

Does the Quality of the Plaintiffs' Law Firm Matter in Deal Litigation?*

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This Article examines how the stock market reacts to the filing of lawsuits against mergers and acquisitions targets as the quality of the plaintiffs' law firm varies. Our primary dataset includes all cases of this type filed in the Delaware Chancery Court from November 2003–September 2008. We group the law firms that file these suits into higher and lower quality categories using several quantitative and qualitative measures. We hypothesize that target firm share value should reflect the likelihood that litigation will result in an increase in merger consideration. This effect is likely to depend, at least in part, on law firm quality. Our evidence is broadly consistent with this hypothesis, and we find similar results when we restrict the analysis to those cases filed several days after the announcement of the deal. Likewise, we find that the effect of law firm quality on firm value endures when we include cases filed after the beginning of the financial crisis. We discuss the implications of these results for debates about the value of corporate litigation.

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I. INTRODUCTION

The likelihood of a merger or acquisition being subject to litigation has skyrocketed in recent years.¹ Nearly every deal involving a public company gets challenged in court soon after announcement of the transaction.² The universality of these challenges has generated significant controversy about the value of this litigation. A cynical take is that many of these cases are strike suits. They are shakedowns by plaintiffs' lawyers who know that the drive to close the deal will lead merger partners to settle even frivolous claims to make them go away.³ Defense lawyers play along because they can purchase claim preclusion through a broad release and a negligible attorneys' fee.⁴ According to this view, only lawyers benefit from these suits, not shareholders.⁵ Skeptics explain away shareholder-friendly case outcomes litigated by experienced plaintiff law firms as having been produced by something other than the lawsuit itself. A more optimistic view suggests that law firm skill at case selection and litigation can affect case outcomes independent of deal characteristics. Under this view, lawyers are not just roosters taking credit for the sunrise. They matter, and so does the time and effort expended to sort out the good firms from the bad.

In this Article, we develop evidence about how market participants value the filing of these merger lawsuits. Our primary focus is on the law firms involved in these cases. Lawsuits that result in a price increase for target shareholders will likely command the highest legal fees and will attract the highest quality counsel.⁶ One might expect that the involvement of those law firms in a lawsuit signals the possibility of a significant settlement for shareholders. Upon observing the presence of a high quality law firm, the market should anticipate a positive settlement leading to an increase in merger consideration, and consequently, would react positively to the filing of suit by such a firm.⁷

1. See Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2012* 1–2 (Harv. L. Sch. F. Corp. Governance & Fin. Reg., Working Paper No. 236, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2216727 (noting that 87.3% of transactions in 2010 experienced litigation, a figure which rose to 91.4% of transactions in 2011).

2. See *In re Revlon, Inc. S'holder Litig.*, 990 A.2d 940, 943 (Del. Ch. 2010) (“As this Court has previously observed, the first cases often appear minutes or hours after the announcement with others following within a matter of days.”).

3. See Liz Hoffman, *First Rule of Mergers: To Fight is to Lose*, WALL ST. J. (March 26, 2014, 12:06 PM), <http://online.wsj.com/articles/SB10001424052702303949704579457414255774166> (“It is almost always cheaper and less risky for companies to settle, especially when facing lawsuits in multiple courts. One unfavorable ruling can derail a deal for months.”).

4. See Sean J. Griffith & Alexandra D. Lahav, *The Market for Preclusion in Merger Litigation*, 66 VAND. L. REV. 1053, 1082 (2013) (discussing how when defendant corporations face multiple claims in multiple jurisdictions, “[t]hey can ‘shop’ for the quickest and cheapest settlement from the various plaintiffs teams”).

5. See Rodney Yap et al., *Merger Suits Often Mean Cash for Lawyers, Zero for Investors*, BLOOMBERG (Feb. 16, 2012, 12:59 PM), <http://www.bloomberg.com/news/articles/2012-02-16/lawyers-cash-in-while-investor-clients-get-nothing-in-merger-lawsuit-deals> (“Of 57 such investor class actions settled or otherwise concluded [in Delaware] in 2010 and 2011, 40—or 70 [%]—made money for plaintiffs’ lawyers but not clients . . .”).

6. See, e.g., ROBERT M. DAINES & OLGA KOUMRIAN, CORNERSTONE RESEARCH, RECENT DEVELOPMENTS IN SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS 15 (Mar. 2012), <http://securities.stanford.edu/research-reports/1996-2012/Cornerstone-Research-Shareholder-MandA-Litigation-03-2012.pdf> (noting that during 2010 and 2011, “the highest [attorneys] fee was in the Del Monte Foods settlement, which also included a large payment to Del Monte’s shareholders”).

7. See generally Sanjai Bhagat & Roberta Romano, *Event Studies and the Law—Part I: Technique and*

At the other end of the spectrum, the less skilled law firms may be less choosy when they file suit. These firms survive by collecting small legal fees in numerous cases.⁸ The fact that these law firms decide to file a case may trigger the expectation that not much benefit is likely to flow to shareholders as a consequence of the lawsuit. Here, we would expect a negative market reaction relative to the filing effect when a high quality firm brings a case.

In defining lawyer quality we focus on lawyerly skill and on case selectivity. Skill should matter for the obvious reason that the energy and diligence that better lawyers bring to cases should enable those lawyers to produce more meaningful settlements in merger cases. As Vice Chancellor Laster of the Delaware Court of Chancery has put it, higher quality law firms should be better able to produce “tangible benefits for shareholders.”⁹

Higher quality lawyers should also be able to make better choices about the cases they file. That selectivity should indicate to the market that a case has a larger likelihood of a positive recovery for shareholders. The market will only react positively to such filing if it anticipates a positive recovery—that is, if it believes that suits brought by top law firms can add value. But if selectivity is part of what differentiates better and worse firms, it does not follow that the market should put substantial weight on the presence of a lesser firm. If those firms file indiscriminately, they will sometimes file a complaint in good cases and sometimes file in poor cases. Instead, what we expect to matter is the presence of a lesser quality firm *and* the absence of the better firms. Those cases should provide a signal of the cases where litigation is unlikely to provide much, if any, benefit to shareholders. In contrast to our hypotheses suggesting that the market reaction should vary according to the quality of the law firm, litigation skeptics would expect to see no market reaction to the law firms at all. Instead, as described more fully below, they would expect to see the market reacting to the deal itself, to its price terms, to its market-relevant characteristics, but not to the plaintiff law firms themselves, who indiscriminately file strike suits without regard to merit, according to the litigation-skeptic theory.

To gauge law firm quality we use both objective and subjective measures. The objective measures include data on the number and amount of settlements that law firms secure. For higher quality firms, we rely on the annual Securities Class Action Services (SCAS) list of the plaintiffs’ firms with highest aggregate securities settlements published by RiskMetrics. While securities cases and merger cases are different,¹⁰ of course, many of these firms also have active merger practice groups.¹¹ Because both securities class

Corporate Litigation (John M. Olin Ctr. L., Econ. & Pub. Pol’y Working Papers, Paper No. 259, 2001), http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1021&context=lepp_papers (discussing event study methodology).

8. See *In re Revlon, Inc. S’holders Litig.*, 990 A.2d 940, 959 (Del. Ch. 2010) (“Traditional plaintiffs’ law firms who bring class and derivative lawsuits on behalf of stockholders without meaningful economic stakes can best be viewed as entrepreneurial litigators who manage a portfolio of cases to maximize their returns through attorneys’ fees.”).

9. Transcript of Motion to Consolidate and Organize Council and the Court’s Ruling at 6:3–6, *In re Compellent Techs., Inc. S’holder Litig.*, (No. 6094-VCL), 2011 WL 6382523 (Del. Ch. Jan 13, 2011).

10. Merger litigation involves shareholders challenging the terms of a transaction involving the company in which they own stock. See David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions*, 38 DEL. J. CORP. L. 907, 909 (2014) [hereinafter Webber, *Private Policing*] (describing the typical deal litigation case brought by shareholders). In a securities class action, shareholders are alleging that the board of directors or officers of the company violated the federal securities laws.

11. For example, the well-regarded law firms of Bernstein Litowitz Berger & Grossman, Grant &

actions and acquisition-related cases rely on assessments of the law firm quality when designating who will represent the lead plaintiff,¹² firms that have high quality securities practices can be expected to care about the reputation of their merger practices, and vice versa. We include any firm with an active deal litigation practice that appeared on the SCAS top ten list at least once during the time frame of our sample (2003–2008).

For the subjective assessment of higher quality firms we rely on the list compiled by Legal 500. These rankings draw on publicly available information and on private information from the law firms themselves.¹³ There is a list of the top merger and acquisitions litigators and we classify any of the plaintiff-side firms as a top firm if they appeared on the most-recent version of the list.

For the objective side of the lower end of firms we rely on a study of settlements in merger cases prepared by Bloomberg. The study tracks law firms that filed a significant number of merger cases in 2011 and orders them based on the number of positive settlements they were able to secure during 2011.¹⁴ We classify firms at the bottom of the list—those who were unable to recover for shareholders or were only rarely able to do so—as lower quality firms. We also include the subjective assessments of the Delaware judiciary in our classification. In the course of selecting lead counsel and blessing settlements, Delaware judges will sometimes comment on firm quality.¹⁵ We group those that receive the harshest comments in the lower quality category.¹⁶

We develop evidence that these quality classifications are consistent with the views of public market participants. In cases where recoveries are most likely—such as management buyouts (MBOs) and controlling shareholder transactions—law firm quality has the anticipated effect on the value of target shares. Upon filing of the case, our results suggest that there is a relative increase in target stock price when higher quality law firms are involved in the litigation. Alternatively, when no top quality law firms are present, but a lower quality firm is, the relative value of the target's shares appears to decrease. We attribute these results to the market's recognition of the possibility that the higher quality firms will be able to obtain a significant settlement for shareholders. Lesser quality firms may be less able to win such settlements, which would explain the negative effect on target share price when they, but not top firms, are litigating cases. The effect of these firms on target share price may be limited to the threat that they can hold up a deal.¹⁷ Alternatively,

Eisenhofer and Labaton Sucharow all have practice groups in both the securities fraud and shareholder rights areas. *Practice Areas*, BERNSTEIN LITOWITZ BERGER & GROSSMAN LLP, <http://www.blbglaw.com/practices/index.html> (last visited Nov. 14, 2015); *Practice Areas*, GRANT & EISENHOFER PA, <http://www.gelaw.com/practice-areas> (last visited Nov. 14, 2015); *Practice Groups*, LABATON SUCHAROW LLP, <http://www.labaton.com/en/practiceareas/index.cfm> (last visited Nov. 14, 2015).

12. See *infra* Part IV (discussing how data was gathered and summary statistics conducted).

13. See *The Basis for Inclusion*, LEGAL 500, <http://www.legal500.com/assets/pages/united-states/united-states.html> (last visited Nov. 14, 2015) (noting the basis for inclusion).

14. See Rodney Yap et al., *Merger Suits Often Mean Cash for Lawyers, Zero for Investors*, BLOOMBERG (Feb. 16, 2012, 1:59 PM), <http://www.bloomberg.com/news/2012-02-16/lawyers-cash-in-while-investor-clients-get-nothing-in-merger-lawsuit-deals.html> (“Of 57 such investor class actions settled or otherwise concluded [in Delaware] in 2010 and 2011, 40—or 70[%]—made money for plaintiffs’ lawyers but not clients, according to data compiled by Bloomberg News.”).

15. See *infra* Part IV (giving a hand-collected dataset comprising all 454 shareholder-derivative and class action lawsuits filed and a summary thereof).

16. See *supra* text accompanying note 9 (discussing one example of a Delaware judge commenting on firm quality).

17. See, e.g., Plaintiffs’ Opposition to Defendants’ Motion to Stay Discovery, *In re Craftmade Int’l, Inc.*

the negative effect of filing by a low quality law firm may reflect the market's "disappointment" that a deal with material flaws will not be targeted by a top law firm.

