

Do Termination Provisions Truncate the Takeover Bidding Process?

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We provide new evidence on termination provisions and the takeover bidding process. Our central contribution is a novel database from Securities and Exchange Commission (SEC) documents that accurately measures the incidence of termination provisions and the depth of competition in takeover deals. We show that biased data in prior research produced incorrect conclusions on the relation between termination provisions and judicial decisions, bidder toeholds, and deal size. Our comprehensive data also show that termination provisions are positively related to takeover competition. Our evidence is consistent with the information/commitment hypothesis in which termination provisions do not truncate bidding but instead culminate the takeover process. (*JEL* G34; K22; D44).

As emphasized by Coase (1992), there is much to be learned from the contractual devices used to guide the incentives of transacting parties. Indeed, a growing body of research under the heading of “law and finance” seeks to understand the interaction between the legal system and the organizational features that evolve across firms and markets (La Porta et al., 1998). As described by Macey and O’Hara (2000, p. 113), the maintained hypothesis of the law and finance research is that “the behavior of markets is a complex process that is crucially dependent on legal rules and structures.”

An important application of law and finance research is the role of termination provisions within the corporate takeover process. These provisions include termination fees that promise a specific amount of money to the bidder and stock option agreements that grant the bidder the option to purchase a certain fraction of the target’s common stock in the event the target is acquired by another party. As surveyed by Roosevelt (2000), a central question in legal and financial research is the impact of termination

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provisions on takeover competition: do the provisions inhibit takeover competition and entrench self-serving target managers or do the provisions instead promote competition by mitigating information costs and facilitating takeover auctions?

The importance of this query has been heightened by a debate in the Delaware courts on related contractual devices used in corporate takeovers. In the 2003 *Omnicare* decision, a divided court voided a shareholder voting agreement in which two insiders owning 65% of a target firm committed to vote their shares in favor of a particular bidder. The majority of the court felt that the agreement disenfranchised minority shareholders. By contrast, the dissenting jurists argued that contractual provisions “cannot be reviewed in a vacuum” and that the “court should review the entire bidding process.” (See *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 2003 Delaware.)

To address the debate highlighted by the split judicial decision, we provide new evidence on the role of termination provisions in the takeover bidding process. Our research sequentially addresses the following three related questions:

- (1) How have termination provisions evolved over time?
- (2) How do termination provisions interact with shareholder voting agreements?
- (3) How do termination provisions affect takeover competition?

The extant empirical research, summarized in Table 1, provides incomplete and inaccurate answers to these questions. Our primary innovation over the prior research is a new database derived from US Securities and Exchange Commission (SEC) filings. The new data more accurately measure the incidence of termination provisions and more completely characterize the level of competition in the takeovers process.

Research by Coates and Subramanian (2000) and subsequent papers reports a growing incidence of termination provisions over time and argues that the Delaware courts have influenced the incidence of provisions and the choice between termination fees and stock option agreements. We show that the prior results are inaccurate and stem from biased data from the Securities Data Corporation (SDC). Using the SEC filings, we find little evidence that the use of termination provisions has increased over time or that judicial decisions have influenced the choice between fees and stock option agreements.

We further show that the inaccurate time series increase in termination provisions reported in prior research has led to incorrect inferences on the association between termination provisions and bidder toeholds. Because toeholds have trended downward over time (Betton, Eckbo, and Thorburn 2005, Figure 4), the purported upward trend in termination

Table 1
Prior empirical analysis of termination provisions

Authors	Time period	Number of observations	Percent with provision	Association of provision with					Conclusion on effect of termination provision
				Average size (%)	Public auction	Target return	Target size	Bidder threshold	
Analysis of stock option agreements Coates and Subramanian (2000) Burch (2001)	1988–1999 1988–1995	3163	23	19.9	–	>0	+	n.a.	Protect deals from high-value bidders (p. 389)
		2067	8	20	–	≥0	0	–	Discourage competition for target (p. 139) Used by target managers to enhance their bargaining position (p. 139)
Analysis of termination fees Coates and Subramanian (2000) Officer (2003)	1988–1999 1988–2000	3163	48	3	–	0	+	n.a.	Reduce allocational efficiency (p. 389)
		2511	42	3.8	–	≥0	+	–	Deterrence effect related to other deal characteristics (p. 454)
Bates and Lemmon (2003)	1989–1998	3037	37	3.3	–	≥0	+	–	Truncate a natural bidding process (p. 471) Improve bargaining position of target managers (p. 502)

This table reviews the empirical analysis of termination provisions.

provisions reported in prior research creates a spurious inverse relation between toeholds and termination provisions. Using the comprehensive SEC data, we find no significant relation between bidder toeholds and termination provisions.

We also provide the first systematic analysis of the interaction of termination provisions with shareholder voting agreements. The absence of prior research on voting agreements is due in part to the fact that the 2003 Omnicare decision came after much of the prior empirical research on termination provisions was initiated. Moreover, data on shareholder voting agreements are not readily available from sources such as SDC. Our analysis of data from SEC filings fills this empirical void.

We also revisit a conclusion in prior research that termination provisions are associated with reduced takeover competition. If accurate, such evidence would cast a dim view on termination provisions in the eye of the courts. However, we show that this result is due to an artificially narrow measure of takeover competition that fails to consider the active bidding process before the public announcement of takeovers.

This article proceeds as follows. Section 1 reviews the theory and prior empirical research and highlights our proposed analysis. Section 2 describes our data from SEC filings and reports biases in information from the SDC database. Section 3 reports our novel information on shareholder voting agreements. Section 4 details our new measure of takeover competition. Section 5 reports regression analysis that tests whether termination provisions promote management entrenchment or instead facilitate takeover competition. Section 6 summarizes the article and notes the implications of our results.

1. Theory, Prior Research, and Proposed Analysis

1.1 Theory on the role of termination provisions

The competing theories on termination provisions reflect the overall debate on the role played by various contractual devices employed in corporate takeovers. As originally structured by DeAngelo and Rice (1983), an integral question is whether a particular device harms shareholders by entrenching management or instead acts in shareholder interests by defining property rights and counteracting information costs. Early research found mixed evidence that antitakeover charter amendments harmed target shareholders (DeAngelo and Rice 1983, Linn and McConnell 1983, and Jarrell and Poulsen 1987). Related early work by Ryngaert (1988) and Malatesta and Walkling (1988) reported that poison pills had a small negative effect on shareholders. However, the more recent comprehensive analysis by Comment and

Schwert (1995) suggests that takeover defenses such as poison pills do not systematically harm shareholders.

Consistent with the general mode of the analysis of the contractual devices used in the takeover process, a central question on termination provisions is the effect that the provisions have on takeover competition. One view is the entrenchment hypothesis which argues that target management uses termination provisions to favor a selected bidder. Management would gain in this scenario by facilitating job security (Kahan and Klausner 1996). Target shareholders, however, would lose because of less active bidding for the firm (Bulow and Klemperer 1996, Schwartz 1986). The entrenchment hypothesis predicts that termination provisions are negatively related to takeover competition.

