)	p-value of t-test of means (U.S. vs. UK cash bids)
% sought in bid	96.4	98.4	0.00
Bid value ($mm)	4.1	4.2	0.93
% bid premium over 1-day prior market price	29.8	29.9	0.93
% with break fees[a]	26.4	80.3	0.00
Break fee as % of bid value	0.9	2.7	0.00
% using tender offer	72.1	28.6	0.00
% cross-border	35.3	21.3	0.00
% bidder and target in same industry (one-digit SIC)	44.4	56.4	0.01
Duration of completed bids, in days	126	133	0.44

[a]But see Boone and Mulherin (2007) on underreporting of break fees in Thomson's database.

Table 9.3 **Trends in break fee size, United States vs. United Kingdom, 1989–2008**

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

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

regularly after they were implicitly legitimized by the adoption of the 1 percent cap in 1999.[21] Thus, the idea that the United Kingdom experienced a regulatory "shock" à la Rajan and Zingales (2003)—the 1 percent rule not only capped fees but made them legitimate, increasing their use—is consistent with practitioner reports and the fact that already in 2000, break fees already are clustering in the United Kingdom near the legal cap of 1 percent, and remain there throughout the sample period. In only one year—2005—are there any reported break fees in excess of 1.0 percent, and that one outlier is an erroneous datum in Thomson, which lists PetroKhazakhstan as a UK target, when it fact it was Canadian. In unreported regressions, there is no relationship of break fee size on bid announcement date over any part of the sample period.

Table 9.4 depicts trends in variation of break fee size in the United Kingdom and in the United States in available years, showing the interquartile difference (i.e., the seventy-fifth percentile-sized fee for the year less the twenty-fifth percentile-sized fee) and the annual standard deviation in break fee size, as a percentage of bid value. In all years but 2005, both measures of variation of fee size are more than double for the United States than for the United Kingdom, and sometimes much larger, than its counterpart in the United Kingdom. After dropping the misclassified deal discussed earlier, the same is true for 2005. There do not seem to be any trends in the variation in the U.S. data: despite years of experience, thousands of deals, and hundreds of lawsuits (discussed later), there remains as much variation in observed break fee size in the early 1990s as there is in the late 2000s.

As an alternative measure, break fee size was regressed separately against industry controls (one-digit SIC codes) and the observed deal characteristics used in the multivariate regressions described following (use of cash consideration, tender offer, cross-border deals, and bid value). Given the paucity of reported break fees in the United Kingdom prior to 2000, this regression was run for the subsample consisting of years after 1999, although the qualitative result is the same without this restriction. For the United Kingdom, this (unreported) regression has an R-squared of 26 percent; for the United States, it is only 6 percent.

In litigation, this variation in the U.S. fees means that defendant fiduciaries will truthfully be able to list a number of billion-dollar bids with fees well above the average—eight over 5 percent since 2000 in this sample, for

21. This statement is based less on the data in Thomson, which is unreliable on break fee incidence, and more on statements in practitioner commentary on break fees (Davies and Palmer 2004; Montgomery, Davies, and Palmer 2005; Tarbert 2003), and the general absence of such commentary prior to 2000. Technically, break fees in deals structured not as tender offers but amalgamations or restructurings would not be subject to the Takeover Code, but the Code's approval of 1 percent fees seems to have increased used of such fees in those types of deals as well, as reflected in the general norm of 1 percent of firm value followed by M&A practitioners under the Companies Act's exception for immaterial financial assistance. See Davies and Palmer 2004.

Table 9.4 **Trends in variation in break fee size, United States vs. United Kingdom, 1989–2008**

	Interquartile range of break fee size		Standard deviation of break fee size	
	UK	U.S.	UK	U.S.
1989	—	0.01066	—	0.00752
1990	—	0.02620	—	—
1991	—	0.00000	—	0.01525
1992	—	0.01965	—	0.01563
1993	—	0.01536	—	0.00820
1994	—	0.00980	—	0.00895
1995	—	0.00738	—	0.00736
1996	—	0.01055	—	0.00846
1997	—	0.00916	—	0.00938
1998	—	0.00995	—	0.00877
1999	0.00000	0.01063	—	0.00932
2000	0.00000	0.00878	—	0.01194
2001	0.00000	0.01258	—	0.00931
2002	0.00000	0.01151	—	0.00756
2003	0.00000	0.01163	—	0.01179
2004	0.00069	0.01314	0.00048	0.00809
2005	0.02523 (0.00556)	0.01062	0.01325 (0.00393)	0.00766
2006	0.00435	0.00815	0.00314	0.00699
2007	0.00060	0.00940	0.00247	0.00812
2008	0.00158	0.00951	0.00087	0.00850

Notes: Dashed cells indicate insufficient observations; for 2005, the UK fee statistics are listed as derived directly from Thomson, and in parentheses as corrected after dropping a misclassified target (see text).

example. Since break fees decrease as a percentage of bid size as bid size increases in this and other samples, a larger set of examples of 5+ percent break fees can be assembled by defendants in smaller, more typical U.S. bids than those in this sample. The U.S. case law—reviewed briefly in section 9.3—suggests it may suffice to defend a fee to show simply that it is not an outlier, and not satisfy the more difficult test that it is in line with overall averages. If so, then this variation will make it easier for defendants to prevail in U.S. court challenges to fees, even if they have to incur costs to do so.

In sum, the data show that M&A break fees in practice vary significantly more in the United States than in the United Kingdom, consistent with the litigation-driven U.S. law in practice providing less clear guidance than UK regulation on the appropriate size of break fees relative to bid value. Given the clarity of the UK rule (the 1 percent cap), and the varied messages U.S. courts have stated regarding the appropriate size of break fees, U.S. dealmakers have considerably more flexibility in choosing the amount of deal protection than their UK counterparts.

9.3 Evidence of Effects of Break Fees

9.3.1 Outcomes: Bid Competition, Bid Completion, and Bid Litigation

If break fees had no impact on bid outcomes, the differences between law and break fee size described before might be of practical importance to bid participants, but little overall significance. However, prior research has found that large break fees can have an impact on whether a given bid will attract competition, and on whether that bid will be completed. The difference in legal approaches to break fees—with the UK fees being kept below 1 percent and those in the United States typically exceeding double that level or more—has a potential effect on allocational efficiency, as higher-valuing bidders in the United Kingdom are more likely to acquire a target than in the United States, while bidders overall in the United Kingdom must take into account the risk that they will lose reliance interests (net of break fees) if they are outbid by competitors. In the United States that risk is substantially lower. The choice between regulation and litigation, in other words, may have an effect on bid incidence and the efficiency of the bid process. In addition, the ex ante and ex post approaches to governance can be expected to have another set of consequences: higher litigation costs for the latter. This section explores whether these effects can be observed in the large bid break fee data.

9.3.2 Univariate Results: Bid Competition and Bid Completion

As shown in table 9.5 (part A), UK bids are more than twice as likely to encounter competing bids than bids for U.S. targets. The UK bids are less likely to be completed than U.S. bids. This difference is attributable to the presence of competing bids, as the completion rate is statistically the same

Table 9.5 Outcomes for large bids in the United States and United Kingdom, 1989–2008

	UK bids	U.S. bids	*p*-value
	A. All bids		
% with public bid competition	19.6 (n = 209)	8.0 (n = 1,137)	0.00
% with litigation	0.0 (n = 209)	5.0 (n = 1,137)	0.00
% completed	82.8 (n = 209)	88.8 (n = 1,137)	0.01
Without competition	88.6 (n = 168)	91.7 (n = 1,046)	0.20
With competition	58.5 (n = 41)	56.0 (n = 91)	0.79
	B. Cash bids		
% with public bid competition	22.8 (n = 209)	10.0 (n = 1,137)	0.00
% with litigation	0.0 (n = 209)	3.9 (n = 1,137)	0.02
% completed	79.4 (n = 209)	88.5 (n = 1,137)	0.00
Without competition	84.7 (n = 105)	91.8 (n = 564)	0.02
With competition	61.3 (n = 31)	58.7 (n = 63)	0.81

for both countries for bids with competition, or for bids without competition, with bids being completed less than 60 percent of the time in the presence of competition, and roughly 90 percent of the time without competition. For bids overall, it is the competition rate that is different, rather than the way that bidders compete conditional on competition. Similarly, bids are much less likely to encounter post-announcement competition if protected by a fee greater than 1 percent than by a fee of less than 1 percent (20.6 percent vs. 7.9 percent, p-value < 0.001), and much more likely to be completed if protected by such a fee (91.4 percent vs. 82.5 percent, p-value < 0.01).