Given that many lawsuits get filed shortly after the announcement of a merger, a fair concern about a study like ours is that the market is responding to an abundance of new information upon announcement of a merger. Although we control for deal premium and market timing, it may be difficult to tease out the segment of the market reaction that can be attributed solely to the quality of the plaintiff firm filing suit. To address this concern we run a robustness check that focuses on the subset of cases filed two or more days after announcement of the deal.¹⁸ Two days should be enough time for the market to react to the announcement of the deal. By examining firm filings more than two days after the deal, we can focus on market reactions that are more readily attributable to the plaintiff law firms alone. We find the same results as we do in the broader analysis: a relative price increase in the target's stock when a higher quality firm files and a relative price decrease when lower quality firms, but not higher quality firms file. These results help confirm that law firm quality matters to market participants.

We conduct several other robustness checks to provide additional confidence in our results. The most prominent of these checks is the inclusion of case data that extends through the end of 2009. We restrict our primary analysis to cases filed before the bankruptcy of Lehman Brothers in September 2008, which is the traditional demarcation point for the beginning of the financial crisis. The crisis had a profound effect on credit markets, causing them to come close to seizing. Deals depend dearly on the availability of credit and the scarcity of financing threatened the ability to close mergers and acquisitions. The uncertainty associated with deal closure likely altered the available cases and thus the strategies that law firms employed. For this reason, we view the post-crisis cases as different from the earlier sample. Nevertheless, when we include these cases in the analysis, our results largely remain the same.

This Article proceeds as follows. Part II reviews the background law and theory surrounding merger litigation. Part III develops this theory into a series of hypotheses about the likely impact different litigation characteristics have on the stock price of targets. Part IV explains our data, variable construction, and provides basic descriptive statistics. Part V provides reports and discusses the results of event studies conducted upon the filing of merger lawsuits. Part VI concludes.

II. BACKGROUND AND THEORY FOR MERGERS AND ACQUISITIONS LITIGATION

A. Delaware Law Governing Mergers and Acquisitions

Delaware law imposes several legal duties on boards of directors for public companies that are takeover targets. Ordinarily, board decisions are reviewed under the deferential business judgment rule.¹⁹ In the face of a cash-based, change-of-control acquisition, target

S'holders Litig., (No. 6950-VCL), 2012 WL 1144734 (Del. Ch. 2012) (describing the court's partial grant of plaintiffs' motion to enjoin shareholder vote and subsequent delay of closing); *see also* Levi & Korsinsky LLP, *Craftmade International, Inc. S'holder Litig.*, C.A. No. 6950-VCL (Del. Ch. 2011), <http://www.zlk.com/success> (scroll down to see case description) (last visited Nov. 14, 2015) ("Won a hard-fought injunction requiring the company to issue numerous corrective disclosures and to publish a 'Fort Howard' press release, inviting potential bidders to make superior offers." Neither an increase in the offer price nor damages were obtained in the case).

18. *Infra* Table 6.

19. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("Under Delaware law, the business

boards must meet the *Revlon* standard requiring them to maximize the price for the target company's shareholders.²⁰ Additional protections exist for target shareholders in situations where the target board faces a conflict of interest, like an acquisition by a controlling shareholder.²¹ In a hostile bidder situation, boards face "enhanced scrutiny," requiring that defensive measures must be instituted in response to a real threat to the target and must be proportional to the threat.²² Target shareholders have standing to bring private class or derivative actions to enforce these rights against recalcitrant boards or managers, and have recently done so with increasing frequency.²³ These actions—and their recent proliferation—have become controversial in both the academic literature and the popular press. From one vantage point, such actions should reduce managerial agency costs—the costs generated by boards and managers acting in their own interests, rather than those of shareholders—by forcing boards and managers to act in the shareholders' interests in the transactional context.²⁴ From another, litigation to enforce these rights generates costs of its own, including the agency costs of plaintiffs' lawyers themselves.²⁵ Much of the academic debate over such litigation focuses on whether it reduces managerial agency costs and, even if it does, whether this benefit outweighs the litigation costs.²⁶

Delaware has attempted to respond to the agency cost concerns of transactional class actions by instituting procedures for selecting the class representative, or lead plaintiff, and the lead counsel. As is true for class actions generally, the interests of the lead plaintiff must align with those of the shareholder class in accordance with the typicality and adequacy requirements of Delaware Chancery Court Rule 23.²⁷ The Delaware Court of Chancery has established criteria for the selection of lead plaintiffs and lead counsel in addition to those set forth in Rule 23. In *TCW Technology Limited Partnership v. Intermedia Communications, Inc.*, the court held that in making the lead plaintiff selection, it should consider the following factors: (1) "the quality of the pleading that appears best

judgment rule . . . 'is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'") (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

20. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

21. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

22. *UNOCAL Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

23. See Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 L. & CONTEMP. PROBS. 215, 218 (1999) (discussing the increase in shareholder direct and class action suits).

24. See Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 143 (2004) (discussing how boards and managers become "more active watchdogs" following derivative litigation).

25. See Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 19 (1991) (attributing high agency costs in class action and derivative litigation primarily to the inability of the class to effectively monitor the attorneys).

26. Compare Thompson & Thomas, *supra* note 24, at 207 ("[W]e conclude that the acquisition-oriented shareholder class actions filed in Delaware add value, even if they also have costs."), with Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 282 (1986) (concluding that derivative suits do not have a material impact on the firm's managerial agency costs and its shareholders because of the insignificant magnitude of the shareholder's wealth-effects).

27. Del. Ch. Ct. R. 23.

able to represent the interests of the shareholder class and derivative plaintiffs[;]"²⁸ (2) which "shareholder plaintiff has the greatest economic stake in the outcome of the lawsuit[;]"²⁹ and (3) "whether a particular litigant has prosecuted its lawsuit with greater energy, enthusiasm or vigor than have other similarly situated litigants."³⁰ The opinion noted that the second factor "is similar to the federal system that now uses a model whereby the class member with the largest economic interest in the action is given responsibility to control the litigation."³¹

In June 2002, the Delaware Court of Chancery settled on final criteria for lead plaintiff selection. In *Hirt v. U.S. Timberlands Service Company, LLC*,³² the court held that it would consider the following factors: (1) the "quality of the pleading[;]" (2) "*the relative economic stakes of the competing litigants . . . (to be accorded 'great weight')*" (3) "the willingness and ability of the contestants to litigate vigorously on behalf of an entire class of shareholders[;]" (4) "the absence of any conflict between larger, often institutional, shareholders and smaller shareholders[;]" (5) "the enthusiasm or vigor with which the various contestants have prosecuted the lawsuit[;]" and (6) "*competence of counsel and their access to the resources necessary to prosecute the claims at issue.*"³³

The theory behind *TCW Technology* and *Hirt* may be traced back to Elliot Weiss and John Beckerman's *Let the Money Do the Monitoring (Monitoring)*.³⁴ In *Monitoring*, Weiss and Beckerman argued that by appointing institutional investors as lead plaintiffs in shareholder class actions, courts could reduce the agency costs of class action lawyers.³⁵ According to the theory asserted in *Monitoring*, institutional investors brought two strengths to the lead plaintiff role. First, they were motivated to monitor class counsel because they had "skin in the game."³⁶ Such funds had the proper incentives to police self-serving behavior by plaintiff lawyers and assure that the case was being litigated skillfully and in the interests of the class. Second, institutional investors were comparatively sophisticated, they served as fiduciaries, and they often had access to internal legal and financial expertise.³⁷ They not only had the incentive to monitor class counsel, they had the skill to do so. Selection of institutional lead plaintiffs would mark a departure from the way lead plaintiffs were selected previously, which often created a "race to the courthouse" in which lead counsel obtained the position simply by being the first to file.³⁸ The "race to

28. *TCW Tech. Ltd P'ship v. Intermedia Commc'ns, Inc.*, No. 18336, 2000 WL 1654504, at *1 (Del. Ch. Oct. 17, 2000).

29. *Id.* at *4.

30. *Id.*

31. *Id.*; accord 15 U.S.C. § 78u-4 (2012).

32. *Hirt v. U.S. Timberlands Serv. Co., LLC*, No. CIV.A. 19575, 2002 WL 1558342, at *2 (Del. Ch. July 9, 2002).

33. *Id.* (emphasis added).

34. See generally Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053 (1995) (discussing the benefits of appointing institutional investors as lead plaintiffs).

35. *Id.*

36. See *id.* at 2088-94 (discussing data on the stakes of institutional investors in recent shareholder litigation).

37. See *id.* at 2106 (discussing the benefits of an experienced institutional investor as a lead plaintiff opposed to an individual).

38. *Id.* at 2062; see also Thompson & Thomas, *supra* note 24, at 136 ("By the early 1990s, plaintiffs' law firms filing securities fraud class actions were accused of a whole host of dubious practices, including using professional plaintiffs in their cases, filing carbon copy complaints, and racing to the courthouse to be the first to

the courthouse” incentivized plaintiffs’ lawyers to maintain stables of potential lead plaintiffs, almost always individuals rather than institutions, who could be quickly identified as potential lead plaintiffs in whose name a lawsuit could be rapidly filed.³⁹ Such lead plaintiffs often had trivial stakes in the outcome of the case, and lacked sophistication, making them poorly qualified to monitor class counsel.⁴⁰

The Private Securities Litigation Reform Act of 1995 (PSLRA) preceded *TCW Technologies* and *Hirt*, and similarly created a preference for institutional investor lead plaintiffs in federal securities fraud class actions.⁴¹ The PSLRA triggered a competition between plaintiff law firms to obtain institutional investor clients, one that was enhanced by *TCW Technologies* and *Hirt*.⁴² The primary means of obtaining and retaining such clients is to offer portfolio monitoring services, by which plaintiff law firms directly monitor the portfolios of institutional clients for exposure to transactional cases.⁴³ This enables the firms to identify institutional clients with a substantial enough stake in the transaction to obtain a lead plaintiff appointment in the litigation.⁴⁴ Large institutional investors who are likely to be repeat players are highly prized as clients, and therefore are well-positioned to discriminate between firms, selecting the most skilled firms, with the most resources, to represent them in class actions.⁴⁵ In contrast, firms that are unable to obtain institutional clients are poorly positioned to command a leading role in the most coveted cases.

All is not lost for such firms. As described more fully throughout this Section, since *TCW Technology* and *Hirt* institutions have assumed a leading role in approximately 40% of all cases.⁴⁶ Thus, even today, most suits proceed much as they did prior to *TCW Technologies* and *Hirt*, with an individual lead plaintiff who lacks motivation (because of small stakes) and sophistication (because of lack of financial or legal training). Such lead plaintiffs are often selected by the lead counsel, rather than the other way around.⁴⁷ They will rarely have the motivation or sophistication to monitor class counsel. Moreover, the law firms in such cases are either part of the group that has been passed over by institutional clients for portfolio monitoring, or among firms that may represent institutional investors but could not find an institutional client for the case. Because 60% of cases are still led by such firms, and monitored by individual clients with small stakes,⁴⁸ we might expect such

file a case . . .”).

39. See Weiss & Beckerman, *supra* note 34, at 2060–61 (discussing the practice of keeping a store of lead plaintiffs at the ready).

40. See *id.* at 2060 (“In a large number of class actions, plaintiffs are poorly informed about the theories of their cases, are totally ignorant of the facts, or are illiterate concerning financial matters.”).

41. See Michael A. Perino, *Did the PSLRA Work?*, 2003 U. ILL. L. REV. 913, 923 (2003) (discussing the lead plaintiff and notice provision of the PSLRA).

42. *Id.* at 966.

