The Shareholder Wealth Effects of Delaware Litigation

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Litigation and Firm Value

The question of how litigation affects firm value has long been of interest to scholars of law and business.

The major existing studies are from the 80s and 90s (Fishel and Bradley, 1985; Romano, 1991; Bhagat, Bizjack & Coles 1994, 1998).

Consistent with the technology of the time, these studies use newspaper reports of lawsuits across the country to define the event. Hand collection kept sample sizes small.

Litigation and Firm Value

There is also intense interest in Delaware litigation given its place as the nerve center of corporate law.

Over half of public companies are incorporated in Delaware and that means much of their corporate litigation can and will take place there.

This litigation include merger-related claims and derivative lawsuits most prominently. Delaware courts also handle a fairly large number of contract disputes for firms headquartered there.

Litigation and Firm Value

A significant change since the earlier studies is the public availability of electronic dockets.

These dockets mean that information about litigation events is available in close to real time.

Dockets can also be scraped. This allows for larger sample sizes and more precise event windows. The latter should lead to better identification. Dockets also contain procedural detail that can be used to collect novel covariates.

An Example

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Forest Labs to Buy Furiex Pharmaceuticals

By DEALBOOK APRIL 28, 2014, 10:42 AM Comment

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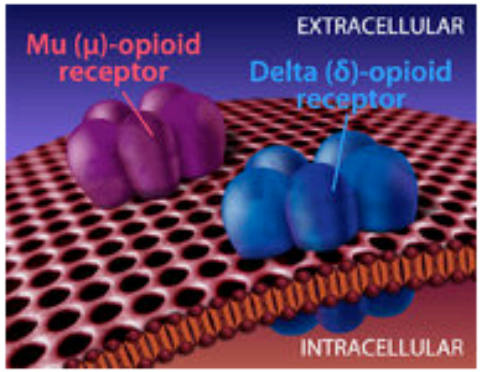
The wave of deal-making in the drug industry continued on Monday when Forest Laboratories agreed to acquire Furiex Pharmaceuticals for up to $1.46 billion.



Furiex

An illustration of cellular activity in Furiex's lead product, eluxadoline, a treatment for irritable bowel syndrome.

Forest Laboratories itself is already the target of a $25 billion takeover by Actavis P.L.C. Forest Labs said in a statement on Monday that Actavis consented to the transaction and that it did not expect the deal for Furiex to alter the timing of the Actavis deal.

An Example

Title: KOLLMAN, STEVEN V. FURIEX PHARMACEUTICALS INC
Court: COURT OF CHANCERY, DELAWARE
Case Number: 9599
Approx. 1 page

Current Date: 05/02/2014

Source: COURT OF CHANCERY, DELAWARE

CASE INFORMATION

Case Title:	KOLLMAN, STEVEN v. FURIEX PHARMACEUTICALS INC
Court:	COURT OF CHANCERY
Case Number:	9599
Filing Id Number:	55377253
Case Type:	CIVIL
Case Subtype:	CIVIL ACTION
Description:	BREACH OF FIDUCIARY DUTIES
Key Nature of Suit:	BUSINESS ORGANIZATIONS (080)

Date Filed: 05/01/2014

SYNOPSIS INFORMATION

Allegations: CLASS ACTION. PLAINTIFF AND THE CLASS SOUGHT AN ORDER TO ENJOIN DEFENDANTS FROM CONSUMMATING THE PROPOSED MERGER AGREEMENT, BECAUSE IT FAILED TO UNDERTAKE AN APPROPRIATE EVALUATION OF THE COMPANY'S NET WORTH.

Damages: CLASS ACTION CERTIFICATION, INJUNCTIVE RELIEF, ACCOUNTING, FEES, AND COSTS.

COMPLAINT (MANUALLY RETRIEVED)
Original Image of this Document (PDF)

Existing Evidence and Hypothesis Development

Studies have found little or no evidence that derivative litigation impacts firm value (Bradley & Fishel, 1985; Romano, 1991; West, 2001).

The sample sizes in these studies were relatively small and markets did not react as quickly as they do now.

Since these studies it has become more difficult to bring a derivative lawsuit. This is largely due to the increased independence of boards.

Existing Evidence and Hypothesis Development

The difficulty of bringing a derivative suit may increase the quality of suits being brought. It is possible that this leads to a larger chance of a negative effect on firm value.

At the same time, markets might account for the effect at the time of the event that forms the basis of the suit and the presence of insurance may mute this effect.