An alternative theory is the information/commitment hypothesis. As noted by Grossman and Hart (1980), Berkovitch and Khanna (1990), and Berkovitch, Bradley, and Khanna (1989), the time between the public announcement of a takeover and the completion of the deal allows other possible bidders the opportunity to free ride on the information generated by the original negotiation and bidding. Such potential free riding might dampen the incentives of bidders to participate in the takeover process in the first place, thereby lessening the returns to target shareholders. By providing compensation in the event that the target is acquired by another bidder, termination provisions are a contractual means to induce participation in the takeover process.

A complementary role of termination provisions derives from the well-known result in auction theory that commitment helps to maximize seller revenues (McAfee and McMillan 1987). In the takeover setting, if bidders do not envision an end to the bidding process, they will not bid as aggressively (Klemperer 1998). Termination provisions are one mechanism for the target firm to commit to the end of bidding (Macey 1990, Thomas and Hansen 1992, Fraidin and Hanson 1994, Povel and Singh 2005). In contrast to the entrenchment hypothesis, the information/commitment hypothesis predicts that termination provisions promote takeover competition.

1.2 Prior empirical research

Prior empirical research, surveyed in Table 1, concludes that termination provisions are associated with reduced takeover competition. In each of the prior papers, termination provisions are found to be inversely related to public takeover auctions. However, the interpretation of the empirical evidence varies somewhat. Coates and Subramanian (2000, p. 389) infer support for the entrenchment hypothesis by concluding that termination provisions protect deals from high-valued

bidders and impair allocational efficiency. Burch (2001, p. 139) concurs that stock option agreements discourage competition but argues that the options improve the bargaining power of target management and enhance target returns. Bates and Lemmon (2003, p. 471) conclude that termination fees truncate a natural bidding process, but they reject the entrenchment hypothesis because they find that termination fees are not inversely related to target returns. Officer (2003, p. 454) argues that any apparent competitive deterrence of termination fees is related to other deal characteristics.

Although noting some of the information issues associated with corporate takeovers, the existing empirical analysis provides little or no direct testing of the information/commitment theory. One reason for this lack of analysis is the conclusion that termination provisions are negatively related to public takeover auctions. Burch (2001, p. 108), for example, expresses doubt about the relevance of theories such as Berkovitch and Khanna (1990) and Berkovitch, Bradley, and Khanna (1989) because of his finding that stock option agreements deter subsequent takeover competition.

1.3 Proposed analysis

The finding that termination provisions are inversely related to takeover competition appears to be at odds with the information/commitment hypothesis. However, we show that this finding stems from the narrow measure of takeover competition used in the prior research. Rather than focus on public takeover auctions, we use SEC documents to measure the private, pre-announcement bidding for the target firms in our sample. Authors such as Bates and Lemmon (2003, footnote 2) have acknowledged that analysis of the nonpublic bidding process could shed light on information/commitment theories such as Berkovitch and Khanna (1990), but they refrained from such analysis because of the absence of readily observable data. Our novel analysis allows us to more fully capture the competitiveness of takeover bidding and thereby perform direct tests of the information/commitment hypothesis.

To further test the information/commitment hypothesis, we also study the interaction of termination provisions with shareholder voting agreements and other ownership variables. For target firms with a large ownership block (Shleifer and Vishny 1986), commitment can also be attained by the blockholder agreeing to vote the shares in favor of the merger. Hence, the information/commitment hypothesis predicts that shareholder voting agreements are a substitute for termination provisions.

Another question that is not fully explored in the prior research is the determinant of the specific type of termination provision chosen in a particular takeover. What affects the choice of a termination fee versus a stock option agreement? The entrenchment hypothesis provides little or

no guidance as to the choice between provisions, arguing generally that some sort of provision would be granted to a favored bidder. By contrast, the information/commitment hypothesis suggests that the choice of provisions will be related to the factors affecting deal completion once a takeover is announced.

To conceptualize the factors affecting the choice between fees and options, note the similarities and differences of the two types of termination provisions. Termination fees and stock option agreements both award money to the initial bidder if the target is ultimately acquired by another party. The monetary amount in the termination fee is the specific figure contracted in the takeover agreement. The value of the stock option is a function of the exercise price in the agreement, the price of the target if the object of another bid, and any cap on the option prescribed in the agreement.

As noted by Wasserstein (2000, p. 675), however, a distinguishing feature of a stock option vis-à-vis a termination fee is that the stock option agreement also conveys possible voting rights to the initial bidder. For example, in the 19.9% stock option granted by Fred Meyer (the target) to Kroger (the bidder) described in a November 9, 1998, S-4 filing by Kroger, Fred Meyer contracted to prepare and file a shelf registration statement for the shares in the option, and Kroger contracted to be present at all stockholder meetings for the purpose of determining quorum.

In terms of the information/commitment hypothesis, this voting feature of stock option agreements is particularly relevant in stock mergers, as such deals generally require a target shareholder vote. The potential for the bidder with the option agreement to vote a fraction of the shares of the target better commits to a completion of the deal for that bidder over possible rivals. Hence, one would expect stock deals to be more likely to employ a stock option agreement than cash deals.

2. The Data Set

2.1 The sample of firms

To provide new tests of the theories on termination provisions, we study 400 takeover attempts that were announced during the 1989–1999 period, roughly the same time period in the prior research. The sample is mostly from the 381 completed and unsuccessful takeovers in Mulherin and Boone (2000). That study began with the firms listed on the Value Line Investment Survey at the beginning of 1990 and tracked those firms that were the object of a takeover attempt during the 1990s. The current sample adds 47 takeovers resolved in 2000 but loses 28 takeovers from the original sample because of missing data. See Boone and Mulherin (2006) for further details on the sample.

The sample of 400 takeover attempts includes 377 completed acquisitions and 23 withdrawn deals. The sample has 103 tender offers and 297 mergers. Cash was used exclusively in 147 takeovers and some or all stock was used in the other 253 takeovers. Sixty of the takeovers began with an unsolicited offer by the bidder or a third party.

2.2 The data on termination provisions

Our analysis focuses on termination provisions granted by the target to the bidding firm. For each takeover in our sample, we reviewed the filings from the EDGAR system of the SEC (for takeovers in 1993 and later) and LexisNexis and Laser Disclosure (for takeovers in 1993 and earlier). Information on termination provisions was garnered from the 14A and S-4 filings (for mergers) and 14D filings (for tender offers).

Table 2 summarizes the incidence of the termination provisions in the sample. As reported at the bottom of the table, 246 of the sample takeovers (62%) have a termination fee only, 48 (12%) have a stock option agreement only, and 69 (17%) have both a termination fee and a stock option agreement. In total, 91% of the sample takeovers have a termination fee, a stock option agreement, or both.