43. Webber, *Private Policing*, *supra* note 10, at 935.

44. *Id.*

45. Perino, *supra* note 41, at 924 n.61 (discussing selection of appropriate lead counsel by large institutional plaintiffs).

46. See David H. Webber, *The Plight of the Individual Investor in Securities Class Actions*, 106 NW. U. L. REV. 157, 166, 167 nn.46–47 (2012) (“As predicted, institutional investors now lead over 40% of securities fraud class actions and around 40% of transactional class actions in Delaware.”).

47. See Fred B. Burnside, “Go Pick A Client”—and Other Tales of Woe Resulting from the Selection of Class Counsel by Court-Ordered Competitive Bidding, 8 FORDHAM J. CORP. & FIN. L. 363, 394–95 (2003) (discussing the importance of having a lead plaintiff).

48. See Webber, *supra* note 46, at 166 (suggesting that if institutional investors lead approximately 40% of

cases to result in worse outcomes for shareholders, either because the cases themselves are too weak to attract a quality firm or plaintiff, or because, even if the cases have merit, the class agents are unable to capitalize on it.

Apart from the majority of cases that simply do not attract quality lead counsel and lead plaintiffs, law firms representing individual clients might still be able to maneuver their way into a case that has institutional lead plaintiffs who have selected quality counsel.⁴⁹ Typically, this can be done by asking for a small share of the overall attorneys' fee and doing little work in the case; attorneys with institutional clients might consent to such an arrangement for fear that the weaker firms might object to any settlement on behalf of their individual clients, or threaten to take the lead plaintiff/lead counsel dispute to the Delaware judges, who historically have expressed their antipathy to deciding such disputes (although recently they have become more amenable to judicial intervention).⁵⁰ In addition, in exchange for a fee, smaller firms may side with one side or another in a fight between two law firm groups for the lead counsel role.⁵¹

Thus, we might expect the agency costs of class action lawyers to be higher in cases with poor quality counsel and no institutional lead plaintiffs. One might also expect worse outcomes for shareholders, either because the cases brought by such lawyers are of poorer quality, because they are litigated poorly by less skilled counsel, or because they are litigated poorly by highly skilled counsel who invest less in the case because of the lack of an institutional lead plaintiff. And while the likelihood of such firms obtaining an improvement in price is virtually nonexistent, they may still introduce uncertainty into the deal process by obtaining a court order that delays the shareholder vote or by forcing the disclosure of negative information. In the worst case scenario, such cases might amount to little more than a strike suit, or a means of selling claim preclusion to defendants for a modest attorneys' fee and no increase in target share price, i.e., no benefit to the target's shareholders. And even in cases with top plaintiff counsel and institutional lead plaintiffs, we might still expect poor firms to have a deleterious effect, if for no other reason than dilution of the attorneys' fee for the highly skilled counsel actually doing the bulk of the work in the case.

We might also expect the effects of law firm quality to be most prominent in cases where deals are vulnerable to conflicts of interest. Compared to third-party acquisitions, controlling shareholder transactions and MBOs raise concerns about conflicted fiduciaries acting in a self-interested fashion. Third-party acquirers do not have access to inside information in the way that controlling shareholders and managers do. Courts and markets rightly worry that insiders might exploit their access to information to favorably time an acquisition in the business cycle or to deprive minority shareholders of a firm-specific benefit, for example, the benefit of a promising new drug that is still in the research and development pipeline.⁵² Controlling shareholders—and managers—play a role in selecting

securities fraud cases, then individual investors would lead approximately 60% of such cases).

49. See Webber, *Private Policing*, *supra* note 10, at 965 (discussing the dynamic between firms representing institutional investors and those representing small individual plaintiffs who are unlikely to be appointed as lead plaintiff).

50. *Id.*

51. Telephone Interview with Joel Friedlander, Partner, Friedlander and Gorris, P.A. (May 5, 2015).

52. See Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 9–10 (2005) (explaining how majority shareholders can take advantage of buyout options to relieve the corporation of being publically held); see also Matthew Cain & Steven Davidoff, *Form over Substance? The Value of Corporate Process and Management Buy-*

the board of directors, who face conflicts in representing the interests of minority shareholders when the controllers or managers seek to acquire the company.⁵³ Consequently, the market may be more likely to scrutinize such transactions. The same is true for courts, though the legal regimes governing controlling shareholder transactions and MBOs differ somewhat. Controlling shareholder transactions face the heightened “entire fairness” review unless they meet certain procedural requirements, such as appointment of a special committee of independent directors and a non-coercive “majority of minority” provision.⁵⁴ MBOs are not subjected to heightened “entire fairness” scrutiny so long as they comply with Delaware’s conflict of interest statute.⁵⁵ Approval by independent directors or a minority of disinterested shareholders suffices to evade entire fairness review for MBOs.⁵⁶ While both transaction types involve conflicts, their differential legal treatment could lead to different market reactions to the quality of firms in each case. Law firm quality ought to matter in both transaction types, but might matter more in MBOs, which can be more challenging to litigate than controlling shareholder transactions. In both cases, the potential for self-serving behavior by managers or controlling shareholders is great, and one might therefore expect litigation designed to thwart such behavior to have its most pronounced impact.

B. Prior Research on M&A Litigation

Most of the prior research on the utility of deal litigation has focused on the fact of the litigation itself, and not on the identity of the class’s agents. The clearest point of agreement between all of these studies is that the volume of such litigation has increased. Almost all transactions valued at more than \$100 million in 2010 and 2011 were targeted by shareholder litigation.⁵⁷ The vast majority of these lawsuits were “filed shortly after the deal’s announcement and often settled before the deal’s closing.”⁵⁸ In 2005, roughly one-third of mergers were subject to lawsuits, while roughly 92% of mergers were challenged in 2012.⁵⁹ Few of these lawsuits resulted in tangible monetary benefits to shareholders; most settled for additional disclosures or, less frequently, changes to the terms of the deal.⁶⁰

outs, 36 DEL. J. CORP. L. 849, 863 (2011) (stating that management’s position as an agent for shareholders enables them to manipulate the corporate process).

53. See Subramanian, *supra* note 52, at 8–9 (explaining corporate structure in a mergers market).

54. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (2014) (holding that freeze-out mergers should be reviewed using the highly deferential business judgment standard).

55. See Steven Davidoff, *The Management Buyout Path of Least Resistance*, DEALBOOK (June 12, 2013, 1:53 PM), http://dealbook.nytimes.com/2013/06/12/the-management-buyout-path-of-less-resistance/?_r=0 (suggesting that in a bid by David H. Murdock, chairman and chief executive of Dole Food, the business judgment rule would have been applied to the effort to take the company private had Mr. Murdock not also been a controlling stockholder).

56. See *In re Wheelabrator Tech. Inc. Sec. Litig.*, 663 A.2d 1194, 1203 (Del. Ch. 1995) (noting that the burden of proof remains on the plaintiff to demonstrate the merger was unfair); see also Cain & Davidoff, *supra* note 52, at 863 (explaining how the board is easily swayed by managers to approve buy outs).

57. See generally Cain & Davidoff, *supra* note 1 (recording that 84.7% of all transactions in 2010 experienced litigation); DAINES & KOUMRIAN, *supra* note 6, at 1 (noting that only five percent were not targeted in 2010 and 2011).

58. DAINES & KOUMRIAN, *supra* note 6, at 1.

59. Cain & Davidoff, *supra* note 1, at 2.

60. See DAINES & KOUMRIAN, *supra* note 6, at 11 (asserting that 83% of settlements in the study’s survey settled only for additional disclosures).

Some studies on the utility of deal litigation conclude that it increases shareholder welfare, but others take a more skeptical view. Some research suggests that many of these cases result in additional disclosures about the merger to shareholders and a payment of relatively small fees to the plaintiffs' lawyers.⁶¹ Some cases, however, result in substantial increases in the amount of consideration that the acquiring firm must pay the target to consummate the merger.⁶² Krishnan, Masulis, Thomas, and Thompson (KMTT) find that M&A subject to litigation were completed at a significantly lower rate than those not subject to litigation.⁶³ They also found that M&A subject to shareholder litigation have significantly higher premiums in takeover deals.⁶⁴ Most importantly, KMTT found that "the expected rise in the takeover premia [for cases subjected to shareholder litigation] more than offsets the fall in the probability of deal completion, resulting in a positive expected gain to target shareholders."⁶⁵

Some prior research has focused on lead plaintiffs, rather than lead counsel. In the aftermath of *TCW Technologies* and *Hirt*, mutual funds and hedge funds remained largely quiescent and rarely participated as lead plaintiffs in these suits, much as they had before.⁶⁶ In contrast, public-pension funds and labor-union funds sharply increased their participation as lead plaintiffs in transactional class actions.⁶⁷

Unlike mutual funds and hedge funds, public pension funds and labor union funds have no true competitors and, therefore, no concerns about free rider problems.⁶⁸ They lack formal business relationships with corporate boards and management, nor, by and large, do public pension trustees travel in the same social circles as potential defendants.⁶⁹ Consequently, their participation in deal litigation is uninhibited by the types of business considerations that discourage the participation of other institutional types.⁷⁰ Some of these funds have entered into portfolio monitoring arrangements with plaintiff law firms, which

61. See *id.* at 11–13 (comparing increased disclosure settlements and decreased plaintiffs' attorney's fees); Cain & Davidoff, *supra* note 1, at 3.

62. An example is the Del Monte Foods buyout where the Court of Chancery initially awarded a preliminary injunction of the shareholder vote and the parties eventually agreed to an \$89 million settlement. DAINES & KOUMRIAN, *supra* note 6, at 11.

63. See C.N.V. Krishnan et al., *Shareholder Litigation in Mergers & Acquisitions*, 18 J. CORP. FIN. 1248, 1250 tbl.2 (2012) [hereinafter Krishnan et al., *Shareholder Litigation*] (noting that the average takeover premium in the sample was 40.5%).

64. *Id.*

65. *Id.* at 1250.

66. See Webber, *Private Policing*, *supra* note 10, at 940–43 (noting that the economic free-rider problem has contributed to this decline).

67. See *id.* at 932 (discussing the role of shareholders in litigant action); see also Adam B. Badawi, *Merger Class Actions in Delaware and the Symptoms of Multi-Jurisdictional Litigation*, 90 WASH. U. L. REV. 965, 992–95 (2013) (noting the table that tracks the presence of institutional investors such as pension funds from 2004 to 2011).

68. See, e.g., Webber, *Private Policing*, *supra* note 10, at 941 ("Individuals employed by a state by a state or local government entity, or in certain capacities by a private company, have their retirement saving automatically invested in the public-pension fund or labor-union fund associated with their employer. If a fund beneficiary is unhappy with the fund's performance, the beneficiary's only option is to change jobs, not move one's retirement savings to a competitor.").

69. See *id.* at 942 (noting that while "mutual fund managers are more likely to travel in the same business, social, and educational circles as do corporate managers and directors," the boards of trustees of pension funds are often composed of teachers, firefighters, and police officers).

70. See *id.* at 943 (suggesting that "free-riding competitors, business conflicts, [and] social-network conflicts" deter mutual funds from pursuing lead plaintiff positions).

may explain their increased participation in these suits.⁷¹ The success of public pension participation may build on itself, leading to even greater participation by these funds.⁷² Prior studies have found that public pension fund lead plaintiffs correlate with an increase from the offer to the final price, lower attorneys' fees, and a higher equity price upon filing.⁷³ These funds have similarly been found to correlate with higher recoveries and lower attorneys' fees in federal 10b-5 securities fraud class actions.⁷⁴ These studies broadly suggest that the basic intuition behind *Monitoring* may be sound, and that comparatively motivated and sophisticated lead plaintiffs pick better cases, better lawyers, and monitor those lawyers more carefully, or at least inspire those lawyers to work harder and accept lower fees when serving institutional clients that are large enough to be repeat players.