The potential size of derivative settlements in options backdating and insider trading contexts has grown (Armour, Black, Cheffins, 2012).

Existing Evidence and Hypothesis Development

There is little existing evidence on the effect of merger-related litigation on firm value.

There are potential methodological difficulties due to the proximity of announcement and filing. Moreover, many settlements are non-monetary and attorneys' fees tend to be modest.

We do not expect to find significant effects related to merger litigation.

Existing Evidence and Hypothesis Development

We are able to control for some proxies of case quality.

Following other studies (Cain & Davidoff, 2013), we expect the number of cases generated by a specific set of facts to increase in case quality, and hence, have a negative effect on firm value.

The dockets also allow us to identify pro hac vice motions (motion to admit counsel from a foreign jurisdiction).

Pro Hac Vice Motion Filed?
(Merger & Derivative Cases)

Year	No	Yes	Total
2004	22	39	61
%	36.1	63.9	
2005	25	55	80
%	31.3	68.8	
2006	20	43	63
%	31.8	68.3	
2007	20	51	71
%	28.2	71.8	
2008	18	40	58
%	31.0	69.0	
2009	18	72	90
%	20.0	80.0	
2010	36	116	152
%	23.7	76.3	
2011	34	109	143
%	23.8	76.2	

Total	193	525	718
%	26.9	73.1	

Existing Evidence and Hypothesis Development

Given that much of Delaware litigation is controlled by out-of-state lawyers, we expect that cases where those lawyers don't bother to show up will be of lower quality. This should mute any negative effect on firm value.

We can also pick up motions to expedite proceedings. Based on conversations with lawyers we believe that, at least on the margin, this is evidence of cases going on elsewhere.

If one believes in reverse auctions, this should drive down the value of claims.

Motion to Expedite Filed?
(Merger & Derivative Cases)

Year	No	Yes	Total
2004	45	16	61
%	73.8	26.2	
2005	47	33	80
%	58.8	41.3	
2006	39	24	63
%	61.9	38.1	
2007	36	35	71
%	50.7	49.3	
2008	30	28	58
%	51.7	48.3	
2009	33	57	90
%	36.7	63.3	
2010	75	77	152
%	49.3	50.7	
2011	59	84	143
%	41.3	58.7	

Total	364	354	718
%	50.7	49.3	

Existing Evidence and Hypothesis Development

We can control for judicial identity. The Chancery has some desirable characteristics for testing whether markets care about who the judge is.

There is little existing evidence on the financial impact of judicial identity.

One must be very careful, however, because assignment is not random and Delaware judges will sometimes confer before ruling on a novel issue.

Data and Methodology

We scraped the Westlaw's electronic dockets from inception (mid-2003) through the end of 2011. We omit the 2003 cases to stick to full calendar years and minimize partial cases.

A fuzzy matching algorithm matches cases with public companies. All hits are hand checked for accuracy.

The sample includes 1379 cases involving 876 different public companies.