One might wonder, based on the differences in bid consideration and bid duration presented earlier, whether it is those differences that are affecting competition rates. On reflection, however, those differences only make the contrast between bid completion rates in the United States and the United Kingdom even more striking. The longer a bid takes to be completed, the longer third parties have to make a competing bid. Yet in the United Kingdom—where bids take less time because they are more commonly for cash—bids are completed less frequently than in the United States, where they take more time, because they are more frequently for stock. In fact, as reflected in table 9.5 (part B), the difference in completion rates spans choice of consideration: all-cash bids in the United States remain more likely to be completed (89 percent) than all-cash bids in the United Kingdom (79 percent, p-value $< .01$). As with bids generally, cash bids are much less likely to be completed in the presence of competition—roughly 60 percent of the time, versus 90 percent without competition—and as before the differences in completion rates in the presence of competition are not statistically different. There is a statistically significant difference in completion rates of cash bids even without competition—92 percent in the United States versus 85 percent in the United Kingdom, possibly reflecting greater power of institutional shareholders in the United Kingdom to refuse to tender to low-ball bids that may be attempted in the absence of competition—but the magnitude of that difference is much smaller than the difference in competition rates.

9.3.3 Bid Incidence

The data reviewed so far are consistent with the hypotheses that UK regulation constrains break fees, increases bid competition, and lowers bid completion rates, relative to U.S. litigation. If break fees are an importance inducement for bidding, the findings thus far suggest that we should also expect to see fewer bids in the United Kingdom. Of course, the United States is a larger economy, so the absolute number of bids would be expected to be higher in the United States. To normalize the bid data in the sample just analyzed, one would ideally want the number of listed firms that could generate \$1 billion bids, but since bid premia themselves vary, and market capitalizations fluctuate frequently, generating the right stock of target firms for the aforementioned bid sample is not easy. A more direct approach is possible: gather a new sample from Thomson of all control bids for distinct listed companies and compare them to the total number of listed companies in each nation. Thomson includes competing bids—that is, bids pending at the same time for the same target—as separate records in its M&A database. Overlapping competing bids, which do not increase overall bid incidence, are removed (although doing this does not much affect the bottom line). This exercise produces the data set out in table 9.6.

The data are consistent with those presented in Andrade, Mitchell, and Stafford 2001, who use data from the Center for Research in Security Prices (CRSP) to construct estimates for total U.S. M&A activity in the years 1962 to 1998. Although they present activity rates ranging from 2 percent to 5 percent in the years 1990 to 1998, the rates presented here are *bid* rates, rather than *merger* rates, as presented there—recall from table 9.6 that 10 to 20 percent of bids are never completed. This time series also includes all *control* bids, and not just bids that result in delistings, as presented in Andrade and collegues. In the sample of large bids analyzed earlier, in both the United States and the United Kingdom, approximately 5 percent of completed control bids do not result in 100 percent of ownership, and an average of 15 to 20 percent of the target's shares remain outstanding after the bid, so that some would continue to be listed after the bid, and not appear in the CRSP M&A delisting sample.

Consistent with hypothesis 9, as reflected in the bottom right cell of the table, the overall control bid incidence rate in the United Kingdom from 1990 through 2008 was 77 percent of that in the United States, and in fourteen of the eighteen years in the sample, the U.S. rate exceeds that of the United Kingdom, usually by a significant margin. These findings are consistent with Rossi and Volpin (2004), who report that 66 percent of U.S. listed firms were acquired in their cross-country analysis of Thomson's M&A database from an earlier but overlapping period, versus only 54 percent of UK listed firms—a ratio of 82 percent. While many other factors may contribute to this difference, a lower bid incidence rate in the United Kingdom is consistent with the findings presented before—that break fee law inhibits some bids that might otherwise occur if the target were free to provide an initial bidder with insurance against the risk of competition.

9.3.4 Break Fee Litigation

What about litigation? Does U.S. reliance on court-enforced fiduciary duties to control the bidding process have an observable effect on the number of disputes generated by bids? The data in table 9.7 suggest the answer to that question is yes: bids in the United Kingdom simply do not generate reported litigation,[22] whereas 5 percent do in the United States. But that difference does not appear to be attributable to break fee disputes. Litigation

22. Prior to the adoption of the bright-line rule in the Takeover Code, there was occasional litigation concerning break fees. See Tarbert (2003); Takeover Panel (UK), Decision 1986/2 (Jan. 29, 1986) (approving break fee adopted in fight between Guiness PLC and Argyll Group PLC for Distillers PLC).

Table 9.6 **Bid incidence, United States vs. United Kingdom, 1990–2008**

		UK				U.S.			
	(a) No. of domestic listed firms	(b) No. of control bids for listed firms	(c) No. of competing control bids for listed firms	(d) Control bids per distinct listed firm [(b) – (c)] / (a) (%)	(e) No. of domestic listed firms	(f) No. of control bids for listed firms	(g) No. of competing control bids for listed firms	(h) Control bids per distinct listed firm [(f) – (g)] / (e) (%)	(i) UK vs. U.S. control bid incidence (d) / (h) (%)
1990	2,047	163	10	7	6,134	395	22	6	123
1991	2,058	152	17	7	6,295	327	37	5	142
1992	1,952	90	6	4	6,080	286	23	4	99
1993	1,930	91	4	5	6,750	312	8	5	100
1994	1,933	76	12	3	7,121	422	32	5	60
1995	1,977	92	5	4	7,507	512	59	6	73
1996	2,098	79	9	3	7,993	537	43	6	54
1997	2,036	107	14	5	7,852	615	50	7	63
1998	1,963	167	20	7	7,520	725	36	9	82
1999	1,819	242	37	11	7,569	768	49	9	119
2000	1,923	197	13	10	6,830	666	58	9	107
2001	1,912	119	2	6	6,362	515	36	8	81
2002	2,400	92	4	4	5,664	359	26	6	62
2003	2,315	126	23	4	5,297	382	30	7	67
2004	2,497	82	11	3	5,243	310	27	5	53
2005	2,751	115	15	4	5,125	344	41	6	61
2006	2,898	159	19	5	5,104	441	46	8	62
2007	2,579	109	20	3	5,130	448	45	8	44
2008	2,415	108	14	4	5,611	324	21	5	72
Total	41,502	2,366	255	5	121,186	8,688	689	7	77

Sources: Worldwide Federation of Exchanges (listings and domestic listings) and Thomson Financial (control bids).

Notes: Control bids are bids for 50.1+ percent of a listed target, excluding self-tenders. For United States, listings include Amex, NYSE, and Nasdaq; for United Kingdom, listings are on the LSE. Bids need not be completed. Domestic listings are as reported for the years 1995–2008; for 1990–1994, the three-year average for 1995–1998 is used.

Table 9.7 **Litigation reported by Thomson in large bids in the United States and United Kingdom, 1989–2008**

	UK bids	U.S. bids	p-value
	A. All bids		
% with litigation	0.0 (n = 209)	5.0 (n = 1,137)	0.00
Break fee reported	0.0 (n = 170)	3.7 (n = 908)	0.22
No break fee reported	0.0 (n = 39)	10.0 (n = 229)	0.00
	B. Cash bids		
% with litigation	0.0 (n = 136)	3.9 (n = 627)	0.02
Break fee reported	0.0 (n = 36)	2.8 (n = 504)	0.31
No break fee reported	0.0 (n = 100)	8.9 (n = 123)	0.00

is actually less frequent in U.S. bids with break fees than in those without break fees (4 percent vs. 10 percent, p-value $< .0001$), and it is only in bids without reported break fees that bid-related litigation reported in Thomson is statistically higher in the United States than in the United Kingdom. Presumably this is because break fees deter bid competition, which is correlated with deal litigation in the United States (8.7 percent of bids facing competition generate litigation reported in Thomson, versus 4.7 percent of bids without competition, p-value $< .10$).

These conclusions should be treated carefully, however, as Thomson's data on litigation appears even more suspect than its data on break fee incidence. Thomson, for example, reports *zero* litigation in \$1+ billion bids from 2000 onwards. This may surprise M&A litigators, who fought lawsuits over many of the \$1+ billion bids in the Thomson database, including (for example) reported disputes (listed in the appendix) over the 2008 bid for William Wrigley Jr. Co.; the 2007 bids for Lear Corp. and Lyondell Chemical Co.; and the 2006 bid for Stone Energy Co.