In a contemporaneous paper, Krishnan, Davidoff, Solomon, and Thomas (KDST) also examine the effect of law firm quality in mergers and acquisitions litigation using a different methodological approach.⁷⁵ Rather than conduct an event study examining the market reaction to the filing and consolidation of deal cases, KDST examined law firm effort (as measured by the number of docket entries and the quality of motion practice) and case outcomes (like the rate of dismissal or whether the case settled for consideration).⁷⁶ They conclude that the quality of the plaintiff law firm correlates with case outcomes, and that law firm skill explains the correlation.⁷⁷ They conclude, as do we, that top plaintiff law firms target conflicted transactions like MBOs.⁷⁸ We believe that our Article's focus on differences in case selection and KDST's detailed analysis of variation in litigation skills mutually reinforce the conclusion that law firm quality matters in deal litigation.

III. HYPOTHESIS DEVELOPMENT

The impact of merger litigation on firm value depends, at least in part, on the potential outcomes associated with that litigation. Those outcomes can vary widely. Most

71. See William B. Rubenstein, *What We Now Know About How Lead Plaintiffs Select Lead Counsel (And Hence Who Gets Attorneys Fees!)* In *Securities Cases*, 3 CLASS ACTION ATT'Y FEE DIG. 219, 219 (2009) ("[S]ome plaintiffs firms have entered into arrangements whereby they monitor pension funds' investments for irregularities and suggest possible grounds for litigation.").

72. See Webber, *Private Policing*, *supra* note 10, at 937 ("[T]hese funds' successful record as lead plaintiffs in these suits may encourage them to bring more of them.").

73. See *id.* ("[P]ublic-pension funds are the only institutions that statistically significantly correlate with the outcomes of utmost interest to shareholders—an increase from the offer price to the final price, and lower attorneys' fees.").

74. See C.S. Agnes Cheng et al., *Institutional Monitoring Through Shareholder Litigation*, 95 J. FIN. ECON. 356, 357–58 (2010) (noting that institutions as lead plaintiffs are more effective than individuals); Michael Perino, *Institutional Activism Through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions*, 9 J. EMPIRICAL LEGAL STUD. 368, 369–70 (2012) (noting that attorney fees are significantly lower when there is a public pension lead plaintiff).

75. C.N.V. Krishnan et al., *Who are the Top Law Firms? Assessing the Value of Plaintiffs' Law Firms in Merger Litigation* 2 (Eur. Corp. Governance Inst., Law Working Paper No. 265/2014, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2490098 [hereinafter Krishnan et al., *Who are Top Law Firms?*].

76. *Id.* at 4.

77. *Id.* ("We find that the top . . . plaintiffs' law firms more actively litigate their cases than other law firms, filing more documents with the court as shown by the number of entries on the case docket sheets and bring significantly more motions for an injunction to stop transactions.").

78. *Id.* at 3 ("We find that . . . top firms tend to pursue transactions that exhibit indicia of greater potential conflicts of interest, such as [MBOs] . . .").

commonly, the parties reach a settlement that involves changes to the shareholder disclosures without an increase in the merger consideration.⁷⁹ Less common, but not rare, are cases where the settlement includes amendments to the merger agreement without an increase in consideration.⁸⁰ These amendments typically reduce the number or strength of the deal protection devices in the merger agreement. In theory, these changes could induce another bidder who will pay a higher price, although existing research suggests that this does not occur very often.⁸¹ In still more rare cases, the settlement can provide for an increase in merger consideration, which is likely to be the most favorable outcome for shareholders.⁸² As a general matter, award of attorneys' fees increase as benefits to shareholders increase.⁸³ Put another way, obtaining an increase in consideration is likely to result in a larger fee award than a disclosure-only settlement.

These different outcomes should have different effects on firm value. To the degree that these results can be predicted before they occur, the target's stock price should reflect these expectations. If the market can observe some potential for an increase in consideration upon filing of the suit, all other things being equal, the stock price should rise. Alternatively, if the market is aware that a disclosure-only settlement is in the offing, such disclosure should have a negative effect on firm value. This effect could arise for several reasons: (1) because disclosure settlements do not provide any more additional information and result only in the payment of the attorneys' fee award; (2) because such suits could result in delay of the merger or judicial criticism of the deal; or (3) because the disclosed information—if meaningful—would be expected to be negative because, if it were positive, the parties would have already disclosed it. That negative information could imperil the merger vote and this lack of deal certainty should result in a negative price. Alternatively, the market may identify flaws with the merger but react negatively upon the filing of a suit by a poor quality firm that would be incapable of capitalizing on those flaws to improve price.

A key question for our analysis is whether we can control for variables that indicate the likelihood of these outcomes. Some of the underlying facts of the case should account for some of this variation. For example, imagine a lawsuit that challenges an attempted hostile takeover. When the market initially learns of interest from the hostile bidder, the price of the potential target may rise to reflect the possibility of a deal.⁸⁴ The market may expect that the initially hostile interest will turn friendly. The company's reaction to a lawsuit that aims to remove defensive measures may signal that there is even more resistance to the deal than initially perceived. As a consequence, the value of the potential target may drop to reflect the decrease in deal certainty. MBOs may offer a counterexample. When a group of insiders bargains to buy the company, the self-dealing

79. Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 557 (2015).

80. See *id.* at 560 (explaining the three basic types of merger litigation).

81. See *id.* at 570 ("Amendment settlements may benefit the shareholders by increasing the likelihood that a third party will make a topping bid.").

82. *Id.* at 560.

83. *Id.* at 566 n.42, 567.

84. See Dale A. Oesterle, *Delaware's Takeover Statute of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 897 n.79 (1988) ("In hostile takeovers, stock price gains provide the market's estimate of the increase in returns likely to result from takeover activity, and empirical evidence gathered on the question suggests that takeovers produce huge gains to target shareholders and marginal or, in the 1980's, insignificant gains to the shareholders of acquirors.").

concerns are evident.⁸⁵ The filing of a lawsuit to challenge the transaction may signal that a substantial settlement is likely and the share price may increase accordingly.

We expect that the identity of the plaintiffs' law firm will also have an effect on how litigation affects the value of the target's shares.⁸⁶ That effect should reflect the quality of the law firm filing the case and beliefs about how that firm decides whether to file a complaint. That decision is likely to be an expected value calculation that pits the expected recovery against the costs of bringing the case. The expected recovery should turn, at least in part, on the specific facts of the case and the identity of the other law firms (and their clients) that have or are likely to file a complaint. This latter factor should matter because it will affect the likelihood of being named as lead counsel in the case. As a general matter, the lead counsel will receive a larger share than the other law firms that have filed a complaint.⁸⁷ While the assignment of lead counsel typically results from a private bargain among the parties that have filed a complaint, that bargain occurs in the shadow of Delaware's selection criteria.⁸⁸ Those firms with large, institutional clients and with strong reputations will usually be designated lead counsel through these agreements because that is the likely outcome if the lead counsel dispute spilled into court.

Law firms with strong reputations may avoid filing in weaker cases because filing them may harm their reputations or because recoveries in these cases are likely to be small. Law firms are particularly sensitive to reputational effects in Delaware, which is the site of a high percentage of this litigation.⁸⁹ Delaware has a comparatively small bar and just five judges who hear these cases at the trial level.⁹⁰ Those law firms who already have low quality reputations may have less to lose in this regard. Accordingly, the potential of being named as lead counsel may make some of these cases enticing for them.⁹¹ It is not clear, however, that the lower quality firms will confine themselves to lower quality cases. As discussed in Section II.A, even though these firms will face long odds of being named lead counsel in high quality cases, they may be able to bargain for a small share of fees.⁹² Their allocation of complaints between high quality and low quality cases should depend on the different expected rewards that these cases bring.

The complexity of the filing decision leads us to question the common perception that those law firms that file the most cases are of low quality. That result is certainly possible, but the dynamics of filing do not lead inexorably to that conclusion. For example, if there

85. See Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 819 (2006) ("While management is acting as the sellers' agents and, in that capacity, is obliged to get the best price it can for the shareholders, it is also acting as a purchaser and, in that capacity, has a strong self-interest to pay the lowest possible price.").

86. See Krishnan et al., *Who are the Top Law Firms?*, *supra* note 75, at 6 (finding that law firm quality correlates with case outcomes).

87. See Jessica Erickson, *The Market for Leadership in Corporate Litigation*, 4 U. ILL. L. REV. 1479, 1513 (forthcoming 2015) (discussing how in winner-take-all systems established law firms are favored); Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1806 (2004) (discussing how Delaware law allows attorneys to behave opportunistically and that courts do not adequately protect shareholders or corporations from the litigation costs).

88. See *supra* Section II.A (for a review of those criteria).

89. DAINES & KOUMRIAN, *supra* note 6, at 1.

90. The Delaware Chancery Court has one Chancellor and four Vice Chancellors. *Judicial Officers of the Court of Chancery*, DEL. ST. CTS., <http://courts.delaware.gov/chancery/judges.stm> (last visited Nov. 14, 2015).

91. *Supra* note 87 and accompanying text.

92. See *supra* note 49 and accompanying text (discussing that attorneys may ask for a small share of the overall attorney's fee and do little work in the case).

are a large number of high quality cases, one may observe the high quality law firms filing cases quite frequently. Alternatively, if there are only a small number of cases that are promising, one might expect the lower quality law firms to file more often. The number of cases filed to challenge mergers may also depend on the other opportunities that are available to law firms. Some scholars have suggested that the increase in merger litigation is a consequence of opportunities drying up elsewhere, such as securities law.⁹³ To the degree that filing decisions depend on other expertise that the law firm has and the opportunity costs of filing those other cases, it is even more difficult to draw inferences from the number of cases filed.

We expect the quality of the law firms filing cases to be reflected in firm value (i.e., to be captured in an event study). If there is a possibility that the case will result in an increase in merger consideration from the buyer to the target, that should increase share value of the target.⁹⁴ Note, however, that the impact need not be uniformly positive. Better law firms may be better able to halt a deal altogether. This possibility could lead to a negative effect on share price because it threatens deal certainty. But top firms derive no benefit from halting a deal. Their optimal outcome is for deals to close with a bump in price because such outcomes secure the highest available legal fees. And while it may be true that top firms secure some negotiating leverage in the next case by occasionally halting a deal in the current case, these firms won't remain profitable for very long if they litigate cases for which they recoup no costs and collect little or no fee because they have thwarted too many deals. Accordingly, we expect a positive effect associated with the involvement of a top firm. The pecuniary benefit of such a firm, or at least its potential to identify a legally vulnerable case that is susceptible to a bump in price, outweighs any increased likelihood that the firm will thwart the deal.⁹⁵

When it comes to lower quality firms, however, we have different expectations. Specifically, when these firms are present, but the higher quality firms are not, we expect a uniformly negative effect on target share price. The presence of these lower quality firms may decrease deal certainty because the existence of the lawsuit creates a holdup threat. It may also signal to the market that the case is not meritorious or that a meritorious case will not be competently litigated. For these reasons, we expect a negative effect associated with the involvement of these firms.

IV. DATA AND SUMMARY STATISTICS

We begin with a hand-collected dataset comprising all 454 shareholder-derivative and class action lawsuits filed in the Delaware Court of Chancery from November 1, 2003 to December 31, 2009. We obtain this data directly from Lexis-Nexis File and Serve, which is utilized by the Delaware Court of Chancery as its electronic filing system.⁹⁶ We began

93. Brian Cheffins et al., *Delaware Corporate Litigation and the Fragmentation of the Plaintiffs' Bar*, 2012 COLUM. BUS. L. REV. 427, 431 (2012).