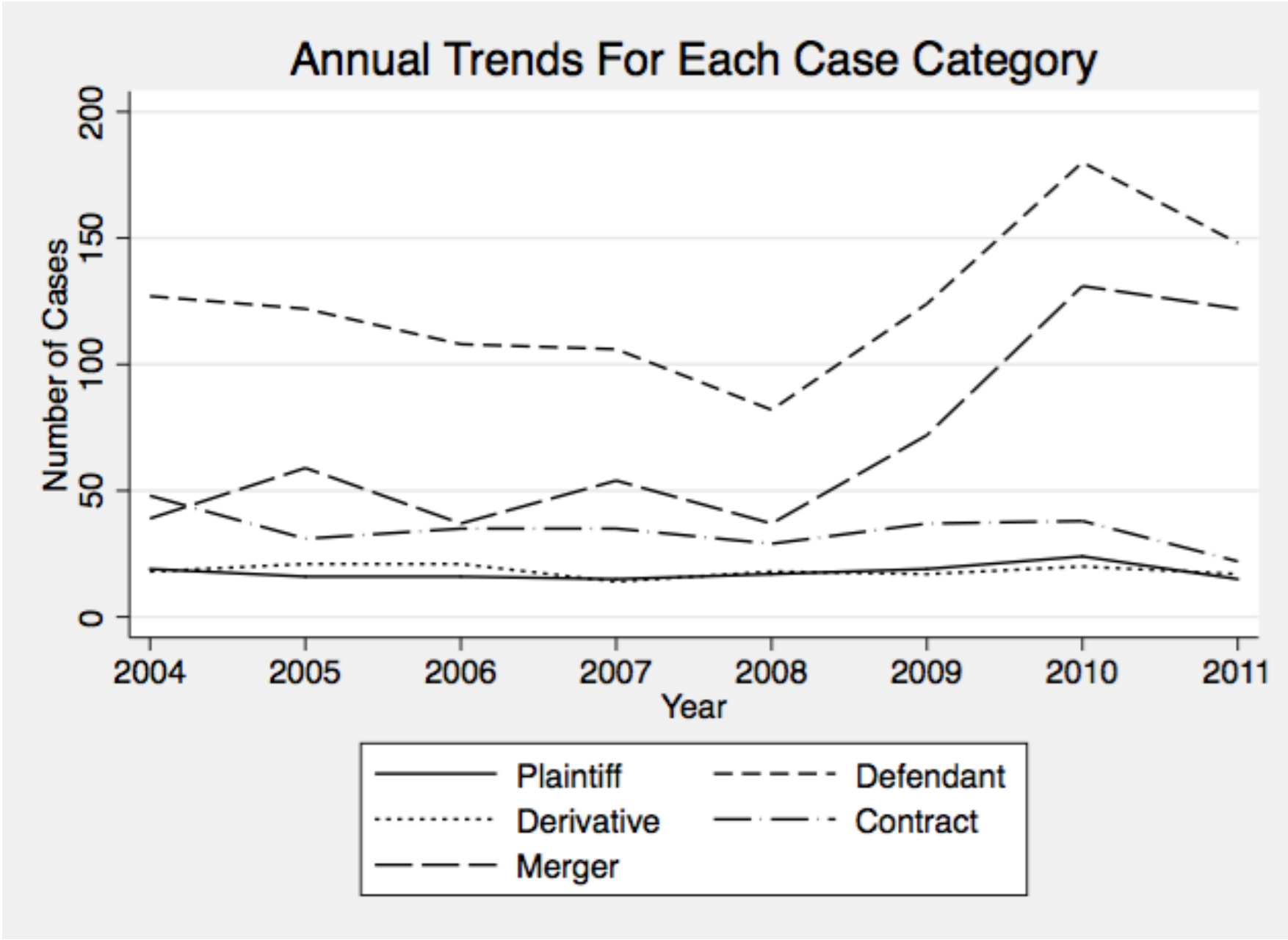
Data and Methodology

Complaints were reviewed to categorize the case types (Derivative, Merger-Related, Contract) and to determine the number of cases related to the same set of facts.

Searched docket entries for pro hac vice motions and motions to expedite. Institutional plaintiffs coded by hand.

The sample includes 1379 cases involving 876 different public companies.

	Complaints	Resolutions
Chancellor or Vice-Chancellor Assigned		
Parsons	15.0%	16.0%
Laster	7.5%	6.8%
Noble	13.2%	12.1%
Strine	27.3%	29.2%
Lamb	13.9%	14.1%
Chandler	23.1%	21.8%
Party Status		
Defendant	84.7%	83.4%
Plaintiff	11.6%	11.5%
Case Type		
Derivative	12.2%	16.2%
Merger	49.3%	42.5%
Contract	27.8%	29.9%


Annual Trends For Each Case Category
Number of Cases
0
50
100
150
200
2004
2005
2006
2007
2008
2009
2010
2011
Year
Plaintiff
Defendant
Derivative
Contract
Merger