As also summarized in Table 2, the high usage of termination provisions persists throughout the sample period. In 1989, the first year of the sample, 91% of the takeovers have a provision, while in 1999, the last year

Table 2
Termination provisions by year

Year	Termination fee only	Option only	Both	None	Percent with provision
1989	9	2	0	1	92
1990	20	2	5	7	79
1991	5	7	2	5	74
1992	12	5	2	2	90
1993	10	2	2	1	93
1994	17	3	4	6	80
1995	33	12	10	4	93
1996	31	2	4	2	95
1997	44	5	9	6	91
1998	31	7	21	2	97
1999	34	1	10	1	98
Full sample	246	48	69	37	91
Percent of sample	62	12	17	9	

This table summarizes the incidence of termination provisions (termination fees and stock option agreements) granted to the bidder by the target by year for the sample of 400 takeovers. *Year* indicates the year the takeover was announced. *Termination fee only* refers to takeovers with a termination fee but no stock option agreement. *Option only* refers to takeovers with a stock option agreement but no termination fee. *Both* refers to takeovers with both a termination fee and a stock option agreement. *None* refers to a takeover with neither a termination fee nor a stock option agreement. *Percent with provision* refers to the fraction of takeovers in a given year with a termination fee, a stock option agreement, or both. Data on termination provisions are taken from Securities and Exchange Commission (SEC) documents.

in the sample, 98% of the takeovers have a provision. The smallest percentage of takeovers with a termination provision is 74% in 1991 and the largest percentage is 98% in 1999.

2.3 Comparing with SDC data

Our SEC data indicate a high and steady incidence of termination provisions in the 1989–1999 period. By contrast, prior research has reported a growing incidence of termination provisions. Coates and Subramanian (2000, p. 315) report that 40% of the takeovers in their sample had a termination provision in 1988 compared with 80% in 1998. Bates and Lemmon (2003, page 472) report that the use of termination fees in their sample increased from 2% in 1989 to 60% in 1998. Officer (2003, Table 1) reports a similar increasing trend of termination fees in his sample period of 1988–2000. Betton, Eckbo, and Thorburn (2005) and Hotchkiss, Qian, and Song (2005) also report a sizeable increase in termination provisions over time.

Our research indicates that the time trends reported in prior research stem from the incomplete reporting of termination provisions in the SDC database. Evidence of the incompleteness of the SDC data is provided in Table 3. Panel A compares the incidence of termination provisions determined from SEC filings with the data reported on SDC for our sample of 400 takeovers. For the full sample, the SEC filings indicate that 91% of the sample takeovers had a termination provision. By contrast, the SDC data report termination provisions for only 66% of the takeovers, a difference of 25%.

To ensure that the SDC omissions are not particular to our sample, we form a random sample of takeovers on SDC. We begin with all takeovers reported by SDC in 1996, the median year of observation in our sample. We impose the data constraints in other studies and require that targets be US public companies and that deal value be at least \$50 million. From an initial screen of 366 takeovers, we create a random sample of 73 takeovers by sampling every fifth observation. For the 73 deals, SDC classifies 23 (31.5%) as having a termination fee, a stock option agreement, or both. By contrast, in our classification based on SEC documents, 57 of the 73 deals (78%) have a termination fee, a stock option agreement or both. Hence, for this sample taken from a broader universe, SDC also under reports the incidence of termination provisions.

As also summarized in Panel A of Table 3, the difference between the SEC filings and the SDC data is especially noticeable in the early years of the sample. In 1989 and 1990, the difference is 50% or more. The differences are also 40% or more in 1993 and 1996. In 1997 and later, the differences are not as large. In results not reported in the table, we find that a regression of the difference between the SEC and SDC data on a simple linear time trend has a negative and significant coefficient.

Table 3
Comparing Securities and Exchange Commission (SEC) and Securities Data Corporation (SDC) Data

Year	SEC data (%)	SDC data (%)	Difference (%)
Panel A: termination provisions by year			
1989	92	33	59
1990	79	29	50
1991	74	58	16
1992	90	62	28
1993	93	53	40
1994	80	60	20
1995	93	61	32
1996	95	51	44
1997	91	80	11
1998	97	87	10
1999	98	83	15
Full sample	91	66	25
Panel B. Regressions of the incidence of provisions using SEC and SDC data			
Paramount	0.599 (0.142)	0.640 (0.124)	0.494 (0.066)
Brazen	0.622 (0.174)	0.639 (0.166)	1.273 (0.000)
			0.319 (0.251)
			1.230 (0.000)
			0.000 (0.000)

We also found that the accuracy of the SDC data is related to firm size. For the 363 deals in our sample where the SEC data indicate the presence of a termination fee, a stock option agreement, or both, we created a dichotomous dependent variable equal to 1 where SDC also indicates the presence of a fee, option agreement, or both. In a logistic regression, this variable was positively and significantly related to deal size.

2.4 Impact on prior research

The biases that we document for SDC raise concerns about the prior research that has modeled the incidence of termination provisions on time-sensitive and size variables. Coates and Subramanian (2000) conjecture that the use of termination provisions reported by SDC are tied to key legal decisions: *Paramount Communications v. QVC Network* in December 1993 (637 A.2d 34) and *Brazen v. Bell Atlantic* in March 1997 (695 A.2d 43). A number of authors listed in Table 1 report that termination provisions are inversely related to bidder toeholds, a variable that Betton, Eckbo, and Thorburn (2005) report has trended downward significantly over time. Much of the prior research also reports a positive, significant relation between termination provisions and deal size.

To gauge the impact of the biases in SDC, we compare the effects of the time-sensitive and size variables used in prior research on termination data from the SEC vis-à-vis SDC. The explanatory variables were (1) a dummy variable for the Paramount decision equal to 1 for deals done in 1994 and later years, (2) a dummy variable equal to 1 for the Brazen decision for deals done in 1997 and later, (3) the amount, if any, of a toehold, and (4) deal size. The results of the analysis are reported in Panel B of Table 3. The first four regressions use SEC data while the second four regressions use SDC data.

As reported in the first four regressions, none of the time-sensitive or deal-size variables is significantly related to the SEC data. By contrast, the SDC data produce the significant relations reported in prior research. In regression 1, the Paramount and Brazen dummy variables are statistically related to the incidence of termination provisions. In regression 2, toeholds are negatively and significantly related to termination provisions. In regression 3, termination provisions are a direct function of size. For the multivariate specification in regression 4, the signs of all the explanatory variables are the same, although the coefficient on the Paramount dummy is insignificant. As a whole, Table 3 indicates that the biases in SDC data have incorrectly influenced prior research.

3. Shareholder Voting Agreements and other Ownership Variables

The SEC takeover filings also report information on related contractual devices such as shareholder voting agreements. In such agreements, blockholders in the target firm such as insiders and founding family

Table 4
Shareholder voting agreements and other ownership variables

	Number of observations	Percent shares mean (%)	Percent shares median (%)
Panel A: shareholder voting agreements and other ownership variables			
Shareholder voting agreements	68	41	40
With termination provision	60	40	39
Without termination provision	8	52	55
Ownership affiliation	28	54	58
With termination provision	8	40	33
Without termination provision	20	60	63
Toehold	28	7	5
With termination provision	24	7	5
Without termination provision	4	3	1
Other deal characteristics	Number of observations	Average percent of shares	
Panel B: takeovers with no termination provision			
Shareholder voting agreement	8	52	
Ownership affiliation	20	60	
No share relation	10	n.a	
Total	37		

Panel A summarizes information on shareholder voting agreements, ownership affiliations, and toeholds for the sample takeovers. Panel B summarizes data on the 37 takeovers with no termination provision. (Note: the total number of observations in Panel B equals 37 because one takeover had both a shareholder voting agreement and an ownership affiliation.) *Shareholder voting agreement* refers to the takeovers where a blockholder(s) commits to vote in favor of the merger or tender shares in a tender offer. *Ownership affiliation* refers to the takeovers where the bidder had a long-term ownership interest in the target. *Toehold* refers to takeovers where the bidder obtains an ownership stake just before the takeover announcement as part of a toehold strategy. *No share relation* refers to cases with no voting agreement or ownership affiliation and no termination provision. Information to construct the table was taken from SEC documents.

members pledge to vote to approve a merger or to tender their shares in a tender offer. The data on the incidence and magnitude of shareholder voting agreements are reported in Panel A of Table 4. Shareholder voting agreements are found in 68 takeovers or 17% of the sample. The fraction of shares in the agreements is sizable, averaging 41% of the target's common stock. Voting agreements in takeovers with a termination provision average 40% while agreements in takeovers without a termination provision average 52%.