94. Cf. Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. REG. 119, 122 ("One important, and undisputed, datum about acquisitive transactions should be noted from the outset: acquisitions generate substantial gains to target company shareholders.").

95. See, e.g., Krishnan et al., *Shareholder Litigation*, *supra* note 63 (discussing how M&A subject to litigation were not completed as often as those not subject to litigation).

96. See *Electronic Filing in the Delaware Judiciary*, JUD. BRANCH ST. DEL., <http://courts.delaware.gov/efiling/index.stm> (last visited Nov. 14, 2015).

collecting data from November 2003 because that is when the Court of Chancery first instituted use of this system.⁹⁷ We searched all cases from this time period using the Clerk of the Court's own search field category for "derivative and class actions." Of these 454 cases, we identified 290 (64%) as class or derivative actions brought in M&A cases; of these, we identified 224 cases which took place prior to the collapse of Lehman Brothers in September 2008. We analyze cases from November 2003 through September 2008 to examine deal litigation prior to the distortions introduced by the financial crisis. Of those cases, we keep only those for which we have sufficient trading data, via Eventus, to conduct our event study. We also eliminate those cases where the premium is negative and where the plaintiffs filed the first lawsuit more than 365 days after the announcement of the merger. That leaves the sample with a total of 125 filed cases with all relevant variables.

Most of the variables are straightforward. For the timing and premium variables, we augment data from the dockets with news reports about each transaction. This information allows us to construct separate indicator variables that signify whether: (1) the plaintiffs filed the first lawsuit challenging the merger on the same day as the announcement of the transaction, and (2) whether the plaintiffs filed the first lawsuit challenging the merger on the first trading day after the announcement of the transaction.⁹⁸ The premium variable reflects the percentage difference between the market price on the day prior to the merger announcement and the deal price. We count the number of plaintiffs' law firms by examining the complaints and the dockets. For the case type variables, we examine the complaints and news reports. If either of those sources allege that the transaction involves a management buyout or an acquisition by a controlling shareholder, we code the case accordingly. We code cases that qualify as both a management buyout and a controlling shareholder transaction as MBOs.

The law firm variables require more explanation. As an initial matter, we review the complaints to ascertain which law firms have filed a complaint in a case. For these purposes, we ignore law firms that are usually acting as Delaware counsel for out of state plaintiffs. These firms include Rosenthal, Monhait & Goddess, P.A. and Chimicles & Tikellis, LLP.⁹⁹ These firms occasionally do the work of representing plaintiffs, but it is usually not evident from the complaints when that is the case. For this reason, we choose to omit these firms from our analysis.¹⁰⁰ For all other firms, we note when they file a complaint in a case and use those data for our law firm categorizations.

Any grouping of law firms by quality is bound to be controversial. We recognize that reality and, to the degree possible, we base these categorizations on observations and studies from external sources. We rely on two rankings for firms on the top end of the spectrum. The first is the Legal 500's ranking of law firms in the area of M&A litigation. The Legal 500 bases its rankings on publicly available information and on private information from the law firms themselves.¹⁰¹ The M&A litigation rankings include both plaintiff-side and defense-side firms. Given our focus on the former, we categorize any

97. See *id.* ("Commencing October 20, 2003, every Civil Action in the Court of Chancery, whether already pending or newly filed, shall be subject to electronic filing or eFiling.").

98. We include this variable because, if the announcement occurred after the close of trading, the first trading day after the announcement would be the market's first opportunity to react to that information.

99. Cheffins, *supra* note 93, at 480.

100. These firms appear in such a high proportion of our cases that it would muddy the analysis to include them.

101. See *The Basis for Inclusion*, *supra* note 13 (explaining the Legal 500 criteria).

plaintiff-side firm that appears in our dataset in our top law firm category.

While helpful, the Legal 500 rankings do suffer from the fact that they are not contemporaneous with our sample window (2003–2008). For this reason, we augment those rankings with those of SCAS during the relevant time frame.¹⁰² For each of the years in our sample window, we note whether a law firm with a merger practice appeared in the top ten of SCAS's rankings for any year in our sample window. Those rankings turn on the overall value of the securities settlements obtained by the firm in that year. While this metric is not a direct measure of quality, we believe it is fair to infer that the best firms are likely to be able to recruit the best clients, which should lead to higher settlements. The obvious issue with these rankings is that they are for securities claims rather than merger challenges. Many of these firms are, however, quite active in both areas.¹⁰³ To the degree that law firm quality spills over different practice areas, the SCAS rankings should provide some measure of ability in merger litigation.

When it comes to the other end of the spectrum, there are no rankings to consult. There are, however, some metrics of quality. One is the amount of legal fees awarded in merger settlements. The Chancellor and Vice Chancellors factor attorney quality into their determinations of legal fee awards. A 2012 report by Ann Woolner, Phil Milford, and Rodney Yap of Bloomberg News compiled data on law firms that had leading roles in Delaware merger cases in five or more cases that were settled and completed in either 2010 or 2011.¹⁰⁴ This compilation includes information on the aggregate legal fees awarded to these firms in these cases.¹⁰⁵ These firms differ dramatically in the fees they received. The top three firms—Grant & Eisenhoffer, Bernstein Litowitz, and Robbins Geller—earned, on average, \$6.1 million in fees per case.¹⁰⁶ All three of these firms qualify as top firms using the measures outlined above. The bottom three firms—Faruqi & Faruqi, Levi & Korsinsky, and Rosenthal Monhait—earned, on average \$670,000 in fees per case.¹⁰⁷

To supplement this categorization we also rely on the qualitative assessments made by Delaware judges. Vice Chancellor Laster has perhaps been most vocal in this regard. In his widely noted opinion in *In re Revlon, Inc. Shareholders Litigation*,¹⁰⁸ he replaced the lead counsel on the basis of their deficiencies in litigating the case and their lack of candor in justifying their positions.¹⁰⁹ In the course of doing so, he shared his impressions of the law firms involved in the case. He noted that a number of firms have a practice of filing merger cases frequently and settling them early.¹¹⁰ The firms he singled out for frequently

102. Institutional Shareholder Services, Inc. (ISS), a company specializing in corporate governance, releases the SCAS 50, which lists the top 50 plaintiffs' law firms by the total dollar amount of final securities class action settlements. Peter Lattman, *The SCAS 50: Which Plaintiffs' Firms Hit It Big in 2006*, WALL STREET J. (Mar. 8, 2007, 4:26 PM), <http://blogs.wsj.com/law/2007/03/08/the-scas-50-who-hit-it-big-in-2006/>.

103. See *supra* note 11 (listing firms active in securities and mergers).

104. Rodney Yap et al., *Merger Suits Often Mean Cash for Lawyers, Zero for Investors*, BLOOMBERG (Feb. 16, 2012, 12:59 PM), <http://www.bloomberg.com/news/2012-02-16/lawyers-cash-in-while-investor-clients-get-nothing-in-merger-lawsuit-deals.html>.

105. *Id.*

106. *Id.* One of the authors of this Article, David Webber, was formerly employed by Bernstein Litowitz. He has no current relationship with the firm.

107. *Id.*

108. *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940 (Del. Ch. 2010).

109. *Id.* at 957 ("I conclude that Old Counsel has not provided adequate representation. This conclusion provides a sufficient grounding to replace Old Counsel.").

110. See *id.* at 959–60 (suggesting that this pattern creates a "system involves little real litigation activity,

filing cookie cutter complaints included: Wolf Popper, LLP, Wolf Haldenstein Adler Freeman Herz, LLP, and Abbey Spanier Rodd & Abrams, LLP.¹¹¹

This is not the only occasion when Vice Chancellor Laster has criticized law firms for their perceived lack of diligence in litigating their claims. In resolving a leadership dispute pre-trial in *In re Compellant Technologies, Inc. Shareholder Litigation*,¹¹² he shared his views on the past work of several firms. He stated, when determining lead counsel, “the key factor for me . . . is what your track record is generating tangible benefits for stockholders.”¹¹³ He praised Abraham, Fruchter & Twersky, LLP and Labaton Sucharow LLP for the results they have achieved in past cases.¹¹⁴ But he noted that Faruqi & Faruqi had not identified a single case where they had produced those tangible results. As he put it, “it’s a big hole in your firm resume.”¹¹⁵

While Vice Chancellor Laster may be the most vocal about law firm quality, he is not alone. In *In re SS&C Technologies, Inc. Shareholders Litigation*,¹¹⁶ Vice Chancellor Lamb considered a motion to impose sanctions on The Brualdi Law Firm.¹¹⁷ The motion involved allegations that the firm had potential improper relationships with investment partnerships operated by the representative plaintiffs. When there was a possibility that the nature of those relationships would become public, the firm filed a motion to withdraw in what the court determined to be bad faith.¹¹⁸ Vice Chancellor Lamb imposed the requested sanctions and, in the course of doing so, noted that the Brualdi firm’s actions “demonstrate a pattern of, at best, carelessness, and, at worst, a deliberate effort to mislead the court.”¹¹⁹

We define any firm in our sample that appears in the bottom three of the Bloomberg attorney fee rankings or has been criticized by Vice Chancellor Laster or Vice Chancellor Lamb as a low quality firm.¹²⁰ Table 1 summarizes our categorization of higher quality and lesser quality firms and the basis for each categorization. From these categories we create variables for cases that involve high quality firms and cases that involve no higher quality firms but do involve lower quality firms. Top firms almost always serve as lead counsel, make most or all of the litigation decisions, and collect most of the fees.¹²¹ Therefore, our high quality firm measure includes cases that have both high quality and low quality firms because those cases are driven by the high quality firms. The omitted category for the law firm quality variables includes cases involving all unclassified firms—

generates questionable benefits for class members, provides transaction-wide releases for defendants, and offers a good living for the traditional plaintiffs bar”). Vice Chancellor Laster noted that the early settling activity leads “some wags in the defense bar to label [these firms] ‘Pilgrims.’” *Id.* at 945.

111. *See id.* at 943–45 (describing the factual background and complaints filed in this case).

112. *In re Compellant Techs., Inc. S’holder Litig.*, No. 6084-VCL, 2011 WL 6382523, at *1 (Del. Ch. Dec. 9, 2011).

113. Transcript of Motion to Consolidate and Organize Council and the Court’s Ruling at 6:3–6, *In re Compellant Techs., Inc. S’holder Litig.*, (No. 6094-VCL), 2014 WL 6382523 (Del. Ch. Jan 13, 2011).

114. *Id.* at 6:17–20.

115. *Id.* at 6:20–21.

116. *In re SS&C Techs., Inc. S’holders Litig.*, 948 A.2d 1140, 1141 (Del. Ch. 2008).

117. *Id.* at 1141 (“The court considers a motion to impose sanctions on the plaintiffs and their counsel [The Brualdi Firm].”).

118. *Id.* at 1143–44.

119. *Id.* at 1151.

120. The bottom three in the Bloomberg study includes Rosenthal & Monhait.

121. Jessica Erickson, *The Market for Leadership in Corporate Litigation*, 2015 U. ILL. L. REV. 1479, 1482 (2015) (“In . . . behind-the-scenes negotiations, [lawyers] are forced to agree to complicated leadership structures that divide governance responsibilities among a surprisingly high number of legal actors.”).

which we largely consider to be the “middle” quality tier.

