



# The impact on shareholder value of top defense counsel in mergers and acquisitions litigation<sup>☆</sup>



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## ABSTRACT

Defense litigation counsel are retained by target firm management to defend them in mergers and acquisition (M&A) litigation. We use hand collected data from a ten-year period (2003–2012) to examine whether the choice of defense litigation counsel affects the outcome of M&A litigation and shareholder value. We construct league tables for defense litigation firms and identify the top 10 defense litigation firms. Comparing these firms with all other defense litigation firms, we find that top defense litigation counsel are involved in a significantly higher proportion of cash deals, non-same-industry deals (implying a lower possibility of antitrust-related concerns), and friendlier deals, all of which are associated with smaller initial takeover premium proposals. We find evidence that, controlling for endogeneity, top defense litigation counsel negotiate cheaper and faster settlements than other defense litigation counsel thereby protecting low premium deals from more serious challenges. We also show that top defense litigation counsel are more effective in multijurisdictional litigation cases, again obtaining cheaper and faster settlements in low premium deals, which we theorize shows that they are better able to handle the complexity and strategy that accompany these lawsuits.

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## 1. Introduction

The critical role of plaintiffs' attorneys' incentives and expertise in class action shareholder litigation has been extensively studied (see, e.g., Coffee, 1986). There have also been several studies examining the economic effects of merger and acquisitions (M&A) litigation on shareholder value (Thompson and Thomas, 2004; Krishnan et al., 2012; and Rosenzweig, 1986). More recently, research has revealed important differences in merger litigation outcomes depending upon which plaintiffs' law firm is selected as lead counsel. Top plaintiffs' law firms have been found to litigate cases more aggressively and to produce superior results for their

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shareholder clients (Krishnan et al., 2016).<sup>1</sup> However, little analytical work has focused on the role of defense lawyers in shareholder litigation, including whether the choice of defense litigation counsel matters for shareholder value.

We seek to fill that gap by looking at the differences between defense litigation law firms in M&A litigation. Once an M&A deal is agreed to by the target and the acquirer, shareholders may challenge the deal's terms as unfair and the target will need to retain litigation counsel to defend any lawsuit. Retaining good defense litigation counsel is important: these attorneys must protect the interests of their clients – the directors and management. We theorize that top defense litigation counsel will seek to ensure that the negotiated transaction is not enjoined, or otherwise halted by shareholders, and that in the absence of competing bidders, the transaction completes on its initial terms and price, even when the target firm's shareholders would prefer a higher price.

We use a hand collected sample of 3683 M&A lawsuits spanning the ten-year period from January 1, 2003 through December 31, 2012 to examine three important issues relating to target firm's choice of defense litigation counsel. First, we seek to determine when top defense litigation counsel is retained. Second, we examine whether top defense litigation counsel makes a difference in the outcome of the litigation and the final premium paid to shareholders. Finally, we attempt to document how top defense litigation counsel achieves superior results.

We begin by determining the identities of defense litigation counsel in M&A litigation. In an approach consistent with annual league-table ranking of financial advisors (investment banks) and legal advisors (law firms) used in the prior literature (see, e.g., Rau, 2000, Krishnan et al., 2012, and Krishnan and Masulis, 2013), we identify top defense litigation counsel based on their number of appearances in the annual top-10 league tables from 2006 through 2012, where top 10 league tables are defined by number of their appearances during the immediate past rolling three-year window. This enables us to avoid look-ahead bias. These firms include well-known law firms such as Skadden Arps Slate Meagher & Flom, Wachtell Lipton Rosen & Katz, and Simpson Thacher & Bartlett, all three of which are in the top-10 league tables every year of our final sample period.

Once we have identified top defense litigation counsel, we turn to our first question: when are top defense litigation counsel retained by the target firm to defend merger litigation? We find that these top firms are more likely to appear in cases defending transactions with significantly lower initial target takeover premiums, on average, as compared to the cases in which non-top defense litigation counsel are retained. When we probe deeper into this finding, we find that top defense litigation counsel is involved in a significantly higher proportion of cash deals, non-same-industry deals (implying a lower possibility of antitrust-related concerns), and friendlier deals, all of which are associated with smaller initial takeover premium offers.

We then address our second question: does the retention of top defense litigation counsel make a difference to lawsuit and deal outcomes? We find that in multijurisdictional litigation top defense litigation counsel are more successful in settling suits cheaply and quickly and avoiding any increase in deal premium. In other words, when cases challenging the transaction are filed in multiple jurisdictions, top defense litigation counsel appear to do a better job of ensuring deal completion at a lower price by settling shareholder litigation without a significant increase in takeover premium paid to target firm shareholders. Specifically, we find that when lawsuits are filed in multiple jurisdictions, top defense litigation counsel is associated with a significantly higher proportion of disclosure-only settlements, a cheap form of settlement which does not involve any increase in the consideration paid to target shareholders. Top defense litigation firms are also more likely to appear in significantly lower takeover premium deals and reach settlements in a quicker time period than other defense litigation counsel. This suggests that top defense litigation counsel may be better able to handle the complexity and strategic issues surrounding multi-jurisdictional litigation, settling suits more cheaply and quickly and allowing lower premium deals to complete.

There are endogeneity issues, however. There may be unobservable deal characteristics which are associated with top defense litigation counsel which drive these outcomes. In other words, the association between top defense litigation counsel and lawsuit success can be complicated by a top defense litigation counsel's unobserved criteria for involvement in a case. We control for this using instrumental variables (IVs) based on lawsuit features which predict defense litigation counsel-lawsuit associations but not lawsuit/deal outcomes.

In selecting our IVs, we recognize that any contemporaneous deal, or lawsuit-related, variable may arguably influence lawsuit/deal outcomes. We therefore use a 3-vector of historical instrumental variables: (1) *Top Lawyer Firm*, an indicator variable based on whether the target firm had, in the three years preceding the filing of any deal lawsuit, hired top defense litigation counsel in an initial public offering, a comparable, sophisticated financial transaction; (2) *Top Lawyer Industry*, an indicator variable based on whether the target firm industry is, during the three years preceding the filing of the deal lawsuit, among the top 5 industry sectors hiring top defense litigation counsel in M&A litigation; and (3) *Interlocking Management*, an indicator variable based on whether any board member/senior executive of a target firm in our sample was also a board member/senior executive of another sample target firm in a previous M&A lawsuit where the target firm had hired a top defense litigation counsel to defend that earlier case. As an alternative endogeneity control mechanism to control for industry shocks, we use interacted fixed effects. We find that the association between top defense litigation counsel and suit/deal outcomes remains robust.

We conclude by addressing our third question, examining why top defense litigation firms are able to produce superior results. We find significant differences in the activity of plaintiffs' law firms when top defense litigation counsel is present. Plaintiff's law firms file more motions to expedite in cases involving top defense litigation counsel. Top defense litigation counsel respond by

<sup>1</sup> Older studies have not differentiated between different groups of plaintiffs' law firms, but rather have treated them as the same. For example, Coffee (1986) theorizes that plaintiffs' attorneys "are uniquely vulnerable to collusive settlements that benefit plaintiffs' attorneys rather than their clients". Weiss and White (2004) argue that shareholder litigation mostly benefits plaintiffs' attorneys as opposed to shareholders because they believe that law firms file opportunistic complaints in pursuit of quick settlements in exchange for receiving payments of attorneys' fees. Other papers also draw similar sweeping conclusions (Perino, 2012; Macey and Mill-er, 1991; and Griffith and Lahav, 2012).

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