To further investigate the extent of U.S. litigation specifically concerning break fees, the break fee cases listed in the appendix were reviewed. Few articulate any "law" that would guide break fee practice. Many concern procedural issues (e.g., whether a complaint, which includes allegations that target fiduciaries breached their fiduciary duties by, among other things, agreeing to a break fee, states a claim; whether plaintiffs' attorneys who sued in part based on break fees are entitled to fees for their efforts). Of those that directly address the substantive question of when and what break fees are legitimate, several Delaware decisions explicitly refuse to provide clear general guidance on the proper size of a break fee, or specific facts that could justify or attack a larger-than-typical break fee, or approve a fee on the primary ground that the same size fee had been approved in prior cases.[23]

23. For example, Louisiana Municipal Police Employees' Retirement System v. Crawford, 918 A.2d 1172, Del. Ch. (Chandler, C.) (2007) (stating in dicta: "Though a '3% rule' for termina-

Still, there are decisions[24] that explicitly allow custom and practice to guide case outcomes by dismissing complaints where the break fee in question was within norms, and it is hard to believe that courts would not be more inclined to approve a break fee within customary size ranges than one that is not.

What effects has the general reluctance of U.S. courts to articulate break fee rules had? One could characterize the overall level of break fee litigation as large or small. On the one hand, benchmarked against the United Kingdom, with zero litigation, it is significantly higher, and as reflected in figure 9.2, it has been increasing in absolute terms since the early 1990s. On the other hand, benchmarked against the approximately 8,000 bids for public targets in the United States in the same time period, however, it is less than the 5 percent litigation rate reported by Thomson for the large bid sample, and much smaller than the 34 percent of hostile bids reported by Thomson to encounter litigation in the United States (Armour and Skeel 2007). Also, the number of break fee cases divided by total bids has not increased significantly over the recent past.

More importantly, many of those litigated cases would likely have existed even if break fees were explicitly authorized up to some set percentage and forbidden beyond that percentage, as nearly all of the cases reviewed in the appendix involved claims that the target's boards breached their fiduciary duties in a number of respects, over and above the size of the break fee granted. Typical, for example, are allegations that target boards had insufficient information, overly rushed the sales process, or favored one bidder over another without a reasonable justification. Thus, the marginal effect on litigation incidence of the U.S. courts' reluctance to announce a rule regarding break fee size is likely to be nearly zero. Only if the entirety of the M&A process were to be governed by a set of bright-line rules would the incidence of M&A litigation diminish to UK levels, and even the United Kingdom (as noted before) does not do without M&A litigation—it merely speeds it up and excludes lawyers from participating in it.

In sum, the data are consistent with the general practitioner view that

tion fees might be convenient for transaction planners, it is simply too blunt an instrument, too subject to abuse, for this Court to bless as a blanket rule."); In re Netsmart Technologies, Inc. Shareholders Litigation, 924 A.2d 171, 32 Del. J. Corp. L. 941, Del. Ch. (Strine, V.C.) (2007) (stating, in reviewing a deal that included a break fee the court characterized as "modest" in size, "The mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics"). Cf. Coates and Subramanian (2000) (recommending courts give bids with fees over 3 percent a "particularly hard look"), quoted in In re Toys-R-Us Shareholder Litigation, 877 A.2d 975, Del. Ch. (Strine, V.C.) (2005) (rejecting any bright-line rules; citing fact that a 3.75 percent fee was not "unprecedented" as part of basis for upholding fee).

24. For example, *Gut v. MacDonough,* Not Reported in N.E.2d, 23 Mass.L.Rptr. 110, 2007 WL 2410131, Mass.Super., August 14, 2007 (NO. CIV.A. 2007-1083-C) (break fees "are customarily included in agreements of this nature . . . the independent financial consulting firm hired by Westborough, RBC, concluded that . . . the amount of the termination fee [i.e., 5 percent, was] reasonable . . .").

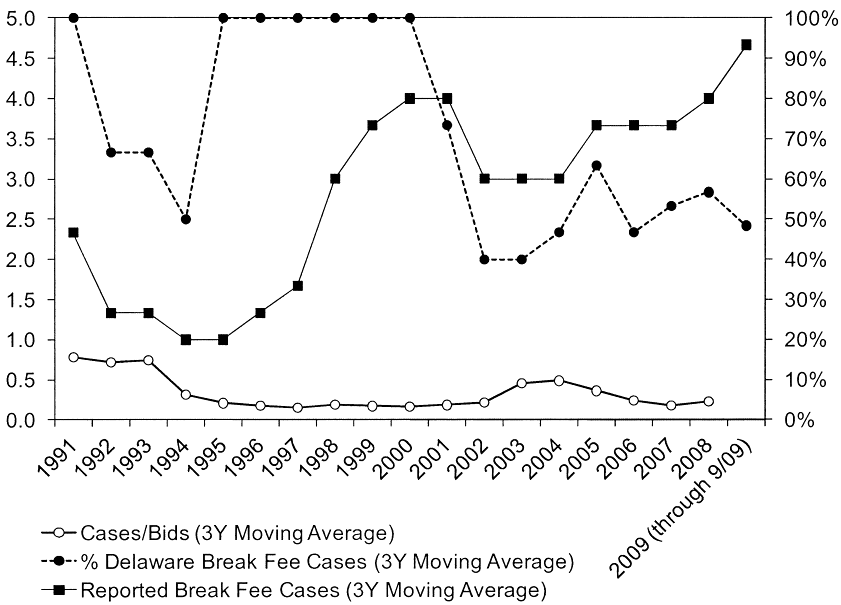

Fig. 9.2 Trends in break fee litigation

UK reliance on a regulatory approach to bid governance essentially eliminates bid-related litigation and its attendant costs, which is common in the United States. At the same time, the more permissive stance toward break fees that has developed in the U.S. litigation-based governance system may actually moderate the amount of bid-related litigation that occurs in the United States, because break fees deter competition and competition generates disputes.

9.3.5 Multivariate Results

The basic univariate results presented before, showing lower break fees, higher competition rates, and lower completion rates in the United Kingdom, may be caused by other factors. Table 9.8 presents multivariate regressions that test this possibility to the extent feasible with available data.

Regressions

In each case, a simple model is reported, with a single explanatory variable (UK = 1 if the target is a UK firm); a second model is reported, with available controls other than year or industry fixed effects; and then a third model is reported, with both year and industry (one-digit SIC code) fixed effects. In parentheses are robust standard errors; coefficients or odds ratios that are statistically significant at the 95 percent level are in bold. In unreported regressions, the limited data on toeholds in Thomson's database was

Table 9.8 **Multivariate regressions**

	Break fee size (% of bid value) coefficients			Competition rate Odds ratios			Completion rate Odds ratios		
UK	–1.728	–1.764	–1.955	2.805	2.701	2.836	0.604	0.246	0.191
	(0.07)	**(0.089)**	**(0.080)**	**(0.577)**	**(0.682)**	**(0.790)**	**(0.124)**	**(0.061)**	**(0.055)**
CASH		0.012	–0.128		2.048	1.825		0.619	0.527
		(0.064)	(0.078)		(0.438)	**(0.456)**		(0.115)	**(0.120)**
TENDER		0.056	0.142		1.264	1.064		5.712	9.023
		(0.079)	(0.079)		(0.299)	(0.279)		(1.578)	**(2.910)**
XBORDER		0.003	–0.022		0.740	0.760		1.557	1.653
		(0.079)	(0.077)		(0.181)	(0.188)		(0.374)	(0.423)
BIDVALUE ($ billion)		–0.009	–0.008		1.026	1.024		0.992	0.989
		(0.003)	**(0.002)**		(0.009)	**(0.008)**		**(0.007)**	(0.007)
SIC1MATCH		0.002	0.005		0.901	0.858		1.617	1.660
		(0.007)	(0.007)		(0.178)	(0.187)		(0.288)	**(0.318)**
LITIGATION								–0.387	0.877
								(0.288)	**(0.381)**
Year FE	No	No	Yes	No	No	Yes	No	No	Yes
Industry FE	No	No	Yes	No	No	Yes	No	No	Yes
N	946	946	945	1,346	1,346	1,296	1,346	1,346	1,344
R^2/Pseudo-R^2	0.009	0.132	0.219	0.026	0.058	0.094	0.005	0.071	0.132
		OLS			Logistic			Logistic	

Note: OLS = ordinary least squares; FE = fixed effects.

also included as a regressor, without affecting the reported results. Litigation is included in the models for completion rate, but omitted from the models for break fee size and competition rates, because of the likelihood of reverse causation.