We tabulated data on two other ownership variables. We determined whether the target had a long-term ownership affiliation with the bidder through a parent-subsidiary or other relation. We also tabulated cases where the bidder attained a toehold stake in the target in the period immediately preceding the takeover. Our separate categorization of long-term affiliations and bidder toeholds differs from prior research such as Burch (2001), Bates and Lemmon (2003), and Officer (2003) which follows SDC and lumps all ownership stakes by the bidder into a single toehold category. We make this distinction to more accurately

reflect the theoretical work (Bebchuk 1982) that models a toehold as a stake strategically obtained before a bid. Betton, Eckbo, and Thorburn (2005) also make some distinction between long-term ownership and short-term toeholds.

In 28 takeovers, or 7% of the sample, the bidder has a long-term ownership affiliation with the target. For these cases, the average fraction of shares in the affiliation is 54%. Ownership affiliations in takeovers with a termination provision average 40% while those without a termination provision average 60%. There are also 28 takeovers in which the bidder obtains a toehold. The average toehold is 7% while the median is 5%. The average toehold for takeovers with a termination provision is 7%, and the average toehold for takeovers without a provision is 3%.

In sum, the data in Panel A of Table 4 indicate that shareholder voting agreements are often found in takeover contracts. They are more prevalent than ownership affiliations or toeholds. The magnitude of the voting agreements is comparable to ownership affiliations and much larger than bidder toeholds.

Panel B of Table 4 offers evidence suggesting that shareholder voting agreements and large ownership blocks provide an alternative commitment device to termination provisions. The data report characteristics of the 37 takeovers in our sample that do not grant a termination provision to the bidder. In 8 cases, the takeover had a shareholder voting agreement that averaged 52% of the target's shares outstanding. In 20 cases, the bidder had an ownership affiliation that averaged 60% of the target's shares outstanding. One takeover had both a shareholder voting agreement and an ownership affiliation, indicating that in 27 of the 37 takeovers without a termination provision (73%), the bidder had a sizable direct or pledged stake in the target firm. Hence, in a large majority of the small fraction of takeovers without a termination provision, the target has an alternative mechanism with which to make a commitment to the bidder.

Indeed, in only 10 takeovers, or 2.5% of the sample, is the deal "naked" in that the takeover agreement does not have a termination provision and/or a shareholder voting agreement or other large ownership block. In results not reported, we find that there is no time series pattern in naked deals. Three of the 101 deals (2.9%) in the 1989–1993 period have neither a termination provision nor a voting agreement. By comparison, 3 of the 128 deals (2.3%) in the 1994–1996 period and 4 of the 171 deals (2.3%) in the 1997–1999 period are without deal protection.

4. A New Measure of Takeover Competition

In addition to containing accurate data on termination provisions and shareholder voting agreements, the SEC filings also provide a more complete characterization of the level of competition in a corporate

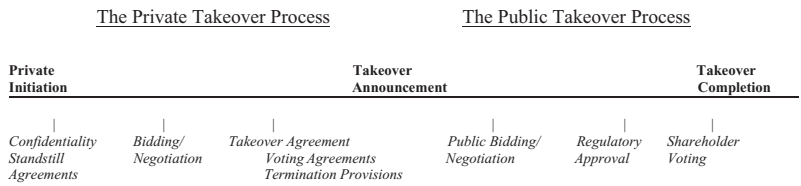


Figure 1
Timeline of the takeover process.

takeover. In extant research, takeover competition is typically defined by the number of publicly reported bidders seeking a target. Our analysis of the SEC filings indicates that this conventional measure of takeover competition significantly underestimates the depth of competition in corporate takeovers by failing to consider the private takeover process that occurs before the public announcement of a takeover bid.

Figure 1 shows the private takeover process that we study. Relevant models include French and McCormick (1984), Hansen (2001), Povel and Singh (2005), and Ye (2004). The process usually begins with the private initiation of a possible sale by the target firm and its investment bank, although it may be initiated by an unsolicited bidder. The target decides how many firms to contact; it may contact a single bidder or instead solicit inquiries from multiple bidders. The target then asks the selected bidder or bidders to sign confidentiality/standstill agreements that facilitate the sharing of nonpublic information but have a quid pro quo that the potential bidders must agree not to make an unsolicited bid. Once potential bidders have received nonpublic information, private bidding for the target is conducted. The detailed takeover proposals made by potential bidders usually contain termination provisions and/or shareholder voting agreements. In our sample, the total time of this private bidding process averages 6–7 months.

The ultimate outcome is a takeover agreement that is usually publicly announced within a day or two of signing. Once announced, the average deal in our sample takes roughly 6 months to complete because of requirements of approval from regulatory agencies and, in the case of a share deal, target shareholders. During the time between public announcement and deal completion, other bidders may make an offer for the target.

To empirically characterize the takeover process in Figure 1, we reviewed the SEC takeover documents for each of the target firms in our sample. From this review, we categorized each sample takeover as either an auction or a negotiation. Takeovers classified as auctions were those where the target firm and its investment bank contacted multiple potential buyers and also had multiple potential buyers attain access to

nonpublic information by signing confidentiality/standstill agreements. By contrast, in takeovers categorized as negotiations, the target contacted only a single bidder and signed a confidentiality/standstill agreement only with that bidder.

The takeover process is illustrated in the two cases in the Appendix. The Boatmen's Bancshares case is an auction where three firms made formal written bids. The ENSERCH Corp. case is a negotiation where the target focused on a single bidder and signed a confidentiality/standstill agreement only with that firm. The text in the Appendix is from the SEC EDGAR filings and indicates the richness of the detail that is available. For example, the filing for the Boatman's Bancshares deal indicates that all three bidders submitting formal offers specified that a termination provision be part of the offer. Another important aspect of the two cases is that while the takeover process for the two firms clearly differed, both deals entailed only one public bidder and therefore neither of the deals would be classified as an auction under conventional measures.

Table 5 provides a summary of the private and public takeover process for the sample firms. Panel A summarizes the data for the full sample of 400 firms. In a representative takeover, the target firm and its investment bank contacted and/or were contacted by nine potential bidders. Roughly, four potential bidders received nonpublic information by signing confidentiality/standstill agreements. On average, 1.29 firms made private written offers and 1.13 firms made a publicly announced bid for the target. The larger value for private bidders reflects in part the fact that, by the design of the rules in the private takeover process, the identities of losing private bidders are often not revealed publicly.