Data and Methodology

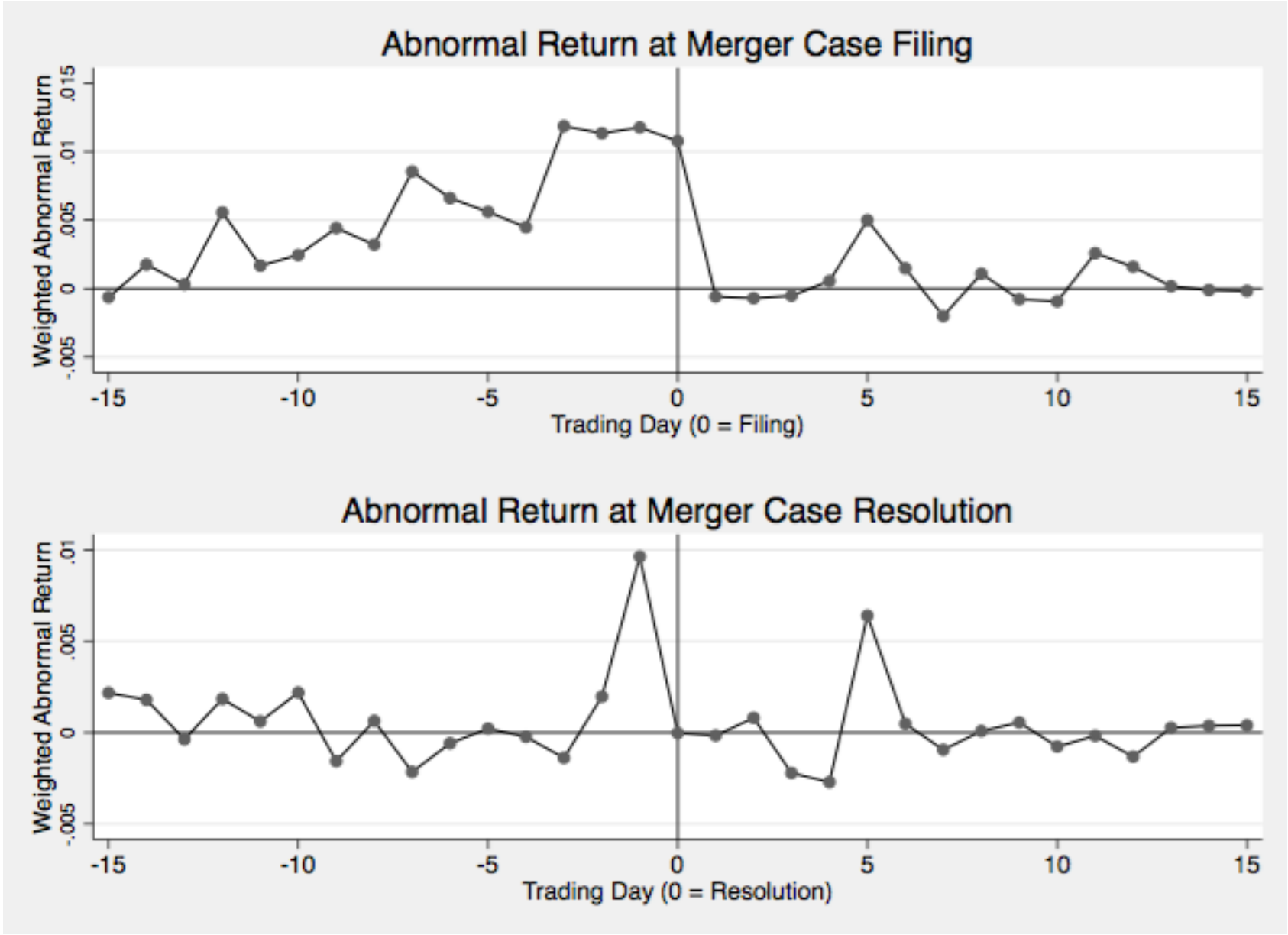
Standard event study methodology (CRSP via Eventus). We weight each observation by the inverse of the variance for the estimate of the abnormal return.

Event windows based on filing of first case and resolution of the cases.

Resolutions include voluntary dismissals, judicial dismissals, settlement hearings, and consolidations.

Abnormal Return to Case Type

	Case Type				
	Derivative		**Merger**	**Contract**	
Window	Filing	Termination	Filing	Filing	Termination
(-2,0)	-0.0124	-0.00155	0.0347	-0.0068	0.00186
	(0.00815)	(0.00447)	(0.00419)***	(0.00336)**	(0.00263)
(-1,0)	-0.0112	-0.00348	0.0233	-0.0064	0.000603
	(0.00644)*	(0.00336)	(0.00341)***	(0.00323)**	(0.00200)
(0, +1)	-0.00601	-0.00235	0.0104	-0.0028	-0.00180
	(0.00354)*	(0.00215)	(0.00229)***	(0.00255)	(0.00244)
(-1, +1)	-0.0121	-0.00414	0.0227	-0.00607	0.000405
	(0.00685)*	(0.00361)	(0.00356)***	(0.00395)	(0.00280)
(-2, +2)	-0.0157	0.000551	0.0333	-0.0052	0.000941
	(0.00764)**	(0.00450)	(0.00428)***	(0.00439)	(0.00346)
N	146	99	551	275	163
Note: Derivative effect translates to loss in firm value of $438M to $657M.					