As can be seen, after controlling for other observed factors, compared to the United States, UK break fees are estimated to be even lower, competition rates to be even higher, and completion rates to be even lower than univariate tests would suggest. For break fees, the only significant control (other than time and industry dummies) is bid size: break fees increase at a decreasing rate in bid size. Other factors held constant, UK break fees are nearly 2 percentage points lower than U.S. fees. For competition, cash bids encounter twice as much competition as other bids, other factors held constant; and for each ten billion dollars a bid is larger, the competition rate increases by a multiple of 10.3. Industry and time controls only sharpen the effects on bid competition, which is nearly three times as likely in the United Kingdom than in the United States. The UK bids, which appear to be completed about 60 percent as often as U.S. bids in a univariate regression, become even less likely to be completed after taking into account the combined effects of the higher incidence of cash consideration (which reduces the odds of bid completion), the higher incidence of tender offers (which dramatically increases the odds of bid completion), cross-border bids (which are more likely to close), and same-industry bids (which are also more likely to close). Litigation, present only in the United States, appears to reduce the odds of deal completion, but this effect does not persist after inclusion of time and industry controls.

If we replace the UK dummy with break fee size in the models of bid competition or bid completion, we get similar results. In unreported results, break fee size is statistically significant correlated ($p < .01$) with bid competition (inversely) and bid completion (positively), with and without the same controls show in table 9.8. The point estimates are reasonable and economically significant. In models with year and industry fixed effects, for every point higher a break fee is as a percentage of bid value, the odds of a competitive bid are reduced by 28 percent—for example, from a sample average of 10 percent to 7.2 percent. Likewise, the odds of bid completion are increased by 128 percent—for example, moving from a typical UK break fee of 1 percent to a typical U.S. break fee of 3 percent would increase the completion rate from 90 percent to about 93 percent.

Placebo Tests on Block Purchases

The results just presented are consistent with the hypothesis that the UK approach to break fees has important effects not only on break fee size but also on bid competition and bid completion rates. A skeptic might wonder about unobserved, omitted factors that might correlate with differences between the UK and U.S. M&A markets, on the one hand, and break fee size and bid outcomes, on the other hand. One way to test for this possibility is to run the same regressions using a different data set that consists of UK and U.S. bids that are much less susceptible (or not susceptible at all) to bid competition; namely, block purchases.

For this purpose, we examine bids that were drawn from the initial sample described earlier but were dropped because the bidders sought less than 50 percent of the target's stock in the bid. Such block purchases are either invulnerable to bid competition because the bidder already owns a control block of the target, because (as with a negotiated buyback from a existing blockholder) the bid would not be subject to shareholder approval, or because the block being sought would not plausibly provide control to a competing bidder, who would typically be better off seeking to purchase a similarly-sized block on the open market after the initial bid is completed. In effect, the subcontrol block bids dropped from the initial sample can be used as a "placebo test" of hypotheses 5 through 8.

The placebo sample consists of 626 bids. Of those, 65 percent (n = 406) are buybacks—bids by a company for its own stock. The rest (n = 220) are third-party bids, but the median bid is for 22 percent of the target, and over a third of the bids are for less than 10 percent. Of those where the bid seeks more than 22 percent, the bidder already owns more than 50 percent of the target in more than 75 percent of the bids, and more than 40 percent in more than 90 percent of the bids. Consistent with the basic idea that break fees are designed to deter competition, or provide insurance against the possibility competition emerges, only six of the nonbuyback placebo bids included a break fee, and only one of the buyback placebo bids included a break fee (the unusual buyback of John Malone's 16 percent toehold in News Corp., which helped preserve 30 percent blockowner's Rupert Murchoch's control and was subject to News Corp. shareholder approval. All were for U.S. targets.

In the placebo sample, unlike the main sample, UK bids encountered no competition, whereas U.S. nonbuyback bids did (although the difference is not statistically significant), and UK bids were more (not less) likely to be completed than U.S. bids, and were completed more often in the United Kingdom than were the aforementioned control bids (95 percent vs. 85 percent, p-value < 0.03). The fact of higher completion rates in the United Kingdom than in the United States—which, recall, is the opposite of what holds in the main sample, where competition is a threat—is not statistically significant when the sample is broken down into buybacks and nonbuybacks (for either subsample), but regains statistical significance for buybacks only after inclusion of the controls used in the main regressions. In sum, the placebo sample shows that in block purchases, where competition is not a serious threat, break fees are uncommon in either nation, UK bids encounter no more competition, and UK bids are, if anything, more likely to be completed than U.S. bids (for buybacks). If something other than break fees is driving the higher levels of competition and lower levels of completion in control bids in the United Kingdom, the omitted factor does not have the same affect on noncontrol block purchases.

9.4 Summary of Findings, Limits, and Lessons

9.4.1 Summary of Findings

The data reviewed in the previous section provide evidence consistent with a number of the hypotheses stated in section 9.2. Break fee law appears to bind in both the United Kingdom and the United States: (1) UK break fees do not exceed 1 percent; (2) U.S. break fees vary more than UK break fees; and (3) the United States experiences break fee litigation, whereas (4) the United Kingdom does not. Break fee demand appears to vary, and the modal demand appears to exceed 1 percent of bid value, so that (5) UK break fees cluster just below or at 1 percent, but (6) U.S. break fees typically exceed 1 percent by two to three times. On the other hand, the data appear inconsistent with common conjectures about the functioning of "common law" courts: (7) U.S. fee litigation appears to be increasing, not diminishing, over time; and (8) U.S. fee variation has not fallen. Finally, the effects of break fee law appears to matter more than to just break fee design: (9) bid competition is higher in the United Kingdom than in the United States; (10) bid completion rates are lower in the United Kingdom than in the United States; and (11) bid incidence for listed target firms is generally lower in the United Kingdom than in the United States.

9.4.2 Limits

A number of factors may limit the extendability of this chapter. First, M&A contests typically promise large benefits to well-funded participants. The parties affected can, in a general sense, afford to lobby and litigate, and are, in general terms, evenly matched. This is not a context in which disputes arise between large, organized, well-funded producers and dispersed resource constrained individuals. One exception—discussed briefly before—was the absence of organized institutional shareholders in the United States when hostile bids first emerged in the 1950s, but even that absence has dissipated over time. Second, M&A contests have few large externalities identifiable ex ante (other than on bidders and shareholders). While the choice of bidder may in fact have important third-party effects (through layoffs, increases in creditor risk, changes in taxes), these effects and their precise incidence are rarely known in advance. Third, M&A break fees are not generally salient—in either political or moral terms—to the public. No politician directly elected by the general population is ever likely to get elected because of his or her position on break fees.

9.4.3 Lessons

With those limits in mind, what are potential lessons from the contrast between the UK and U.S. approaches to M&A break fees?

Observed Advantages of Regulation

The United Kingdom's regulatory approach exhibits clear benefits. It generates little or no litigation, provides clear guidance for market participants, keeps fees low, and increases bid competition. More generally, it may make it harder for target fiduciaries to favor bidders for private benefits, but such a conjecture presumes target fiduciaries are not otherwise constrained or incentivized properly, and that ex post litigation would do a worse job of constraining target agency costs than regulation.

Observed Advantages of Litigation

On the other hand, by capping fees at what is a low amount, relative to that chosen in the less regulated U.S. M&A environment, UK regulation likely results in the underprovision of insurance for bidders for transaction and opportunity costs if they bid and another bidder ultimately prevails, and for the noncontractible certification benefit a bid gives a target. Given that 95 percent of U.S. break fees exceed the 1 percent cap applicable in the United Kingdom, it seems unlikely that all of these fees represent target agency costs. The U.S. litigation approach likely permits more value-adding fees to be used. The result is likely to be more bidding in the United States than in the United Kingdom. If targets are otherwise forced or pressured to sell themselves, the social loss may not be significant. But if targets can and do refuse to put themselves "in play" with a bid they consider too low, and if bidders hold back because they cannot insure against competition risk, there may be welfare losses from too little M&A in the United Kingdom.