Table 5
Summary of the private and public takeover process

	Number of observations	Contact	Confidential	Private bidders	Public bidders
Panel A: the full sample					
Full sample	400	9.49	3.75	1.29	1.13
Panel B: the sample categorized by the takeover procedure					
Auction	202	20.67	6.83	1.57	1.24
Negotiation	198	1.02	1.00	1.00	1.02

This table summarizes the takeover process for the sample of 400 target firms. Panel A characterizes the entire sample. *Contact* indicates the average number of potential bidders with which the target firm and its investment bank were in contact. *Confidential* indicates the average number of potential bidders that signed a confidentiality/standstill agreement. *Private bidders* indicate the average number of bidders that submitted a private written offer. *Public bidders* indicates the average number of bidders that announced a formal bid for the target in the financial media. Panel B summarizes the data by takeover procedure. *Auction* refers to takeovers in which multiple potential bidders were contacted and signed confidentiality agreements. *Negotiation* refers to a process focusing on one bidder.

From the data in Panel A, consistent with conventional definitions, the takeovers in our sample did not have much public competition for the target firms—only 13% of the sample takeovers had multiple public bidders. But by measuring the activity in the private takeover process that occurs before the public announcement of a bid, the data in Panel A indicate that the takeovers during the 1990s were much more competitive than can be garnered by focusing solely on the number of publicly announced bidders.

Panel B of Table 5 stratifies the data into the two sales procedure categories, auction and negotiation. The auction category has 202 observations, or slightly more than half of the sample. In a representative auction, 21 potential buyers are contacted and roughly 7 sign confidentiality/standstill agreements. On average, 1.57 firms make private written offers and 1.24 firms make a publicly announced bid for the target.

In the 198 negotiations, the target firm focuses on a single bidder. The average number of firms contacted is slightly greater than one because of some cases where the target firm did not respond to an unsolicited inquiry or where preliminary talks with a potential bidder did not materialize (see, for example, the ENSERCH case in the Appendix). In negotiations, the number of confidentiality/standstill agreements and the number of private bids always equals one. The average number of public bidders is slightly greater than one because of a few public, unsolicited bids for the targets in negotiated deals.

We use our classification of auctions and negotiations to provide new evidence on termination provisions and takeover competition. Table 6 summarizes information on the incidence of termination provisions for the two takeover procedures. The termination provision data refer to the bidding firm that reaches a takeover agreement with the target. As shown in Panel A, auctions are more likely to have a termination provision than are negotiations; indeed, virtually every auction in the sample has a termination provision.

Panel B of Table 6 summarizes related results on the magnitude of the termination provisions across the two takeover procedures. For both auctions and negotiations, the median termination fee is 3% of deal size, which is comparable to that reported in prior research listed in Table 1. Similarly, the median stock option agreement is 19.9% for both auctions and negotiations, again comparable to prior research (Table 1). Overall, the results in Table 6 indicate that both the incidence and magnitude of termination provisions are not inversely related to takeover competition.

5. Regression Analysis of the Incidence and Choice of Termination Provisions

In this section, we report four logit regressions that test the entrenchment and information/commitment hypotheses. The first three regressions use

Table 6
Summary statistics of termination provisions by takeover procedure

	Termination fee only	Option only	Both	None	Percent with provision
Panel A: incidence by takeover procedure					
Auction	151	20	25	6	97%
Negotiation	95	28	44	31	84%
	Number of observations	Mean	Median		
Panel B: magnitude of termination fees by takeover procedure					
Termination fees					
Auction	176	3.71%	3.32%		
Negotiation	139	3.34%	3.10%		
Stock option agreements					
Auction	45	21.51%	19.90%		
Negotiation	72	19.36%	19.90%		

This table summarizes the incidence and magnitude of termination provisions granted to the bidder by the target for the auction and negotiation sub-samples. Panel A summarizes the incidence by takeover procedure. *Termination fee only* refers to takeovers with a termination fee but no stock option agreement. *Option only* refers to takeovers with a stock option agreement but no termination fee. *Both* refers to takeovers with both a termination fee and a stock option agreement. *None* refers to a takeover with neither a termination fee nor a stock option agreement. *Percent with provision* refers to the fraction of takeovers with a termination fee, a stock option agreement, or both. Data on termination provisions are taken from Securities and Exchange Commission (SEC) documents. Panel B summarizes the mean and median magnitude of fees and options by takeover procedure. For fees, the denominator is the equity value of the target firm 21 days after the takeover announcement. For options, the data reflect the fraction of the target's common stock in the stock option agreement.

all 400 observations in the sample. The first regression is a logit specification where the dependent variable equals one in the 363 deals where a takeover has a termination fee, an option agreement, or both. In the second regression, the dependent variable equals one in the 315 takeovers with a termination fee, and in the third regression, the dependent variable equals one in the 117 takeovers with a stock option agreement. The fourth regression uses the 363 observations with a termination fee, an option agreement, or both, and the dependent variable equals one for the takeovers with a stock option agreement (with or without a termination fee) and equals zero in the takeovers with a termination fee only.

The explanatory variables used in the regression analysis include those reported in prior research such as deal size, dummy variables for the Paramount and Brazen judicial decisions, and bidder toeholds. To provide new tests that distinguish the entrenchment hypothesis and the information/commitment hypothesis, we include variables for our estimate of shareholder voting agreements and affiliated ownership blocks, our novel measure of takeover competition, and a dummy variable for stock transactions.

As an additional test for management entrenchment, we develop a dummy variable, CEO job, that takes a value of 1 if the target CEO maintained a position in the combined firm following the takeover, as reported in the first proxy statement following the takeover (Harford 2003). The entrenchment hypothesis, which argues that termination provisions can serve as a job protection device, would predict that deals where the CEO retains a job are more likely to have a termination provision.

We also include a dummy variable for deals in the banking industry to control for the fact that banks tend to choose option agreements because of regulatory capital rules (Coates and Subramanian 2000, p. 325). Our results confirm that the incidence of termination fees is negatively related to the bank dummy variable while the use of stock option agreements is more likely for deals in the banking industry. As in the prior research, we include a dummy variable for unsolicited deals as a control variable. In the regressions, we find that termination provisions are less likely in unsolicited deals, which is consistent with prior research such as Bates and Lemmon (2003) and Officer (2003).

5.1 Deal size and termination provisions

The regression analysis is summarized in Table 7. The first explanatory variable is deal size. For the overall termination provision regression, the use of termination provisions is insignificantly related to deal size. Similarly, the second regression indicates that the incidence of termination fees is not significantly related to deal size. By contrast, the later two regressions in Table 7 indicate that stock option agreements are significantly more likely to be found in larger deals.

The results in Table 7 on deal size differ from prior research. In particular, the lack of a relation between termination fees and deal size contrasts with the positive and significant relation reported by Bates and Lemmon (2003, Table 5), Officer (2003, Table 11), Coates and Subramanian (2000, Table 3), and Betton, Eckbo, and Thorburn (2005, Table 4). As suggested by our earlier analysis in Section 2, the findings in the prior research appear to stem from the biased classification of termination provisions by SDC which is more likely to code a takeover as having a provision in larger deals.