Abnormal Return at Merger Case Filing
Weighted Abnormal Return
-.005
0
.005
.01
.015
-15
-10
-5
0
5
10
15
Trading Day (0 = Filing)
Abnormal Return at Merger Case Resolution
Weighted Abnormal Return
-.005
0
.005
.01
-15
-10
-5
0
5
10
15
Trading Day (0 = Resolution)

Cumulative Abnormal Return and Case Characteristics

Abnormal Return Window	(0, +1)				
Event	Case Filing			Case Termination	
Case Type	Merger	Contract	Derivative	Contract	Derivative
Firm is Plaintiff	0.0110	0.00185		0.00182	
	(0.0139)	(0.00547)		(0.00475)	
Pension Fund	0.0134	-0.0104	0.0125	0.00369	0.00165
	(0.00584)**	(0.0189)	(0.00999)	(0.0296)	(0.00728)
Log of Market Cap.	-0.000945	-0.00102	-0.00154	0.00240	-0.00101
	(0.00116)	(0.00117)	(0.00198)	(0.00119)**	(0.00156)
Pro Hac Vice Motion	-0.00242	-0.0120	-0.0191	-0.00734	0.00320
	(0.00582)	(0.00549)**	(0.00940)**	(0.00480)	(0.00609)
Motion to Expedite	-0.00108	0.00903	0.0187	0.00384	0.0000855
	(0.00498)	(0.00593)	(0.00943)**	(0.00555)	(0.00666)
Total Cases	0.00511	-0.0283	-0.0122	0.00441	0.00325
	(0.00140)***	(0.00563)***	(0.00491)**	(0.00611)	(0.00325)
Constant	0.0343	0.0380	0.0124	-0.0356	-0.00583
	(0.0158)**	(0.0165)**	(0.0272)	(0.0153)**	(0.0186)
Observations	551	275	146	163	99
R-squared	0.136	.197	.225	0.367	0.189

Note: All regressions include year and Fama-French industry classification (ten categories) fixed effects.

Cain and Davidoff Data (2012)
(Merger Litigation in Multiple States)

Year	Avg. # of Suits	% Multi-Jurisdictional
2005	2.2	8.6%
2006	2.6	25.8%
2007	3.0	21.9%
2008	2.8	28.0%
2009	4.6	43.3%
2010	4.7	47.6%
2011	4.8	47.4%

Cumulative Abnormal Return of Merger Case Filing with Interaction Effects

Window	(0,+2)	(-1,+1)	(-1,0)	(0,+1)
Motion to Expedite	0.0562	0.0865	0.0736	0.0561
	(0.0174)***	(0.0269)***	(0.0258)***	(0.0168)***
2005*Expedite	-0.0748	-0.100	-0.0900	-0.0680
	(0.0217)***	(0.0335)***	(0.0322)***	(0.0209)***
2006*Expedite	-0.128	-0.156	-0.128	-0.125
	(0.0236)***	(0.0365)***	(0.0351)***	(0.0228)***
2007*Expedite	-0.0591	-0.0789	-0.0669	-0.0620
	(0.0222)***	(0.0343)**	(0.0329)**	(0.0214)***
2008*Expedite	-0.0342	-0.0725	-0.0593	-0.0438
	(0.0267)	(0.0414)*	(0.0397)	(0.0258)*
2009*Expedite	-0.0501	-0.0712	-0.0577	-0.0507
	(0.0285)*	(0.0440)	(0.0423)	(0.0275)*
2010*Expedite	-0.0605	-0.101	-0.0875	-0.0591
	(0.0198)***	(0.0306)***	(0.0294)***	(0.0191)***
2011*Expedite	-0.0510	-0.0918	-0.0798	-0.0516
	(0.0198)**	(0.0306)***	(0.0294)***	(0.0191)***
Constant	0.00232	0.0168	0.0230	0.00458
	(0.0179)	(0.0276)	(0.0265)	(0.0172)
Observations	551	551	551	551
R-squared	0.188	0.138	0.135	0.188

Notes: All regressions include Fama-French industry classification (ten categories) and yearly fixed effects as well as all the covariates from the previous table.

Judicial Identity

As noted earlier, assignment is not random.

We test for allocation by regressing the market cap, plaintiff, pension fund, total cases, expedite, pro hac vice motion, and industry fixed effects against judge fixed effects with year and case type controls.

Only one of the joint tests in these sixteen regressions is significant and that is at the ten-percent level.