Table 1: Law Firm Categorization

Category	Securities Class Action Services Top 10	Legal 500 M & A Rankings	Criticized by Chancery	Ranked at Bottom of Bloomberg Study
Law Firm				
The Brualdi Law Firm			X	
Bernstein Litowitz Berger & Grossmann	X	X		
Faruqi & Faruqi			X	X
Grant & Eisenhofer	X	X		
Labaton Sucharow	X	X		
Lerach Coughlin Stoia Geller Rudman & Robbins	X			
Levi Korsinsky				X
Milberg Weiss Bershad & Schulman	X			
Morris, Nichols, Arsht & Tunnell		X		
Richards Layton & Finger		X		
Robbins Geller Rudman & Dowd	X			
Schiffman & Barroway	X			
Wolf Popper			X	
Wolf Haldenstein			X	

We provide simple descriptive statistics in Table 2. We briefly highlight a few of those numbers to provide an overview of the dataset. As one might expect, plaintiffs can be extremely quick to file. About one-third of merger challenges have the first complaint filed on the day of the announcement or on the day after the announcement. While this is a substantial percentage of cases, a majority of suits in our sample are filed more than two days after announcement of the transaction. This suggests that something other than the “race to the courthouse” drives filing in Delaware, and with good reason, since Delaware abandoned “race to the courthouse” in *TCW Technologies* and *Hirt*.¹²² Finally, we note that a fairly large number of cases involve the types of transactions where self-dealing is likely to be a concern. Around 14% of the cases involve MBOs and about 23% involve controlling shareholder transactions.

Table 2: Summary Statistics

	(1) Mean	SD	p10	p50	p90
Num. of Plain. Firms	2.800	2.052	1	2	5
Premium	0.193	0.132	0.0459	0.178	0.389
Time to File	18.03	32.22	0	4	58
Filed Same Day	0.168				
Filed Day After	0.168				
Top Firm Involved	0.360				
Lower and No Top Firms	0.216				
MBO	0.136				
Controlling Shareholder	0.232				
Derivative	0.0160				
Observations	125				

Table 3 provides the simple correlations for the primary variables. Several of these correlations are of note. Given the concern about the filing of cookie cutter complaints in merger cases, one might think that lesser quality firms are more likely to file cases more

122. See *supra* notes 38–40 and accompanying text (describing why Delaware got rid of the “race to the courthouse”).

quickly. If these are the firms that produce these sorts of complaints, they should be able to produce them quickly and get them before the court in short order. However, the higher quality firms are more likely to be involved in the more quickly filed cases. The simple correlation between the same day filing and the presence of a top firm is .212 and the correlation for next day filing and the presence of a top firm is .190. While our data does not allow us to confirm that it is the top firms that are, in fact, filing first, the data is consistent with that possibility. In the cases where top firms do not file, the lesser quality firms appear to be slow to file. The correlations with the presence of lesser quality firms, but no top firms, are negative for both same day filing and next day filing. This evidence suggests that poor quality firms may wait to see what other firms file in Delaware before making a decision on how to proceed. If a top firm files first, poor quality firms may attempt to maneuver their way onto the lead counsel team in Delaware in the hopes of doing little work and collecting a small fee, file elsewhere, or abandon the suit.

Table 3: Correlation Matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Num. of Plain. Firms (1)	1.0000								
Premium (2)	0.0170 (0.8352)	1.0000							
Time to File (3)	-0.1310 (0.0866)	0.1204 (0.1381)	1.0000						
Filed Same Day (4)	0.1571 (0.0395)	0.0414 (0.6111)	-0.1458 (0.0563)	1.0000					
Filed Day After (5)	0.1241 (0.1049)	-0.0371 (0.6490)	-0.1236 (0.1063)	-0.1882 (0.0131)	1.0000				
Lower and No Top Firms (6)	0.0988 (0.1972)	0.0445 (0.5851)	-0.0694 (0.3658)	0.0354 (0.6441)	-0.0024 (0.9754)	1.0000			
Top Firm Involved (7)	0.2234 (0.0032)	-0.0579 (0.4774)	0.0098 (0.8982)	0.2121 (0.0051)	0.1903 (0.0121)	-0.3907 (0.0000)	1.0000		
Controlling Shareholder (8)	0.2700 (0.0003)	-0.1139 (0.1610)	-0.0247 (0.7476)	0.1244 (0.1039)	0.1196 (0.1182)	0.0465 (0.5445)	0.1360 (0.0752)	1.0000	
Derivative (9)	0.2230 (0.0033)	-0.0491 (0.5463)	-0.0236 (0.7590)	0.0558 (0.4672)	-0.0549 (0.4741)	-0.0673 (0.3801)	0.0793 (0.3008)	0.2027 (0.0077)	1.0000

V. EVENT STUDY ANALYSIS

A. Event Study Methodology

We use standard event study methodology to analyze the effect of Delaware litigation

on equity prices.¹²³ This approach assumes that stock returns follow a market model, $r_t = \alpha + \beta r_t^m + \varepsilon_t$, where: r_t is the return on a particular stock at time t ; r_t^m is the compounded return on a market portfolio; and ε_t is a stochastic error. If an event, such as a lawsuit filing, occurs on day T , then there may be an “abnormal return” to the particular stock on that day. This can be captured by first calculating the predicted return, which we call r_t^* , using the constant and coefficient calculated in the market model equation. To calculate the cumulative abnormal return for firm i we subtract the actual cumulative return during the event window from the predicted return during that window: $CAR_i = r_i - r_i^*$. We use event periods of varying lengths, as detailed below, and a 255-day, pre-event window consisting of $T-300$ to $T-45$.

We perform a number of regressions that use the cumulative abnormal return as the dependent variable and various lawsuit and firm characteristics as the independent variables. We use weighted least squares (WLS) to estimate these regressions, which helps to correct for heteroskedasticity.¹²⁴ For weights, we use the inverse of the variance of the predicted residual in the market model.¹²⁵

B. Results

1. Primary Analysis

This Section presents the results of event studies conducted at the time of filing the lawsuit. For each of these events, we regress the estimated cumulative abnormal return for each firm for different event windows against the case characteristics that we expect to matter. We begin with a basic model and then introduce case controls to see how that affects the coefficients. Tables 4 through 8 report the returns to case filing for the $[0, +1]$ and $[0, +2]$ windows, i.e. the cumulative return for the day of the event and the following day and the day of the event and the following two days, respectively.¹²⁶

As suggested earlier, many merger lawsuits get filed shortly after the announcement of the transaction.¹²⁷ We want to isolate the stock price effect that can be attributed to the lawsuit and, for this reason, we try to control for any stock price effects that can be attributed to the fact of the transaction. We use two interaction variables to control for this effect. The first interacts the deal premium¹²⁸ with an indicator for the first case being filed

123. “Event studies are among the most successful uses of econometrics in policy analysis.” Sanjai Bhagat & Roberta Romano, *Event Studies and the Law--Part I: Technique and Corporate Litigation* 1 (John M. Olin Ctr. For Studies in Law, Econ., and Pub. Policy, Paper No. 259, 2001), http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1021&context=lepp_papers.

124. For other papers that use this WLS technique see e.g., Husayn Shahur, *Industry Structure and Horizontal Takeovers: Analysis of Wealth Effects on Rivals, Suppliers, and Corporate Customers*, 76 J. FIN. ECON. 61 (2005); Marie Dutordoir & Linda Van de Gucht, *Are There Windows of Opportunity for Corporate Debt Issuance? Evidence for Western Europe*, 31 J. BANKING & FIN. 2828 (2007).

125. Our results are largely unchanged when we conduct unweighted OLS regressions, although some of the standard errors are larger for some of the coefficients of interest.

126. *Infra* Tables 4, 5, 6, 7, and 8. While event studies sometimes use the $[-1, +1]$ window, we are wary of doing so in this study. Many of the lawsuits get filed the day of or the day after the announcement of the deal. One of our chief concerns is that the market activity associated with the deal may affect target prices in ways that we cannot completely control for. To limit this potential we both control for the deal premium and limit the beginning of the abnormal return window to the day the plaintiffs file the complaint.

127. See DAINES & KOUMRIAN, *supra* note 6, at 1.

128. The deal premium is that amount by which the acquirer’s offer for the target’s stock exceeds the current

on the day of the announcement. The second interacts the deal premium with an indicator for the first case being filed on the day after the announcement. The following example illustrates why it is important to control for the deal premium. Company XYZ's stock is trading at \$25 per share on the New York Stock Exchange. ABC is interested in acquiring XYZ. It offers a traditional premium of 20% over the current trading price of XYZ.¹²⁹ ABC therefore offers \$30 per share for XYZ's stock trading at \$25 per share. The immediate market reaction will be to bid up the price of XYZ to somewhere close to, but still less than, the full \$30 per share offered by ABC. Many investors are happy to sell their shares for \$29 per share, locking in their gains. On the other hand, merger arbitrageurs will purchase the stock, acquiring many shares at \$29 per share, betting that the deal will close and that they will reap profits of \$1 per share. These arbitrageurs assume the risk that the deal will not in fact close and that the shares they purchased for \$29 may plummet in value. Because arbitrageurs move into the stock shortly after the deal is announced, the stock price will react immediately, and therefore, the price will go up immediately. If the first case is filed on the same day the deal is announced, or the day after the deal is announced, then the market is still reacting to the announced premium, and that increase cannot be attributed solely to a law firm effect. We therefore expect the coefficients on variables relating deal premium with suits filed the day of or the day after the announcement of the deal to be large, positive, and highly statistically significant because the stock price is likely to reflect the deal price minus some discount for the potential that the deal will not close. Unsurprisingly, that is exactly what we find. The coefficients for these variables are large, positive, and highly statistically significant across all the case filing regressions that we report.

Table 4¹³⁰ reports the regressions for high quality law firms and cumulative abnormal returns. We report results for two cumulative abnormal return windows ([0, +1] and [0, +2]), and we run both specifications with and without yearly fixed effects. Our hypothesis is that law firm quality is most likely to matter in the cases where potential conflicts make the deal vulnerable, such as MBOs and controlling shareholder transactions.¹³¹ Discussions by the authors with merger arbitrageurs confirm that interested market participants pay attention to litigation when it involves these kinds of cases. For this reason, we are most concerned with the quality of law firms in those cases. To isolate this effect we interact our law firm variables with case type indicators. In Table 4, we do this for top firms and both controlling shareholders and MBOs. We find that the variables for the interaction between top firms and MBOs are large, positive, and statistically significant at the 5% level in all specifications. For controlling shareholder cases, the top firm interaction variable is large, positive, and statistically significant at the 5% level in three of the four

trading price of the target's stock. If the target's stock price is currently \$25 per share, and the acquirer offers \$30 per share, then the premium is 20%.

129. In our sample, the mean premium is 19%. *Supra* Table 1.

130. This table presents results from OLS regressions that use the cumulative abnormal return as the dependent variable. The cumulative abnormal return covers the windows indicated in the tables. Day zero is the day the first complaint is filed against the target firm. Some variables, including the deal premium, indicator variables for whether the case was filed on the same day as the announcement, and fixed effects for year, have been omitted for brevity. Each observation is weighted by the inverse of the variance associated with estimate of the cumulative abnormal return. Heteroskedasticity-robust standard errors are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% confidence levels, respectively.