5.2 Judicial decisions and time series patterns in termination provisions

As discussed in Section 2.4, prior research has argued that judicial decisions in the 1990s significantly influenced the overall incidence and particular choice of termination provisions. Our results in Table 7 for the effect of the Paramount and Brazen judicial decisions are not consistent with the prior findings. While the positive coefficient on the Paramount

Table 7
Regression analysis of the incidence of termination provisions

Variable	Coefficient (<i>p</i> value)			
	All provisions	Termination fee	Stock option	Fee versus option
Intercept	2.650 (0.244)	2.273 (0.187)	-4.132 (0.001)	-4.154 (0.001)
Deal size	0.002 (0.992)	-0.068 (0.587)	0.228 (0.016)	0.242 (0.011)
Paramount	1.270 (0.031)	1.114 (0.011)	-0.276 (0.482)	-0.431 (0.285)
Brazen	-0.198 (0.740)	0.506 (0.256)	0.127 (0.699)	0.134 (0.683)
Toehold	5.808 (0.690)	8.306 (0.541)	-8.799 (0.485)	-9.287 (0.473)
Affiliated/agreement	-6.544 (0.000)	-4.758 (0.000)	-1.955 (0.014)	-0.799 (0.337)
Auction	2.598 (0.000)	1.494 (0.000)	-0.375 (0.211)	-0.492 (0.104)
Stock	0.971 (0.056)	0.310 (0.441)	0.703 (0.040)	0.682 (0.050)
Bank	—	-4.959 (0.000)	4.889 (0.000)	4.762 (0.000)
Unsolicited	-2.990 (0.000)	-1.261 (0.014)	-1.687 (0.010)	-1.438 (0.031)
CEO Job	-0.880 (0.102)	-0.160 (0.685)	-0.233 (0.435)	-0.196 (0.518)
<i>R</i> ²	0.45	0.45	0.32	0.30
Model <i>p</i> value	0.000	0.000	0.000	0.000
Number of observations	400	400	400	363

This table reports logit regression analysis of termination provisions granted to the bidder by the target firm. The first three regressions have 400 observations and the fourth regression has 363 observations. In regression 1, the dependent variable is equal to one for the 363 takeover agreements where any termination provision is granted. In regression 2, the dependent variable is equal to 1 in the 315 takeover agreements granting the bidder a termination fee. In regression 3, the dependent variable is equal to 1 in the 117 takeover agreements granting the bidder a stock option agreement. In regression 4, the dependent variable equals 1 in the 117 takeover agreements granting the bidder a stock option agreement (with or without a termination fee) and zero in the 246 takeover agreements granting the bidder only a termination fee. *Deal size* is the equity value of the target firm 21 days after the takeover announcement. *Paramount* is a dummy variable equal to 1 if the announcement of the takeover occurred in 1994 or later. *Brazen* is a dummy variable equal to 1 if the takeover announcement occurred in 1997 or later. *Toehold* is the fraction shares held by the bidder as part of a toehold strategy. *Affiliated/agreement* is the fraction of the target's common stock either held by a long-term affiliated bidder or committed by a blockholder in an agreement in favor of the takeover. *Auction* is a dummy variable equal to 1 if the takeover procedure was an auction. *Stock* is a dummy variable equal to 1 if the payment terms entail some or all stock. *Bank* is a dummy variable equal to one if the target firm is in the banking industry. *Unsolicited* is a dummy variable equal to one if the bidder or a third party made an unsolicited offer for the target. *CEO Job* is a dummy variable equal to 1 if the CEO of the target obtains an employment and/or board position in the merged company. The first regression does not have a bank dummy because all deals where a bank is a target employ a fee, option, or both. The reported statistics for each variable are coefficient (*p* value in parentheses). The *p* value for the individual coefficients is based on the Wald chi-square test. The model *p* value is based on the Wald chi-square test for global significance of the explanatory variables.

dummy for the termination fee regression resembles the prior analysis, the overall results do not concur with the story that the Paramount decision shifted targets from stock option agreements to termination fees. Indeed, the coefficients on the Paramount dummy in regressions 3 and 4 are both insignificant. Moreover, unlike the results in Coates and Subramanian (2000), we find no effect of the Brazen decision on the incidence or structure of termination provisions. As summarized in Table 7, none of the coefficients of the Brazen dummy in any of the regressions is statistically significant. The results in Table 7 suggest that the prior evidence on

the time series effects of judicial decisions on the use and choice of termination provisions stemmed from biases in SDC.

Although we do not find the effect of the judicial decisions reported in prior research, we do find evidence of changes in the design of termination provisions over time. We find a growing use of option caps in the termination provisions in our sample, where an option cap is defined as a dollar limit on the gain that a bidder can attain by exercising a stock option agreement. For example, in the takeover of Boatmen's Bancshares by NationsBank in 1996 (see the Appendix), the bidder was granted an option to obtain 19.9% of the target's common stock. However, the agreement limited the profit that the bidder could make from the option to \$250 million.

Panel A of Table 8 reports the time series incidence of option caps. The first cap in the sample occurs in 1994, the year after the Paramount legal decision. There is a steady increase in option caps over time, and by

Table 8
Use of option caps

Year	Number of option caps	Percent of sample	Percent of options with caps
Panel A: option caps by year			
1989	0	0	0
1990	0	0	0
1991	0	0	0
1992	0	0	0
1993	0	0	0
1994	1	3	14
1995	8	14	36
1996	5	13	83
1997	6	9	43
1998	22	36	79
1999	10	22	91
All Caps	52	13	44
	Number of caps	Mean	Median
Panel B: magnitude of option caps			
All With Caps	52	3.91	3.85
Auction	20	4.00	3.30
Negotiation	32	3.86	3.92

This table summarizes the annual incidence and the average magnitude of caps on the stock option agreements granted to bidders by targets. An option cap places a dollar limit on the gain that the bidder could attain by invoking the option. Panel A summarizes the incidence of caps by year. *Number of caps* reports the number of stock option agreements to the bidder that have an option cap. *Percent of sample* reports the fraction of takeovers with an option cap in a given year. *Percent of options with caps* reports the fraction of takeovers having a stock option to the bidder that have a cap on the option. Panel B summarizes the mean and median of the magnitude of the option caps, where magnitude is the dollar value of the cap divided by the equity value of the target firm 21 days after the takeover announcement. The data are presented for all takeovers having option caps as well as for the auction and negotiation subsamples. Data on option caps are taken from Securities and Exchange Commission (SEC) documents.

the final year of the sample, 91% of the takeovers having a stock option agreement also have an option cap. Panel B of Table 8 summarizes data on the magnitude of the option caps in the sample, where magnitude is defined as the dollar amount of the cap divided by the equity value of the target 21 days after merger announcement. For the full sample of 52 caps, the mean (median) is 3.91% (3.85%). The average magnitude of the cap is similar for the two takeover procedures. Auctions have a mean (median) cap of 4.00% (3.30%) while negotiations have a mean (median) cap of 3.86% (3.92%). Hence, the growing use of option caps has made the relative magnitude of stock option agreements converge to that for termination fees. Overall, the evidence indicates that the design, although not the incidence, of termination provisions has changed over time.

5.3 Toeholds and shareholder voting agreements

The next variable summarized in Table 7 is Toehold, defined as the fraction of shares, if any, obtained by a bidder as part of a toehold strategy. For the first two regressions, the coefficient on this variable is positive but insignificant. In the second two regressions, the coefficient is negative but insignificant. Hence, toeholds are not related to the use of either termination fees or stock option agreements.