To be sure, factors (legal or nonlegal) other than break fees may explain this difference: the U.S. economy may be more dynamic to achieve economies of scale or scope or other benefits of deal activity, and other rules or practices (e.g., inhibitions against high levels of executive compensation and severance in the United Kingdom) may drive the difference. Even if it could be established that the United Kingdom has less M&A than the United States as a result of break fee governance, some would argue that is a good thing, as many deals may be driven by misvaluations or other market imperfections (e.g., Shleifer and Vishny 2003). Net benefits of UK regulation of fees are difficult to gauge, at best.[25]

25. An interesting question, not taken up here, would be to compare the performance of firms acquired and not acquired in the United States and the United Kingdom, to see if the difference in bid rates may contribute to differences in observable corporate performance over time.

Missing Advantage of Regulation

While the UK approach seems to provide some of the conventionally identified benefits of regulation, it does not seem to reflect one: expertise. While the UK Takeover Panel does have greater expertise than generalist courts, it does not seem to have used that expertise in devising its rule on break fees. Nothing in the brief statement accompanying the adoption of the 1 percent rule suggests that any careful study or analysis went into the rule, and the Panel has left it unchanged for the past ten years. Indeed, given the character of the rule, it is hard to see how the Takeover Panel could develop expertise; with variation essentially eliminated, they have lost the ability to look for differential effects of different fees.

Missing Advantage of Litigation

Likewise, the U.S. approach, while preserving greater flexibility and variation in break fee use, does not seem to reflect one of the conventionally identified benefits of litigation: evolution toward clearer and better standards over time. The U.S. courts, particularly in Delaware, seem to go out of their way to refuse to provide guidance on what is or is not an acceptable fee, retaining discretion to find the same fee acceptable in one case and unacceptable in another, based on factors that they never identify clearly. As noted before, the general standard used in Delaware—fees that induce bids are acceptable, fees that preclude bids are not—is useless in practice, since nearly all fees may do both. This standard is the same standard used twenty years ago, after dozens of cases have presented Delaware's chancery with the opportunity to refine or clarify the standard. As a result, litigation over break fees in the United States continues at a high pace, showing no signs of diminishing over time.

Nor can Delaware's reluctance to clarify its fee standard be attributed to the general desire of courts to retain some discretion to prevent private parties from evading or working around a clear rule. It would be possible, for example, for the court to establish a presumption that a 2 to 3 percent fee would be presumed to be legitimate absent clear evidence suggesting that it was produced by a violation of the target board's duties in some other respect, or a presumption that a fee over 4 percent would be presumed to be excessive absent clear evidence that the bidder had incurred greater than normal bidding costs. Such presumptions could provide parties with guidance, increasing bidding certainty and lowering legal costs, without committing the court to strike down (or uphold) fees contrary to the presumptions. Delaware courts have not been willing to go even this far.

Stasis in Both Regimes

Neither the United Kingdom nor the United States seem to exhibit meaningful legal change over time, as applied to break fees. Legal inertia can be a benefit: it allows for greater awareness of the legal rule to spread and shape behavior, and it encourages private parties to make investments that depend on the law not changing. On the other hand, if laws are imperfect but can be improved over time, with experience, the fact of inertia in both regimes may be troubling. It is consistent with a public choice explanation of law in both nations.

Interaction of Lawmaker Incentives and Private Interests

In the United Kingdom, the Takeover Code is still dominated by institutional shareholders, who reap the immediate benefits of greater competition conditional on a bid, and whose power to choose among bids would be diminished by a looser regime governing break fees. A looser regime might benefit shareholders by encouraging more bidding, but the incidence of increased M&A would be hard to predict, and would be shared with bidders and other market participants, who face collective action problems already overcome in the United Kingdom by institutions represented on the Takeover Panel. By reflecting institutional shareholder dominance in the membership rules governing the Takeover Panel, the United Kingdom has institutionalized a political victory dating back to the 1950s, which seems highly unlikely to be open to legal changes that would hurt its dominant constituency, even if doing so would benefit the economy or society. In addition, the structure and incentives of the Takeover Panel may explain the initial choice of a bright-line rule. Although the Panel has a full-time staff, Panel members themselves (who decide Panel policy and resolve disputes) have other full-time jobs, and are not compensated for their work on the Panel, which at least blunts—and probably reverses—any incentive they might have to maintain vague standards to preserve disputes. When break fees began to be used more widely in the 1990s in the United Kingdom, the rule adopted by the Panel minimizes the need for Panel guidance or dispute resolution on break fees, reducing the time demanded of Panel members.

In the United States, break fee law remains an opaque preserve of professional lawyers and courts. The loose standards used to evaluate fees generate widely varying business norms and expensive litigation, and prevents others from easily knowing what is and what is not legal, in a key aspect of M&A practice. This state of affairs generates rents for litigators and transactional lawyers, who can honestly claim an ever-so-slightly greater ability to read the legal tea-leaves in a particular context, and leverage that advisory role into boardroom networks and repeat business. It also makes life more interesting for judges, who serve full-time multiyear terms, until they retire and join the ranks of well-compensated lawyers. Delaware's Chancellor Chandler, who wrote one of the recent Delaware decisions firmly rejecting bright-line rule-like approaches to fee review,[26] was a lawyer at one of the

26. Louisiana, supra note 12; see also *Orman v. Cullman,* 794 A.2d 5, 45 (2002) (declining to adopt bright-line test for whether a consulting fee was material for purposes of determining a

leading Delaware corporate litigation law firms before becoming a judge.[27] One need not imagine—and I do not suggest—that the Chancellor had any intent to benefit his future self, or his fellow jurists, in writing that decision. All that is required was a judiciary socialized in a culture of standards-based justice (Kamar 1998; Rock 1997). The other Vice Chancellors have exhibited similar concerns for "justice" as expressed in a resistance to rules in favor of standards.[28] In the United States, the cadre of deal lawyers are at the forefront of defending Delaware, and its judiciary, against the slightest risk of intrusion by Congress or the SEC and its tendency toward bright-line rules.[29]

At the same time, a simple dichotomy of UK regulation protected by institutions and U.S. litigation protected by lawyers is overly simple. The UK approach to break fees is in the context of a legal system that still relies to a significant extent on litigation. Even the subject of M&A is governed by a system that is at most a hybrid—a specialized regulatory body applying general standards—but using a bright-line rule for break fees. And the U.S. approach is in the context of a legal system that is replete with bright-line rules, including rules adopted by the SEC,[30] statutes adopted by the Delaware legislature,[31] and rules articulated by the Delaware courts.[32] In the United States, too, institutional shareholders have become increasingly

director's independence in reviewing a conflict transaction) (Chandler, C.). There is a certain irony in the Chancellor's refusal to provide better guidance to practitioners, given his criticism of the failure of practitioners to provide sufficient guidance to courts in drafting M&A contracts. Cf. *United Rentals, Inc. v. RAM Holdings, Inc.,* et al. Civil Action No. 3360-CC (Del. Ch. Dec. 13, 2007) (Chandler, C.), slip op. at 2 (characterizing use of hierarchical phrases such as "subject to" in lieu of harmonizing disparate contract language as "inartful drafting") with *United Rentals, Inc. v. RAM Holdings, Inc. and RAM Acquisition Corp.,* case: 937 A.2d 810 (Del. 2007) (Chandler, C.) (characterizing agreement as the product of "a deeply flawed negotiation in which both sides failed to clearly and consistently communicate their client's positions" but holding that an "interpretation of the Agreement that relies on the parties' addition of hierarchical phrases, instead of the deletion of particular language altogether, is not unreasonable as a matter of law" and acknowledging that "the law of contracts . . . does not require parties to choose optimally clear language; in fact, parties often riddle their agreements with a certain amount of ambiguity in order to reach a compromise").

27. See www.courts.delaware.gov/courts/court%20of%20chancery/?jud_off.htm (describing careers of current Delaware court); see also www.paulweiss.com/resources/news/detail.aspx?news=1947 (announcing move of recently retired vice-chancellor to start major New York law firm's Delaware office).

28. For example, Netsmart, supra note 25 (Strine, V.C.).

29. Comments from major law firms on the recently proposed SEC rule providing shareholders access to company proxy statements illustrates the point. See www.sec.gov/comments/s7-10-09/s71009.shtml, and particularly the comment from seven law firms, available at www.sec.gov/comments/s7-10-09/s71009-212.pdf at 3 (suggesting the SEC not adopt its proposed rule 14a-11 "in the interests of federalism" in order to allow state law initiatives in Delaware and elsewhere "to flourish").