	Abnormal Return to Case Filing					
	Merger		Contract		Derivative	
Chancellor or Vice Chancellor (relative to Parsons)	(+1, +4)		(+1, +4)		(+1, +4)	
Chandler	0.00321	0.00446	0.00828	0.0137	0.000487	0.0383
	(0.00524)	(0.00583)	(0.00871)	(0.00930)	(0.0226)	(0.0292)
Laster	0.000507	0.00160	-0.00561	-0.00870	0.0118	0.0351
	(0.00633)	(0.00694)	(0.0135)	(0.0153)	(0.0325)	(0.0419)
Noble	0.00343	0.00514	-0.00148	-0.000426	0.00307	0.0138
	(0.00574)	(0.00594)	(0.00938)	(0.00996)	(0.0294)	(0.0332)
Strine	0.00893	0.00850	-0.00503	-0.00411	0.0141	0.0488
	(0.00478)*	(0.00509)*	(0.00833)	(0.00950)	(0.0240)	(0.0286)*
Lamb	0.00285	0.00456	-0.00151	0.00719	0.00554	0.0375
	(0.00573)	(0.00670)	(0.00965)	(0.0110)	(0.0255)	(0.0329)
Controls	N	Y	N	Y	N	Y
Observations	548	548	248	248	144	144
R-squared	0.010	0.042	0.014	0.146	0.006	0.111

Abnormal Return to Case Termination				
	Merger Cases			
Chancellor or Vice Chancellor	(0, +1)			
(relative to Parsons)				
Chandler	-0.00449	-0.00611	-0.00335	-0.00541
	(0.00502)	(0.00541)	(0.00516)	(0.00554)
Laster	-0.00956	-0.00792	-0.00818	-0.00695
	(0.00619)	(0.00704)	(0.00636)	(0.00711)
Noble	0.00417	-0.00198	0.00468	-0.000842
	(0.00552)	(0.00586)	(0.00561)	(0.00595)
Strine	-0.00474	-0.00257	-0.00393	-0.00176
	(0.00434)	(0.00465)	(0.00446)	(0.00475)
Lamb	-0.000133	-0.00481	0.000768	-0.00460
	(0.00602)	(0.00660)	(0.00615)	(0.00698)
Case Controls	N	Y	N	Y
Resolution Controls	N	N	Y	Y
Observations	257	257	257	257
R-squared	0.025	0.189	0.03	0.196

Abnormal Return to Case Termination

	Contract Cases			
Chancellor or Vice Chancellor	(0, +1)			
(relative to Parsons)				
Chandler	-0.0305	-0.0160	-0.0303	-0.0162
	(0.00962)***	(0.00948)*	(0.00978)***	(0.00950)*
Laster	-0.0108	0.00956	-0.0106	0.0118
	(0.0119)	(0.0137)	(0.0123)	(0.0148)
Noble	-0.00698	0.0000442	-0.00764	0.00241
	(0.00919)	(0.00937)	(0.00948)	(0.00985)
Strine	-0.00256	0.00359	-0.00294	0.00488
	(0.00860)	(0.00835)	(0.00878)	(0.00852)
Lamb	0.00233	0.00726	0.00190	0.00873
	(0.0101)	(0.0101)	(0.0104)	(0.0102)
Case Controls	N	Y	N	Y
Resolution Controls	N	N	Y	Y
Observations	140	140	140	140
R-squared	0.112	0.500	0.113	0.513

Abnormal Return to Case Termination				
	Derivative Cases			
Chancellor or Vice Chancellor	(0, +1)			
(relative to Parsons)				
Chandler	-0.0176	-0.0202	-0.0172	-0.0178
	(0.0108)	(0.0128)	(0.0110)	(0.0136)
Laster	-0.0144	-0.0241	-0.0177	-0.0279
	(0.0134)	(0.0180)	(0.0138)	(0.0184)
Noble	-0.0282	-0.0273	-0.0263	-0.0237
	(0.0160)*	(0.0178)	(0.0162)	(0.0185)
Strine	-0.00783	-0.00921	-0.00698	-0.00860
	(0.0113)	(0.0130)	(0.0115)	(0.0135)
Lamb	-0.0117	-0.0141	-0.0126	-0.0133
	(0.0120)	(0.0139)	(0.0121)	(0.0140)
Case Controls	N	Y	N	Y
Resolution Controls	N	N	Y	Y
Observations	98	98	98	98
R-squared	0.067	0.239	0.084	0.265