Our insignificant results for the relation between bidder toeholds and termination provisions differ from prior research. Burch (2001, Table 3) reports a significant inverse relation between stock option agreements and toeholds. Bates and Lemmon (2003, Table 5), Officer (2003, Table 11), and Betton, Eckbo, and Thorburn (2005, Table 4) report a significant inverse relation between termination fees and bidder toeholds. Consistent with the analysis in Panel B of Table 3, the time series upward trend in the accuracy of SDC data, together with the temporal decline in toeholds reported by Betton, Eckbo, and Thorburn (2005), appears to have impacted the findings reported in prior research. Our results indicate that the likelihood that a takeover agreement contains a termination provision is not affected by whether a bidder obtains a small stake in a target firm before commencing the takeover attempt. In essence, a toehold is not a substitute for a termination provision. While a toehold can possibly compensate a bidder for investing in information about the target (Bebchuk 1982), a toehold does not provide any commitment that the target will sell to that bidder.

By contrast, the results in Table 7 indicate that the larger ownership blocks represented by shareholder voting agreements and affiliated ownership stakes are significantly related to the incidence of termination provisions. The variable affiliated/agreement is the fraction of the

target's common stock either held by a long-term affiliated bidder or committed by a blockholder in an agreement in favor of the takeover. As reported in the first regression, the coefficient on affiliated/agreement is negative and statistically significant, indicating that shareholder voting agreements and other long-term ownership stakes provide substitutes for termination provisions. As reported in the second and third regression, these results hold for the specific cases of both termination fees and stock option agreements. These results are consistent with the information/commitment hypothesis.

5.4 Termination provisions and takeover competition

The Auction variable summarized in Table 7 is a dummy variable equal to 1 for takeover auctions. In the first regression in Table 7, the coefficient on the auction dummy is positive and significant. Hence, in contrast to prior research, termination provisions are positively associated with takeover competition. By using a more complete measure of takeover competition, we find support for the information/commitment hypothesis and reject the entrenchment hypothesis.

We also stratified the analysis by the type of termination provision. The regression for termination fees finds a positive and significant relation between the use of fees and takeover competition. In the third and fourth regressions, the coefficient on the auction variable is negative but not statistically significant. Hence, neither of the specific types of termination provisions is associated with reduced takeover competition.

As a robustness check, we replicated our analysis using continuous measures of takeover competition based on variables described in Table 5: the number of firms contacted, the number of firms signing confidentiality/standstill agreements, the number of private bidders and the number of public bidders. In results not reported in the table, but available upon request, we found that these alternative measures of takeover competition were positively and significantly related to the use of termination provisions.

5.5 Possible entrenchment effects

Our result that termination provisions do not inhibit takeover competition is direct evidence against the entrenchment hypothesis. Similarly, the lack of a relation between deal size and the incidence of termination provisions is suggestive evidence counter to the entrenchment hypothesis. Assuming that agency costs are potentially greater at larger targets, the entrenchment hypothesis would predict that larger deals would be more likely to have a termination provision.

The results for our direct proxy for entrenchment, CEO Job, are also inconsistent with entrenchment. In all four regressions in Table 7, the

coefficient on CEO Job is negative and statistically insignificant. Hence, the likelihood of the target CEO maintaining a position in the new firm is not related to the incidence of termination provisions.

5.6 The choice of termination provision: fee versus option

We also study why some deals employ termination provisions while others employ stock option agreements. We find that the method of payment, as measured by the Stock dummy variable, is an important factor. In the second regression in Table 7, the use of termination fees is not significantly related to the use of stock. By contrast, in the third regression, the use of a stock option agreement is positively and significantly related to stock deals. Similarly, the fourth regression indicates that the choice of a stock option rather than a termination fee is positively and significantly related to stock deals. As discussed in Section 1.3, the positive relation between stock option agreements and the use of stock is consistent with the information/commitment hypothesis.

6. Conclusion

The contribution of our research can be pinpointed by returning to the depiction of the takeover process in Figure 1. Prior research has focused on the public aspects of this process. In doing so, the prior research has incorrectly concluded that termination provisions are negatively associated with takeover competition. Our research, by more accurately capturing both the private and public takeover process, indicates that termination provisions enhance rather than impede takeover competition.

Our results have important policy implications. Consistent with the framework of law and finance research (Macey and O'Hara 2000), takeover law is all about process (Varallo and Raju 2000). Because of the concern that termination provisions obstruct the process by foreclosing auctions (Ayres 1990), Bainbridge (1990, pp. 327–328) suggests a requirement that boards of directors shop the company before implementing a termination provision. Similarly, Kahan and Klausner (1996, footnote 47) state that “We would not object if targets made an ex ante commitment to grant a lockup to the party that offers the highest bid in a properly structured auction.” Our analysis of the private takeover process indicates that targets actually do shop the company before implementing termination provisions and that termination provisions often culminate an auction. Such findings allay concerns that termination provisions foreclose takeover competition.

Our detailed treatment of the takeover process has related policy implications for other contractual devices found in takeover deals. We

have uncovered new evidence on the use of shareholder voting agreements in which target blockholders pledge to vote in favor of a proposed takeover. We find that such agreements act as substitutes for termination provisions as a means of committing to a deal and should not be viewed by the courts as *de facto* anticompetitive.

Our research also has implications for broader debates in corporate law. Analysis by legal scholars such as Easterbrook and Fischel (1982) and Bebchuk (1982) has contested the pros and cons of corporate takeover auctions and has proposed policies ranging from an outright ban on to a mandatory prescription of takeover auctions. The setting of this debate was on the public takeover auctions of an earlier era. Our evidence on the private takeover process indicates that auctions are an endogenous aspect of the current takeover environment. Such evidence supports the position of Macey (1990) that there should not be any particular sales procedure imposed by the courts.

Our research is also informative for models of the takeover process. Bulow and Klemperer (1996) predict that takeover auctions generate greater returns than one-on-one negotiation and argue against the use of termination provisions. By contrast, Povel and Singh (2005) point out the commitment aspects of termination provisions and argue that the provisions can enhance the wealth of target shareholders. Since we find that the use of termination provisions is directly related to takeover competition, our evidence is more in line with the arguments of Povel and Singh (2005). Indeed, in a companion paper (Boone and Mulherin 2006), we find that the wealth of target shareholders is invariant to the use of auctions with multiple bidders and negotiations with a single bidder.

Our detailed analysis of the takeover process also has more general implications for research methods. Our evidence from SEC documents suggests inaccuracies in the prior research that relied on the machine-readable data from SDC. In particular, we document a widespread use of termination provisions and do not find the time series changes in the use and choice of termination provisions reported in prior research. We also show that the inaccuracies in the data used in prior research have led to incorrect inferences on the association of termination provisions with judicial decisions, bidder toeholds, and deal size.

As a whole, our evidence is consistent with the theory that termination provisions mitigate information problems inherent in the takeovers of publicly traded corporations and enable the target firm to commit to the end of the bidding process. Termination provisions do not truncate bidding but instead culminate the bidding process.

Appendix: Examples of the Private Takeover Process

This appendix details the private takeover process for Boatmen's Bancshares (auction) and ENSERCH (negotiation). The text is taken directly from SEC filings.