131. See Krishnan et al., *Who are Top Law Firms?*, *supra* note 75, at 10–12 (discussing the types of deals top plaintiffs' law firms are associated with).

regressions. Restated, there is evidence of a large and positive market reaction to the filing of suit by a top law firm in an MBO and to the filing of suit by a top law firm in a controlling shareholder transaction. This result confirms our hypothesis that top firms should correlate with returns in conflicted, legally vulnerable deals. The positive market reaction to top firms in both MBOs and controlling shareholder transactions suggests that the pecuniary benefit associated with these firms outweighs the increased risk that they might jeopardize the deals.¹³²

Table 4: Higher Quality Law Firms and Abnormal Returns to Filing

	CAR [0,+1]		CAR [0,+2]	
	(1)	(2)	(3)	(4)
Num. of Plain. Firms	0.00504 (0.00292)*	0.00532 (0.00352)	0.00549 (0.00289)*	0.00553 (0.00343)
Premium*Same Day	0.745 (0.145)***	0.713 (0.167)***	0.731 (0.150)***	0.699 (0.173)***
Premium*Next Day	0.891 (0.169)***	0.805 (0.179)***	0.887 (0.166)***	0.797 (0.178)***
Top Firm Involved	-0.0119 (0.0140)	-0.0220 (0.0152)	-0.0114 (0.0140)	-0.0220 (0.0155)
MBO	0.0400 (0.0216)*	0.0348 (0.0219)	0.0414 (0.0227)*	0.0349 (0.0227)
Top Firm*MBO	0.0625 (0.0289)**	0.0706 (0.0325)**	0.0611 (0.0298)**	0.0701 (0.0332)**
Controlling Shareholder	-0.0236 (0.0177)	-0.0358 (0.0190)*	-0.0225 (0.0152)	-0.0343 (0.0166)**
Top*Control	0.0612 (0.0331)*	0.0712 (0.0332)**	0.0667 (0.0323)**	0.0794 (0.0324)**
Constant	-0.0195 (0.0129)	0.0290 (0.0267)	-0.0203 (0.0134)	0.0311 (0.0263)
Observations	125	125	125	125
R ²	0.671	0.701	0.673	0.706
Year Fixed Effects	No	Yes	No	Yes

=

In contrast, lower quality firms should have a more uniformly negative effect on stock price. These firms should be able to impact deal certainty because filing a suit creates some ability to hold up the transaction until the parties reach a settlement, or because such firms will be unable or unwilling to obtain a positive litigation outcome. If these firms are unable to produce benefits for shareholders—such as an increase in deal consideration—one should expect the stock price to reflect the risk that the lawsuit will delay the deal without an expectation of any benefits. Alternatively, deal characteristics may lead the market to expect an above-average result, only to have such expectations dashed when a lesser quality firm brings suit.¹³³ Table 5¹³⁴ presents the results for lesser quality firms. Our primary variable of interest, NoTop, indicates when no higher quality firm is involved, but those of lesser quality have filed a complaint

Table 5: Lower Quality Law Firms and Abnormal Returns to Filing

	CAR [0,+1]			CAR [0,+2]		
	(1)	(2)	(3)	(4)	(5)	(6)
Num. of Plain. Firms	0.00667 (0.00262)**	0.00648 (0.00264)**	0.00651 (0.00314)**	0.00738 (0.00254)***	0.00695 (0.00259)***	0.00681 (0.00301)**
Lower and No Top Firms	-0.0208 (0.0166)	-0.000642 (0.0191)	0.0149 (0.0189)	-0.0191 (0.0163)	0.00185 (0.0189)	0.0174 (0.0193)
Premium*Same Day	0.701 (0.166)***	0.732 (0.146)***	0.693 (0.173)***	0.680 (0.177)***	0.716 (0.154)***	0.677 (0.181)***
Premium*Next Day	0.915 (0.171)***	0.884 (0.171)***	0.792 (0.181)***	0.907 (0.167)***	0.879 (0.168)***	0.780 (0.179)***
MBO		0.0664 (0.0177)***	0.0624 (0.0218)***		0.0677 (0.0181)***	0.0627 (0.0224)***
NoTop*MBO		-0.0491 (0.0297)	-0.0385 (0.0309)		-0.0515 (0.0336)	-0.0401 (0.0336)
Controlling Shareholder		0.0178 (0.0241)	0.0167 (0.0223)		0.0229 (0.0252)	0.0243 (0.0233)
No Top*Control		-0.0474 (0.0282)*	-0.0693 (0.0293)**		-0.0511 (0.0273)*	-0.0764 (0.0283)***
Constant	-0.0140 (0.0149)	-0.0273 (0.0127)**	0.0403 (0.0255)	-0.0152 (0.0151)	-0.0284 (0.0132)**	0.0415 (0.0247)*
Observations	125	125	125	125	125	125
R ²	0.610	0.663	0.693	0.611	0.665	0.698
Year Fixed Effects	No	No	Yes	No	No	Yes

the candidate's abnormal return. Heteroskedasticity robust standard errors are reported in parentheses.

***, **, and * denote significance at the 1%, 5%, and 10% confidence levels, respectively.

The results of the regressions are broadly consistent with our expectations. The interaction terms for the presence of lower quality firms and no top firms, and MBO cases, is negative, but not significant. We also find that lower quality firms, when interacted with controlling shareholders, yield large, negative, and statistically significant results. This provides some evidence for our hypothesis that low quality firms should negatively correlate with returns. We view the combination of results in Tables 3 and 4 as suggestive evidence that law firm quality matters in conflicted transactions.¹³⁵

We note that with regard to Tables 4 and 5 it is possible that our results understate the actual market reaction to filings by top law firms. As noted in Table 1, top firms correlate with quick filing that is, with filing on the day of or the day after the deal is announced. Still, it remains possible that top firms may file suit after our one and two day windows have closed. Consequently, in some instances, the market reaction for “top firms” will understate what the market reaction likely would have been had the market actually observed the top firm filing within the window. As a result, our results likely understate the effect we describe.

Though it is not our primary variable of interest, it is worth discussing the number of plaintiffs’ law firms involved in each case. The coefficient for this variable is very slightly positive and statistically significant in almost all specifications in Tables 5 and 6. There are two ways of interpreting this result. First, one might infer that the number of law firms signals the quality of the case. If high quality cases are likely to result in an increase in consideration, then they are also likely to attract more plaintiff law firms eager to collect the attorneys’ fees associated with price improvements. That could account for the relative increase in stock price associated with the involvement of each additional law firm.¹³⁶ A

135. We do not control for the market capitalization of the firms in these regressions. It is not entirely clear why the size of the firm should affect the litigation dynamics. The securities of large firms tend to be more liquid, but this is unlikely to be a concern in the context we study because the stock of merger targets tends to be highly liquid when deals are announced. One might also argue that better firms could be drawn to deals of larger firms. But market participants should not care about the total size of any recovery for target shareholders; instead, their focus should be on the size of the recovery relative to overall market capitalization. In any event, we perform regressions that include the log of market capitalization, and the unreported results come out largely the same. The biggest difference is that the standard errors for the NoTop*Control coefficient estimates in Table 5 are larger.

136. Other studies use the number of complaints filed—which should correlate highly with the number of

second interpretation is that the incentive to free ride on the effort of other firms increases as more plaintiffs firms file complaints in a case. In the context of merger litigation, this incentive may arise because any firm's share of a settlement is likely to decrease as more law firms become involved.¹³⁷ This dynamic could make settlement more likely because settling the case helps to avoid the high cost that comes with diligently litigating a case, particularly if most of that cost will be borne by the lead counsel while the benefit will be shared by non-lead counsel. The market might have a positive reaction to this development because it increases the certainty that the deal will close.

2. Robustness Checks

One concern about our results is whether we can accurately discern a law firm effect when the suit is filed the day of or the day after a merger is announced, given that the market is still reacting to the announcement of the merger itself. That announcement may contain useful information beyond just the offer premium and the deal structure, including information that extends beyond the specifics of the transaction itself, such as the financial health of particular market sectors. And even if we can discern a lawsuit effect, Tables 4 and 5 raise questions whether the market is reacting to the presence of a high quality law firm or, instead, is responding to the facts of the underlying case. In those cases where the lawsuit gets filed shortly after the announcement, we cannot discern between these two effects.

Table 6¹³⁸ attempts to address these concerns by examining the market reaction to suits filed more than two days after the deal is announced. Two days provides ample time for the market to price any information associated with the deal itself. This table provides some of the strongest support for our hypotheses. Not surprisingly, the MBO and controlling shareholder variables are insignificant in all specifications. The market has known the deal structure for at least two days. But the identity of the firm filing the suit is new information. While we do not find statistically significant results for law firm quality and controlling shareholders, the variable for top firms interacted with MBOs correlates with a strongly positive and statistically significant market reaction. In contrast, no top firms interacted with MBOs has a negative coefficient that is statistically significant in three of four specifications.¹³⁹ Both of these results support our claim that law firm quality

plaintiffs' firms involved—as a measure of case quality. See Matthew Cain & David Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 476 (2015) (discussing plaintiffs' attorneys' use of jurisdictions with previously favorable judgments); Adam Badawi & Daniel Chen, *Shareholder Wealth Effects of Delaware Litigation* 8 (Sept. 5, 2015) (unpublished manuscript), <http://users.nber.org/~dlchen/papers/Delaware.pdf> (noting markets' reactions to Delaware litigation); Webber, *Private Policing*, *supra* note 10 (describing shareholders litigation and results).

137. See, e.g., Erickson, *supra* note 121, at 1506 (estimating that 65% of the attorneys' fee in merger litigation goes to the lead counsel and 35% to the executive committee and liaison counsel, based on telephone interviews with plaintiffs' counsel).

138. This table presents results from OLS regressions that use the cumulative abnormal return as the dependent variable. The cumulative abnormal return covers the windows indicated in the tables. Day zero is the day the first complaint is filed against the target firm. Some variables, including the deal premium, indicator variables for whether the case was filed on the same day as the announcement, and fixed effects for year, have been omitted for brevity. Each observation is weighted by the inverse of the variance associated with estimate of the cumulative abnormal return. Heteroskedasticity-robust standard errors are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% confidence levels, respectively.

139. To limit the number of tables, we include both the top and no top firm variables. If we run separate

matters. The results suggest that the market does not react, at this point, to the MBO itself, but only to the quality of the law firm bringing suit over the MBO.¹⁴⁰ If the market were reacting to deal characteristics alone, then we would expect to see no market reaction to firm filings two days after the deal terms are announced. The fact that we observe statistically significant market reactions to law firm filings two or more days after the deal terms are publicly known provides further evidence that the law firms matter.

Table 6: Cases Filed More than Two Days after Merger Announcement

	CAR [0,+1]			CAR [0,+2]		
	(1)	(2)	(3)	(4)	(5)	(6)
Num. of Plain. Firms	0.00938 (0.00478)*	0.00822 (0.00223)***	0.00927 (0.00467)*	0.00949 (0.00475)**	0.00884 (0.00219)***	0.00932 (0.00462)**
Top Firm Involved	-0.00323 (0.0179)	-0.00940 (0.0146)	-0.0102 (0.0153)	0.000799 (0.0176)	-0.00473 (0.0145)	-0.00572 (0.0151)
Lower and No Top Firms	-0.0162 (0.0214)	-0.0204 (0.0191)	-0.0115 (0.0228)	-0.0148 (0.0210)	-0.0176 (0.0185)	-0.00939 (0.0224)
Controlling Shareholder	-0.0103 (0.0194)		-0.00862 (0.0201)	-0.0166 (0.0193)		-0.0149 (0.0199)
No Top*Control	-0.0285 (0.0308)		-0.0306 (0.0316)	-0.0158 (0.0278)		-0.0185 (0.0285)
Top*Control	-0.0182 (0.0470)		-0.00571 (0.0417)	-0.00279 (0.0476)		0.0101 (0.0420)
MBO		0.0266 (0.0244)	0.0266 (0.0253)		0.0278 (0.0232)	0.0274 (0.0240)
Top Firm*MBO		0.0995 (0.0306)***	0.0987 (0.0313)***		0.0947 (0.0301)***	0.0951 (0.0307)***
NoTop*MBO		-0.0443 (0.0277)	-0.0535 (0.0296)*		-0.0600 (0.0265)**	-0.0684 (0.0286)**
Constant	-0.0183 (0.0162)	-0.0241 (0.0111)**	-0.0255 (0.0137)*	-0.0196 (0.0166)	-0.0264 (0.0122)**	-0.0268 (0.0146)*
Observations	83	83	83	83	83	83
R ²	0.170	0.252	0.279	0.182	0.271	0.292

Another potential concern is the relatively small sample size in our study. While we have case data that span through calendar year 2009, we restrict our primary analysis to the period ranging from October 2003 (the beginning of electronic docket coverage) to

tables for the top and notop variables, we see similar results (i.e., positive and statistically significant coefficients for the top firms interacted with MBOs in all specifications and negative and statistically significant for no top firms interacted with MBOs in all specifications).