30. For example, companies with more than $10 million in assets and 500 shareholders must register with the SEC. Securities Exchange Act of 1934 § 12(g)(1); SEC Rule 12g-1.

31. A majority of directors and a majority of shareholders may approve a merger of a company with another and, if desired, cash out other shareholders, by following formal steps specified in D.G.C.L. § 251.

32. For example, Delaware shareholders may not seek to enjoin a merger simply on the ground that it will convert their stock into cash or stock of another company (Weiss 1983).

active in politics over the past twenty years, but have exhibited no general preference for regulation over litigation, and no interest in lobbying to law relevant to break fees. At a minimum, this suggests that a plausible theory of the incidence of regulation and litigation will require finer explanatory variables than those that apply to nations as a whole, such as their legal origin, and will need to include some allowance for historical contingencies. A theory that points to differential collective action costs will need to attend to the fact that the same set of trade organizations and institutions can produce a system that includes bright-line rules and vague standards simultaneously. The vices and virtues of each method are likely to have different values at different levels of legal specificity. Exploring law with that much precision will no doubt complicate the theory, and perhaps make it difficult to articulate any plausible regularities spanning laws within a nation, much less across multiple nations, and make it harder for an institution like the World Bank to use the analysis to create simple rule-like schemes to reward or punish growth-oriented legal reform. Resulting theories may lack the merit of simplicity, but have the virtue of truth.

9.5 Conclusion

This chapter has contrasted UK and U.S. governance of M&A break fees with a view to what the contrast can teach us about the trade-offs between litigation and regulation, including how laws change under each regime over time. The United Kingdom caps fees at a low level with a simple ex ante rule based not on regulatory expertise but on an arbitrarily chosen percentage of bid value, which nonetheless has the virtues of clarity and lower litigation costs, and enhances competition conditional on an initial bid. The U.S. courts evaluate fees ex post with a complex standard, allowing for greater variation and higher average fees, reducing the risk of bidding and possibly increasing M&A overall, at the cost of significant amounts of ongoing litigation, in part because courts resist articulating clear rules. Laws in each nation exhibit inertia; are protected by entrenched interest groups (institutions in the United Kingdom, lawyers in the United States); and coexist with the opposite approach (litigation in the United Kingdom, regulation in the United States), even within the domain of M&A law. Subject to strong limits on external validity, the case study suggests that interest groups may be the most important factors shaping the initial choice between regulation and litigation, even for otherwise similar nations in a similar context, and that a combination of interest groups formed in response to a given choice, as well as lawmaker incentives, may preserve those choices even after the conditions giving rise to the initial choice have passed away.

Appendix

List of U.S. Cases Concerning M&A Break Fees 1989 to 2009 Reported in Westlaw "Allcases"

Initial Search Terms: "(merger "tender offer")" and "("break fee" "termination fee" "bust-up fee" "break-up fee)" and "fiduciary duty". Search returned 225 opinions as of September 9, 2009. Each opinion was reviewed to verify that it concerned an M&A break fee, and an allegation that such a fee violated the target board's fiduciary duties, or was unenforceable as a matter of public policy. Opinions were excluded if they were in bankruptcy court (where bankruptcy law applies), only involved disclosure claims regarding break fees, or involved disputes between the bidder and the target as to whether the fee was payable (other than on grounds that it violated the target board's fiduciary duties or public policy).

2009

1. *Pennsylvania Avenue Funds v. Borey,* Slip Copy, 2009 WL 902070, W.D.Wash., March 30, 2009 (NO. C06-1737RAJ)
2. *Somers ex rel. EGL, Inc. v. Crane,*—S.W.3d—, 2009 WL 793751, Tex.App.-Hous. (1 Dist.), March 26, 2009 (NO. 01-07-00754-CV, 01-08-00119-CV)
3. *Indiana State Dist. Council of Laborers v. Brukardt,* Slip Copy, 2009 WL 426237, Tenn.Ct.App., February 19, 2009 (NO. M200702271COAR3CV)
4. *In re Wm. Wrigley Jr. Co. Shareholders Litigation,* Not Reported in A.2d, 2009 WL 154380. Del.Ch., January 22, 2009 (NO. CIV.A. 3750-VCL)

2008

5. *In re Bear Stearns Litigation,* 23 Misc.3d 447, 870 N.Y.S.2d 709, 2008 N.Y. Slip Op. 28500, N.Y.Sup., December 04, 2008 (NO. 600780/08)
6. *Greenspan v. Intermix Media, Inc,* Not Reported in Cal.Rptr.3d, 2008 WL 4837565, Nonpublished/Noncitable (Cal. Rules of Court, Rules 8.1105 and 8.1110, 8.1115), Cal.App. 2 Dist., November 10, 2008 (NO. B196434)
7. *County of York Employees Retirement Plan v. Merrill Lynch & Co., Inc.,* Not Reported in A.2d, 2008 WL 4824053, Del.Ch., October 28, 2008 (NO. CIV.A. 4066-VCN)
8. *In re Lear Corp. Shareholder Litigation,* 967 A.2d 640, Del.Ch., September 02, 2008 (NO. CIV.A. 2728-VCS)
9. *Ryan v. Lyondell Chemical Co.,* Not Reported in A.2d, 2008 WL 2923427, 34 Del. J. Corp. L. 333, Del.Ch., July 29, 2008 (NO. CIV.A. 3176-VCN)

2007

10. *Gut v. MacDonough,* Not Reported in N.E.2d, 23 Mass.L.Rptr. 110, 2007 WL 2410131, Mass.Super., August 14, 2007 (NO. CIV.A. 2007-1083-C)

11. *In re Topps Co. Shareholders Litigation,* 926 A.2d 58, Del.Ch., June 14, 2007 (NO. CIV.A 2786-VCS, CIV.A. 2998-VCS)

12. *In re Netsmart Technologies, Inc. Shareholders Litigation,* 924 A.2d 171, 32 Del. J. Corp. L. 941, Del.Ch., March 14, 2007 (NO. CIV.A. 2563-VCS)

13. *Shaper v. Bryan,* 371 Ill.App.3d 1079, 864 N.E.2d 876, 309 Ill.Dec. 635, Ill.App. 1 Dist., March 08, 2007 (NO. 1-05-3849)

14. *Louisiana Municipal Police Employees' Retirement System v. Crawford,* 918 A.2d 1172, Del.Ch., February 23, 2007 (NO. CIV.A. 2635-N, CIV.A. 2663-N)

2006

15. *Energy Partners, Ltd. v. Stone Energy Corp.,* Not Reported in A.2d, 2006 WL 4782287, Del.Ch., October 11, 2006 (NO. 2402-N, 2374-N)

16. *In re Guidant Corp. Shareholders Derivative Litigation,* Not Reported in F.Supp.2d, 2006 WL 290524, S.D.Ind., February 06, 2006 (NO. 1:03 CV 955 SEB WTL)

2005

17. *Romero v. U.S. Unwired,* Not Reported in F.Supp.2d, 2005 WL 2050280, E.D.La., August 11, 2005 (NO. CIV.A.04-2312, CIV.A.04-2436)

18. *In re Toys "R" Us, Inc. Shareholder Litigation,* 877 A.2d 975, Del.Ch., June 22, 2005 (NO. CIV.A. 1212-N)

19. *In re Prime Hospitality, Inc.,* Not Reported in A.2d, 2005 WL 1138738, Del.Ch., May 04, 2005 (NO. CIV.A. 652-N)

20. *In re Wachovia Shareholders Litigation,* 168 N.C.App. 135, 607 S.E.2d 48, N.C.App., January 18, 2005 (NO. COA04-402)

2004

21. *Jasinover v. Rouse Co.,* Not Reported in A.2d, 2004 WL 3135516, 2004 MDBT 12, Md.Cir.Ct., November 04, 2004 (NO. 13-C-04-59594)

22. *Orman v. Cullman,* Not Reported in A.2d, 2004 WL 2348395, 30 Del. J. Corp. L. 635, Del.Ch., October 20, 2004 (NO. CIV.A. 18039)

23. *Consolidated Edison, Inc. v. Northeast Utilities,* 332 F.Supp.2d 639, S.D.N.Y., August 24, 2004 (NO. 01 CIV. 1893 (JGK))