Boatmen's Bancshares [S-4 Filing by Nationsbank Corp, November 15, 1996]

Classification: Auction

At its regular meeting on August 13, 1996, the Boatmen's Board authorized and directed Boatmen's senior management, with the assistance of its financial and legal advisors, to explore more formally the interest expressed by four bank holding companies.... In the course of these discussions, one of the four bank holding companies determined not to proceed further.... The three companies then participating in the process, including NationsBank, were invited to submit on August 26, 1996 proposals...

...[E]ach of the three proposals contemplated a stock-for-stock merger in which holders of Boatmen's Common Stock would receive in the merger shares of the counterparty's common stock at a specified exchange ratio. Each company...required that Boatmen's and such company enter into a stock option agreement substantially similar to the Boatmen's Stock Option Agreement or a termination fee agreement...

Boatmen's management advised NationsBank that it would recommend a revised NationsBank proposal for approval by the Boatmen's Board and would execute promptly a definitive merger agreement and stock option agreement if NationsBank agreed to increase its proposed exchange ratio of 0.643 to the Exchange Ratio, and NationsBank submitted such a revised proposal.

A special meeting of the NationsBank Board was held on the morning of August 29, 1996 to consider a proposal to acquire Boatmen's.... After due consideration...the NationsBank Board unanimously approved the Agreement...

On the afternoon of August 29, 1996, the Boatmen's Board met again to consider the NationsBank proposal.... The Boatmen's Board then unanimously approved the Agreement and the Boatmen's Stock Option Agreement.

As an inducement to NationsBank to enter into the Agreement, Boatmen's (as issuer) and NationsBank (as grantee) entered into the Stock Option Agreement, dated August 29, 1996 (the "Boatmen's Stock Option Agreement"), pursuant to which Boatmen's granted NationsBank an irrevocable option (the "Boatmen's Option") to purchase from Boatmen's up to 31,218,660 shares of Boatmen's Common Stock (subject to adjustment in certain circumstances, but in no event to exceed 19.9% of the shares of Boatmen's Common Stock outstanding upon exercise thereof), at a price of \$43.375 per share...the total profit that NationsBank may derive from the Boatmen's option cannot exceed \$250 million.

ENSERCH Corp [424B3 Filing by TUC Holding Co, September 27, 1996]

Classification: Negotiation

In February 1995 ENSERCH retained the services of Morgan Stanley to suggest procedures that would enable ENSERCH to evaluate unsolicited business combination proposals.... On August 15, 1995, Morgan Stanley presented the results of its analysis to ENSERCH senior management.

On November 29, 1995, Mr. Erle Nye, President and Chief Executive of TUC, informally approached Mr. David W. Biegler, Chairman, President and Chief Executive Officer of ENSERCH.... At the regular ENSERCH Board Meeting on February 13, 1996, Mr. Biegler reported his conversation with Mr. Nye, as well as the possibility that other companies might have an interest in ENSERCH...

On February 27, 1996, ENSERCH senior management met with Morgan Stanley to discuss undertaking a strategic review. On or about March 1, TUC formally retained Barr Devlin as financial advisor with respect to the possible transaction.

On March 12, 1996, the ENSERCH Special Committee met again with Morgan Stanley, Mr. Biegler and other senior officers of ENSERCH.... While not ruling out any alternatives, the ENSERCH Special Committee was of the view that a business combination could be the most attractive strategy for ENSERCH, but only if the combined businesses would complement each other sufficiently to enhance shareholder value over the long term and if the transaction would have good prospects of surmounting any regulatory hurdles and achieving broad public support. The ENSERCH Special Committee also was of the view that a negotiated transaction with a selected partner would be the most likely transaction to be successfully consummated. On the basis of the compatibility of corporate cultures, overlapping service areas and the likelihood of a favorable public response and regulatory acceptance, the ENSERCH Special Committee expressed its belief that TUC was the partner most likely to satisfy these considerations...

On March 20, 1996, ENSERCH and TUC executed a confidentiality agreement in which TUC undertook to keep confidential all information provided by ENSERCH in connection with TUC's review of a possible transaction. TUC also agreed not to make any offer regarding a possible business combination or to participate in any proxy solicitation involving ENSERCH without written consent of the ENSERCH board. At ENSERCH's regular Board Meeting on March 26, 1996, Mr. Biegler and the ENSERCH Special Committee reported to the ENSERCH Board on the status of the activities of the ENSERCH Special Committee and Morgan Stanley.

Following the ENSERCH Board meeting, in a discussion with one of the directors, Mr. Biegler learned that another company had a possible interest in a business combination with ENSERCH. The chairman of the other company subsequently telephoned to request a meeting with Mr. Biegler, which was scheduled for April 9, 1996.

At a meeting on March 27, 1996, Mr. Biegler advised Mr. Nye of the possible interest by the other company. Mr. Nye reported that he had heard rumors of the other company's interest and stated that TUC would not look favorably upon a bidding contest.

On April 8, 1996, Mr. Biegler and Mr. Nye met. Mr. Nye indicated that TUC was considering valuations of ENSERCH in the range of \$1.6 billion to \$1.7 billion...

On April 9, 1996, Mr. Biegler met with the chairman of the other company.... The other chairman indicated interest in discussing a negotiated business combination with ENSERCH, but presented no offer.

On April 12, 1996, the ENSERCH Board and senior ENSERCH management again met to continue to review the progress of the negotiations.... The principal issues discussed consisted of the conversion ratio, the break-up fees and stock option, the limits on the collar on the conversion ratio, TUC credit support for ENSERCH public debt, the circumstances under which the parties could terminate the Plan of Merger.... While the meeting was in progress, the ENSERCH Board received a formal proposal from TUC...

The ENSERCH Board and senior management met on April 13, 1996, to consider the TUC proposal.... It was generally agreed by the ENSERCH Board that the TUC proposal was not acceptable but was of sufficient interest to merit continued negotiations...

The meeting recessed in order to permit Mr. Biegler to meet with Mr. Nye. Mr. Biegler returned and reported to the ENSERCH Board that Mr. Nye had agreed on behalf of TUC to modify the proposal to accommodate certain concerns the ENSERCH Board had raised. The conversion ratio was increased to \$8.00 per share and the collar was broadened to 10% from 7 1/2%, the break-up fee was reduced, the duration of any unilateral extension of the closing date by TUC was reduced.... After these discussions...the ENSERCH Board voted unanimously to approve the merger proposal.

Following the meeting on April 13, 1996 the relevant agreements for the Mergers were executed.... On April 15, 1996, the proposed Mergers were publicly announced.

Pursuant to the Stock Option Agreement dated as of April 13, 1996, by and between ENSERCH and TUC, ENSERCH has granted TUC the right, to purchase, under certain circumstances relating to a Business Combination proposal by a third party, up to 3,363,570 authorized but unissued shares of ENSERCH Common Stock, subject to adjustment (which represents 4.9% of the shares of ENSERCH Common Stock outstanding on March 31, 1996), at \$16.375 per share.

Where indicated, termination will result in the payment by one party to the other, as liquidated damages, of either or both (i) out-of-pocket expenses and fees incurred by the other in connection with the Mergers in an amount of up to \$15 million ("Out-of-Pocket Expenses") and (ii) a termination fee equal to \$42.5 million less Out-of-Pocket Expenses (the "Termination Fee").

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