140. We conduct an F-test to test the null hypothesis that the top firm * MBO variable is equal to the no top firm * MBO variable. In all specifications we can reject the null at the one-percent level of statistical significance (i.e., we have substantial evidence that the abnormal returns associated with these two variables are different).

September 15, 2008. The reason we do so is because the bankruptcy of Lehman Brothers on the latter date is the event that many mark as the beginning of the most acute phase of the financial crisis.¹⁴¹ This period of the crisis involved a near-total seizure of credit markets. This credit crunch made financing deals difficult and, unsurprisingly, merger activity cratered during that time.¹⁴² The deepening of the crisis may also have given prospective buyers cold feet in deals that did get signed. Those putative buyers may have been more willing to walk away from a transaction as an even more dour outlook for the economy diminished the potential gains from a deal.

The decline in mergers and the hesitance of prospective buyers likely dimmed the prospects of deal litigation for plaintiffs' firms. For one, there were fewer cases to litigate. If there was no substantial change in the quality of the cases available, firms likely faced the choice of pursuing lesser quality cases or hardly litigating at all. Even the top-tier firms may have opted to take less inviting cases. The reticence of acquirers may also have diminished the prospect of a significant recovery for plaintiffs' firms. Merger litigation can create pressure to settle a case because the parties prefer to resolve disputes prior to closing. If a buyer is looking for a reason to walk away, that can significantly diminish the leverage that plaintiffs have. Both of these reasons suggest that the relationship between law firm quality and the likelihood of a significant recovery may have attenuated during the post-Lehman period.¹⁴³

Despite our belief that the financial crisis cases are different, we still include them as a robustness check because it allows us to increase our sample size from 125 cases to 168 cases. Tables 7¹⁴⁴ and 8¹⁴⁵ present the results of the same regressions as Tables 4 and 5,

141. See Steven L. Schwarcz, *Keynote Address: Understanding the Subprime Financial Crisis*, 60 S.C. L. REV. 549, 552–53 (2009) (detailing how Lehman's bankruptcy turned the mortgage crisis into a more far-reaching financial panic); Adam Schell, *Collapse Upended Economic Supports; Investment Bank's Failure Nearly Triggered Meltdown*, USA TODAY, Sept. 11, 2009, at 1B (observing that the Lehman bankruptcy helped produce "almost 6 million lost jobs. A 5,000-point Dow plunge. The government bailing out cash-starved banks. General Motors and Chrysler declaring Chapter 11. The unemployment rate doubling to almost 10%. Consumers getting \$4500 handouts from Uncle Sam to buy a car. Talk of a 1930s-style depression.").

142. See Michael J. De La Merced, *Mergers Hit 7-Year High, Propelled by Series of Blockbuster Deals*, DEALBOOK (June 30, 2014, 8:13 PM), http://dealbook.nytimes.com/2014/06/30/propelled-by-a-series-of-blockbuster-deals-mergers-hit-a-7-year-high/?_r=0 (showing a precipitous drop in merger activity after the quarter of the Lehman bankruptcy).

143. The descriptive statistics for the post-Lehman period provide support for these expectations about the change in case mix. For the pre-Lehman period the number of cases that are MBOs and/or a controlling shareholder transaction is over 27%. The comparable statistic for the post-Lehman cases is less than 14%. There are also fewer cases filed in short order. While a third of cases in the pre-Lehman period were filed on the day of deal announcement or the day after, just less than 13% were filed in that time frame for the post-Lehman cases. Though we are hesitant to read too much into these descriptive statistics, it is possible that the increased delay reflects some increased uncertainty about whether to file a case.

144. This table presents results from OLS regressions that use the cumulative abnormal return as the dependent variable. The cumulative abnormal return covers the windows indicated in the tables. Day zero is the day the first complaint is filed against the target firm. Some variables, including the deal premium, indicator variables for whether the case was filed on the same day as the announcement, and fixed effects for year, have been omitted for brevity. Each observation is weighted by the inverse of the variance associated with estimate of the cumulative abnormal return. Heteroskedasticity-robust standard errors are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% confidence levels, respectively.

145. This table presents results from OLS regressions that use the cumulative abnormal return as the dependent variable. The cumulative abnormal return covers the windows indicated in the tables. Day zero is the day the first complaint is filed against the target firm. Some variables, including the deal premium, indicator

but with the inclusion of the post-Lehman cases. The results are largely similar to the primary analysis. The interaction term of top firm and controlling shareholder cases in Table 7 has very similar coefficients and standard errors as compared to Table 4. The coefficients for the top firm and MBO interaction term are smaller in Table 7 and the standard errors are somewhat larger. We likewise find similar results when comparing the main variables of interest in Tables 5 and 8. The NoTop and MBO interaction term coefficients are not significant in any of the specifications in both Tables 5 and 8. The NoTop and controlling shareholder interaction term coefficients are, however, highly similar in both tables, as are the standard errors. We view the substantial similarity of the results both with and without the post-Lehman cases as further evidence in support of our hypothesis about the connection between law firm quality and the response of market participants.

Table 7: Higher Quality Law Firms and Abnormal Returns to Filing with the Inclusion of Post-Lehman Data

	CAR [0,+1]		CAR [0,+2]	
	(1)	(2)	(3)	(4)
Num. of Plain. Firms	0.00501 (0.00295)*	0.00593 (0.00332)*	0.00548 (0.00290)*	0.00640 (0.00321)**
Premium*Same Day	0.743 (0.122)***	0.697 (0.148)***	0.716 (0.128)***	0.666 (0.156)***
Premium*Next Day	0.773 (0.177)***	0.716 (0.163)***	0.738 (0.188)***	0.677 (0.170)***
Top Firm Involved	-0.0196 (0.0138)	-0.0244 (0.0135)*	-0.0187 (0.0139)	-0.0236 (0.0138)*
MBO	0.0374 (0.0200)*	0.0339 (0.0202)*	0.0384 (0.0213)*	0.0341 (0.0211)
Top Firm*MBO	0.0594 (0.0301)*	0.0626 (0.0312)**	0.0572 (0.0316)*	0.0599 (0.0324)*
Controlling Shareholder	-0.0214 (0.0166)	-0.0378 (0.0184)**	-0.0209 (0.0138)	-0.0374 (0.0156)**
Top*Control	0.0567 (0.0308)*	0.0689 (0.0301)**	0.0608 (0.0304)**	0.0742 (0.0292)**
Constant	-0.0129 (0.00987)	0.0389 (0.0258)	-0.0157 (0.0103)	0.0401 (0.0255)
Observations	168	168	168	168
R ²	0.633	0.684	0.628	0.684
Year Fixed Effects	No	Yes	No	Yes

been omitted for brevity. Each observation is weighted by the inverse of the variance associated with estimate of the cumulative abnormal return. Heteroskedasticity-robust standard errors are reported in parentheses. ***, **, and * denote significance at the 1%, 5%, and 10% confidence levels, respectively.

Table 8: Lower Quality Law Firms and Abnormal Returns to Filing with the Inclusion of Post-Lehman Data

	CAR [0,+1]			CAR [0,+2]		
	(1)	(2)	(3)	(4)	(5)	(6)
Num. of Plain. Firms	0.00630 (0.00250)**	0.00579 (0.00260)**	0.00671 (0.00297)**	0.00697 (0.00245)***	0.00630 (0.00256)**	0.00723 (0.00283)**
Lower and No Top Firms	-0.0146 (0.0153)	0.00511 (0.0174)	0.0178 (0.0165)	-0.0134 (0.0151)	0.00649 (0.0173)	0.0193 (0.0168)
Premium*Same Day	0.706 (0.143)***	0.749 (0.119)***	0.687 (0.153)***	0.672 (0.155)***	0.719 (0.128)***	0.653 (0.163)***
Premium*Next Day	0.765 (0.190)***	0.769 (0.184)***	0.713 (0.164)***	0.726 (0.201)***	0.733 (0.194)***	0.671 (0.168)***
MBO		0.0638 (0.0171)***	0.0605 (0.0196)***		0.0642 (0.0177)***	0.0598 (0.0204)***
NoTop*MBO		-0.0464 (0.0288)	-0.0363 (0.0299)		-0.0474 (0.0330)	-0.0363 (0.0331)
Controlling Shareholder		0.0185 (0.0231)	0.0158 (0.0201)		0.0217 (0.0243)	0.0198 (0.0211)
No Top*Control		-0.0480 (0.0273)*	-0.0723 (0.0271)***		-0.0494 (0.0265)*	-0.0757 (0.0261)***
Constant	-0.0105 (0.0118)	-0.0218 (0.00936)**	0.0428 (0.0232)*	-0.0136 (0.0121)	-0.0248 (0.0100)**	0.0429 (0.0223)*
Observations	168	168	168	168	168	168
R ²	0.571	0.624	0.677	0.568	0.620	0.678
Year Fixed Effects	No	No	Yes	No	No	Yes

VI. CONCLUSION

The evidence presented broadly confirms our hypothesis that law firm quality matters in controlling shareholder transactions and MBOs. In these transactions, cases with top firms tend to correlate with an increase in the target's stock price, whereas cases with low quality firms and no top firms negatively correlate with the target's stock price. Because managers and controlling shareholders have access to inside information or may favorably

time an acquisition in the business cycle, both courts and the market scrutinize them with greater care than third-party acquisitions. Top firms may select better cases, or may litigate them better, whereas poor quality firms are less selective, and may succeed only in delaying the deal without any prospect for a bump in the price of the target's shares. Hence, the negative market reaction to them.

As noted in the Introduction, skeptics take the position that law firm quality does not matter at all in deal litigation. To the extent that there is price improvement beyond the initial offer price, skeptics would argue that the improvement is attributable to factors other than the lawsuit or the law firm itself, like deal characteristics. Our data suggests that this view is incorrect. In conflict-ridden transactions like MBOs and controlling shareholder deals, markets appear to react positively to suits filed by top-quality plaintiff law firms, and negatively to suits filed by poor quality firms. The results hold for cases filed more than two days after the deal is announced, by which time all deal characteristics are known and should be reflected in market prices. Although our data do not allow us to claim that litigation itself is value-adding, we can conclude that, conditional upon there being a lawsuit, there is some utility to the effort exerted by courts and institutional clients to sift for plaintiff law firm quality. At a minimum, the information about the law firms that file cases sends some signal either about the underlying quality of the case or about the value that those firms are likely to produce, or perhaps both. Our results show that markets listen to those signals.

APPENDIX A: VARIABLE DEFINITIONS

Number of Plaintiff Firms:	The number of plaintiff firms filing suit in a case.
Top Firms:	One of the top firms, as defined by Legal 500 and SCAS's ranking, has filed a complaint in the case.
Lower and No Top Firms:	Bottom three firms of the Bloomberg attorney fee rankings, or firms that have been criticized by Vice Chancellor Laster or Vice Chancellor Lamb have filed in the case AND none of the top firms have filed a complaint.
MBO:	The case involves an acquisition where a company's existing managers acquire a large part or all of the company.
Top*MBO:	Interaction term for the Top Firm and MBO variables.
NoTop*MBO	Interaction term for the Lower and No Top Firms and MBO variables.
Controlling Shareholder	The case involves an acquisition where a company's controlling shareholder(s) acquire(s) a large part or all of the company.
Top*Control	Interaction term for the Top Firm and Controlling Shareholder variables.
NoTop*Control	Interaction term for the Lower and No Top firms and Controlling Shareholder variables.
Premium	Difference between price offered by acquirer and the pre-offer trading price of the target's stock in percentage terms.