24. *Marcoux v. Prim,* Not Reported in S.E.2d, 2004 WL 830393, 2004 NCBC 5, N.C.Super., April 16, 2004 (NO. 04 CVS 920)

25. *In re MONY Group Inc. Shareholder Litigation,* 852 A.2d 9, 29 Del. J. Corp. L. 956, Del.Ch., February 17, 2004 (NO. CIV.A. 20554)

2003

26. *In re Cysive, Inc. Shareholders Litigation,* 836 A.2d 531, Del.Ch., August 15, 2003 (NO. CIV.A. 20341)

27. *Omnicare, Inc. v. NCS Healthcare, Inc.,* 818 A.2d 914, Del.Supr., April 04, 2003 (NO. 605, 2002, 649, 2002)

2002

28. *Shepard v. Humke,* Not Reported in F.Supp.2d, 2002 WL 1800311, S.D.Ind., July 09, 2002 (NO. IP 01-1103-C H/G)
29. *McMurray v. De Vink,* 27 Fed.Appx. 88, 2002 WL 13793, (Not Selected for publication in the Federal Reporter), C.A.3 (N.J.), January 03, 2002 (NO. 01-1346)

2001

30. *In re: POLICY MANAGEMENT SYSTEMS CORPORATION SHAREHOLDER LITIGATION,* Not Reported in S.E.2d, 2001 WL 34131445, S.C.Com.PI., December 10, 2001 (NO. 00-40-CP-1289)
31. *First Union Corp. v. Sun Trust Banks, Inc.,* Not Reported in S.E.2d, 2001 WL 1885686, 2001 NCBC 09, N.C.Super., August 10, 2001 (NO. 01-CVS-10075, 01-CVS-8036, CIV.A. 01-CVS-4486)
32. *Shepard v. Meridian Ins. Group, Inc.,* 137 F.Supp.2d 1096, S.D.Ind., April 10, 2001 (NO. IP 00-1360-C H/G)
33. *McMichael v. U.S. Filter Corp.,* Not Reported in F.Supp.2d, 2001 WL 418981, Fed. Sec. L. Rep. P 91,406, C.D.Cal., February 23, 2001 (NO. DECV 00-340VAP(MCX), EDCV 00-196VAP(MCX), EDCV 00-341VAP(MCX), EDCV 00-528VAP(MCX), EDCV 99-182VAP(MCX), EDCV00-223VAP(MCX))
34. *In re Pennaco Energy, Inc.,* 787 A.2d 691, Del.Ch., February 05, 2001 (NO. CIV.A. 18606)

2000

35. *McMillan v. Intercargo Corp., 768* A.2d 492, Del.Ch., April 20, 2000 (NO. CIV. A. 16963)
36. *State of Wisconsin Inv. Bd. v. Bartlett,* Not Reported in A.2d, 2000 WL 238026, 26 Del. J. Corp. L. 469, Del.Ch., February 24, 2000 (NO. C.A. 17727)

1999

37. *In re IXC Communications, Inc. v. Cincinnati Bell, Inc.,* Not Reported in A.2d, 1999 WL 1009174, Del.Ch., October 27, 1999 (NO. C.A. 17334, C.A. 17324)
38. *ACE Ltd. v. Capital Re Corp.,* 747 A.2d 95, Del.Ch., October 25, 1999 (NO. CIV.A. 17488)
39. *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.,* 1999 WL 1054255 (Del.Ch. Sept.27, 1999)
40. *Chaffin v. GNI Group, Inc.,* Not Reported in A.2d, 1999 WL 721569, Del.Ch., September 03, 1999 (NO. CIV. A. 16211-NC)

41. *Goodwin v. Live Entertainment, Inc.,* Not Reported in A.2d, 1999 WL 64265, Del.Ch., January 25, 1999 (NO. CIV. A. 15765)

1998

42. *Golden Cycle, LLC v. Allan,* Not Reported in A.2d, 1998 WL 892631, 24 Del. J. Corp. L. 688, Del.Ch., December 10, 1998 (NO. CIV.A. 16301)

43. *Matador Capital Management Corp. v. BRC Holdings, Inc.,* 729 A.2d 280, Del.Ch., November 25, 1998 (NO. C. A. 16758)

44. *In re First Interstate Bancorp Consol. Shareholder Litigation,* 729 A.2d 851, Del.Ch., October 07, 1998 (NO. 14623)

45. *In re Chips and Technologies, Inc. Shareholders Litigation,* Not Reported in A.2d, 1998 WL 409155, Del.Ch., June 24, 1998 (NO. C.A. 15832)

46. *United Vanguard Fund, Inc. v. TakeCare, Inc.,* 727 A.2d 844, 24 Del. J. Corp. L. 358, Del.Ch., June 08, 1998 (NO. CIV.A. 13343)

1997

47. *Brazen v. Bell Atlantic Corp.,* 695 A.2d 43, 65 USLW 2802, Del.Supr., May 27, 1997 (NO. 1997, 130)

1996

48. *Kahn v. Dairy Mart Convenience Stores, Inc.,* Not Reported in A.2d, 1996 WL 159628, 21 Del. J. Corp. L. 1143, Del.Ch., March 29, 1996 (NO. CIV. A. 12489)

49. *Kysor Indus. Corp. v. Margaux, Inc.,* 674 A.2d 889, Del.Super., January 31, 1996 (NO. CIV.A.94C-12-196-JOH)

50. *Wells Fargo & Co. v. First Interstate Bancorp.,* Not Reported in A.2d, 1996 WL 32169, 21 Del. J. Corp. L. 818, Del.Ch., January 18, 1996 (NO. CIV. A. 14696, CIV. A. 14623)

1995

51. *In re Santa Fe Pacific Corp. Shareholder Litigation,* 669 A.2d 59, Del. Supr., November 22, 1995 (NO. 224, 1995)

1993

52. *Paramount Communications Inc. v. QVC Network Inc.,* 637 A.2d 828, 1993 WL 544314, Fed. Sec. L. Rep. P 98,000, (Table, Text in WESTLAW), Unpublished Disposition, Del.Supr., December 09, 1993 (NO. 427,1993, 428,1993)

53. *In re Corporate Software Inc. Shareholders Litigation,* Not Reported in A.2d, 1993 WL 1501008, Del.Ch., November 23, 1993 (NO. CIV.A. 13209)

1992

54. *Seinfeld v. Bays,* 230 Ill.App.3d 412, 595 N.E.2d 69, 172 Ill.Dec. 6, Fed. Sec. L. Rep. P 97,024, Ill.App. 1 Dist., May 22, 1992 (NO. 1-90-3414, 1-90-3415, 1-90-3416)

1991

55. *In re Vitalink Communications Corp. Shareholders Litigation,* Not Reported in A.2d, 1991 WL 238816, Fed. Sec. L. Rep. P 96,585, 17 Del. J. Corp. L. 1311, Del.Ch., November 08, 1991 (NO. CIV.A. 12085)

1990

56. *Roberts v. General Instrument Corp.,* Not Reported in A.2d, 1990 WL 118356, Fed. Sec. L. Rep. P 95,465, 16 Del. J. Corp. L. 1540, Del.Ch., August 13, 1990 (NO. CIV.A. 11639)

57. *Lewis v. Leaseway Transp. Corp.,* Not Reported in A.2d, 1990 WL 67383, Fed. Sec. L. Rep. P 95,275, 16 Del. J. Corp. L. 815, Del.Ch., May 16, 1990 (NO. CIV. A. 8720)

1989

58. *Braunschweiger v. American Home Shield Corp.,* Not Reported in A.2d, 1989 WL 128571, Fed. Sec. L. Rep. P 94,779, 15 Del. J. Corp. L. 997, Del.Ch., October 26, 1989 (NO. CIV.A. 10755)

59. *In re Holly Farms Corp. Shareholders Litigation,* 564 A.2d 342, 58 USLW 2011, Fed. Sec. L. Rep. P 94,486, Del.Ch., June 14, 1989 (NO. CIV. A. 10350)

60. *Mills Acquisition Co. v. Macmillan, Inc.,* 559 A.2d 1261, 57 USLW 2674, Fed. Sec. L. Rep. P 94,401, Del.Supr., May 03, 1989 (NO. 415,1988, 416,1988)

61. *In re Formica Corp. Shareholders Litigation,* Not Reported in A.2d, 1989 WL 25812, Fed. Sec. L. Rep. P 94,362, Del.Ch., March 22, 1989 (NO. CIV.A. 10598)

References

Aghion, P., and P. Bolton. 1987. Contracts as a barrier to entry. *American Economic Review* 77 (3): 388–401.

Andrade, G., M. Mitchell, and E. Stafford. 2001. New evidence and perspectives on mergers. *Journal of Economic Perspectives* 15 (2): 103–20.

André, P., S. Khalil, and M. Magnan. 2007. Termination fees in mergers and acquisitions: Protecting investors or managers? *Journal of Business Finance and Accounting* 34 (3–4): 541–66.

Armour, J., and D. Skeel. 2007. Who writes the rules for hostile takeovers, and why?—The peculiar divergence of U.S. and U.K. takeover regulation. *Georgetown Law Journal* 95:1727.
Ayers, I. 1990. Analyzing stock lock-ups: Do target treasury sales foreclose or facilitate takeover auctions? *Columbia Law Review* 90 (3): 682–718.
Bates, T. W., and M. L. Lemmon. 2003. Breaking up is hard to do? An analysis of termination fee provisions and merger outcomes. *Journal of Financial Economics* 69 (3): 469–504.
Bebchuk, L. 1989. The debate on contractual freedom in corporate law. *Columbia Law Review* 89:1395–415.
Becker, G. S., and G. J. Stigler. 1974. Law enforcement, malfeasance and compensation of enforcers. *The Journal of Legal Studies* 3 (1): 1–18.
Boone, A. L., and J. H. Mulherin. 2007. Do termination provisions truncate the takeover bidding process? *Review of Financial Studies* 20 (2): 461–89.
Burch, T. R. 2001. Locking out rival bidders: The use of lockup options in corporate mergers. *Journal of Financial Economics* 60 (1): 103–41.
Chapple, L., B. Christensen, and P. M. Clarkson. 2007. Termination fees in a "bright line" jurisdiction. *Accounting and Finance* 47 (4): 643–65.
Coates, J. 1999. "Fair value" as a default rule of corporate law: Minority discounts in conflict transactions. *University of Pennsylvania Law Review* 147:1251.
———. 2001. Explaining variation in takeover defenses: Blame the lawyers. *California Law Review* 89 (5): 1301–421.
Coates, J., and G. Subramanian. 2000. A buy-side model of M&A lockups: Theory and evidence. *Stanford Law Review* 53 (2): 307.
Cook, P. J., and J. Ludwig. 2002. Litigation as regulation: Firearms. In *Regulation through litigation,* ed. W. K. Viscusi, 67–93. Washington, DC: AEI-Brookings Joint Center for Regulatory Studies.
Davies, G., and J. Palmer. 2004. Break fees common but not always legal. *International Financial Law Review* (April 2004 Supplement): 179–82.
Diamond, P. A., and E. S. Maskin. 1979. An equilibrium analysis of search and breach of contract, I: Steady states. *Bell Journal of Economics* 10 (1): 282–316.
Dreyfuss, R. C. 1995. Forums of the future: The role of specialized courts in resolving business disputes. *Brooklyn Law Review* 61:1–44.
Ehrlich, I., and R. Posner. 1974. An economic analysis of legal rulemaking. *Journal of Legal Studies* 3 (1): 257–86.
Gennaioli, N., and A. Shleifer. 2007. The evolution of common law. *Journal of Political Economy* 115 (1): 43–68.
Glaeser, E., S. Johnson, and A. Shleifer. 2001. Coase versus the Coasians. *Quarterly Journal of Economics* 116 (3): 853–99.
Glaeser, E. L., and A. Shleifer. 2003. The rise of the regulatory state. *Journal of Economic Literature* 41 (2): 401–25.
Hanson, J., and S. Fraidin. 1994. Toward unlocking lockups. *Yale Law Journal* 103 (6): 1739–834.
Kahan, M., and M. Klausner. 1996. Lockups and the market for corporate control. *Stanford Law Review* 48 (6): 1539–71.
Kamar, E. 1998. A regulatory competition theory of indeterminacy in corporate law. *Columbia Law Review* 98 (8): 1908–59.
Kaplow, L. 1992. Rules versus standards: An economic analysis. *Duke Law Journal* 42 (3): 557–629.
Kennedy, D. 1976. Form and substance in private law adjudication. *Harvard Law Review* 89 (8): 1685–778.
Kraakman, R. R., J. Armour, P. Davies, L. Enriques, H. B. Hansmann, G. Hertia,

K. Hopt, and H. Kanda. 2009. *The anatomy of corporate law: A comparative and functional approach,* 2nd ed. New York: Oxford University Press.

La Porta, R., F. Lopez-de-Silanes, and A. Shleifer. 1999. Corporate ownership around the world. *The Journal of Finance* 54 (2): 471–517.

Landis, J. 1938. *The administrative process.* Westport, CT: Greenwood Press.

Llewellyn, K. 1951. *The bramble bush: On our law and its study.* New York: Oceana.

Montgomery, A., G. Davies, and J. Palmer. 2005. Deal protection measures in the UK. *International Financial Law Review* 24:156–59.

Niblett, A., R. A. Posner, and A. Shleifer. 2008. The evolution of a legal rule. NBER Working Paper no. 13856. Cambridge, MA: National Bureau of Economic Research, March.

Officer, M. S. 2003. Termination fees in mergers and acquisitions. *Journal of Financial Economics* 69 (3): 431–67.

Olson, M. 1965. *The logic of collective action: Public goods and the theory of groups.* Cambridge, MA: Harvard University Press.

Pace, N. M., S. J. Carroll, I. Vogelsang, and L. Zakaras. 2007. *Insurance class actions in the United States.* Santa Monica, CA: Rand Corporation.

Posner, R. A. 1973. *Economic analysis of law,* 1st ed. Boston: Little Brown.

———. 2005. Foreward: A political court (the Supreme Court 2004 term). *Harvard Law Review* 119 (1): 31–102.

Rajan, R., and G. L. Zingales. 2003. The great reversals: The politics of financial development in the twentieth century. *Journal of Financial Economics* 69 (1): 5–50.

Revesz, R. 1990. Specialized courts and the administrative lawmaking system. *University of Pennsylvania Law Review* 138 (4): 1111–74.

Rock, E. 1997. Saints and sinners: How does Delaware corporate law work? *UCLA Law Review* 44:1009.

Rossi, S., and P. F. Volpin. 2004. Cross-country determinants of mergers and acquisitions. *Journal of Financial Economics* 74 (2): 277–304.

Rottman, D., M. T. Cantrell, C. R. Flango, R. Hansen, N. LaFountain, and D. B. Rottman. 2000. State Court Organization 1998. Available at: http://bjs.ojp.usdoj.gov/index.cfm?ty=pbdetail&iid=1203.

Schwartz, A. 1986. Search theory and the tender offer auction. *Journal of Law, Economics, and Organization* 2 (2): 229–53.

Schwartzstein, J., and A. Shleifer. 2009. Litigation and regulation. NBER Working Paper no. w14752. Cambridge, MA: National Bureau of Economic Research, February.

Shavell, S. 1984a. A model of the optimal use of liability and safety regulation. *The Rand Journal of Economics* 15 (2): 271–80.

———. 1984b. Liability for harm versus regulation of safety. *Journal of Legal Studies* 13:357.

———. 1993. The optimal structure of law enforcement. *The Journal of Law and Economics* 36 (S1): 255–87.

Shleifer, A., and R. W. Vishny. 2003. Stock market driven acquisitions. *Journal of Financial Economics* 70 (3): 295–311.

Summers, J. 1983. The case of the disappearing defendant: An economic analysis. *University of Pennsylvania Law Review* 132:145.

Sunstein, C. 1995. Problems with rules. *California Law Review* 83:953.

Tarbert, H. 2003. Merger breakup fees: A critical challenge to Anglo-American law. *Law and Policy in International Business* 34:627.

Thomas, R., and R. Thompson. 2004. The public and private faces of derivative lawsuits. *Vanderbilt Law Review* 57:1747.

U.S. State Department. 2009. Background note: United Kingdom (March). Available at: www.state.gov/r/pa/ei/bgn/3846.htm (visited 8/19/09).
von Jhering, R. 1883. *Der Geist des Romischen Recht.* Leipzig: Breitkopf und Härtel.
Weiss, E. 1983. Balancing interests in cash-out mergers: The promise of Weinberger v. UOP, Inc. *Delaware Journal of Corporate Law* 8 (Fall): 1–58.