The Advocate
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M&A Litigation and the Institutional Investor Factor

As Lead Plaintiffs, Does Their Leadership Make a Difference?

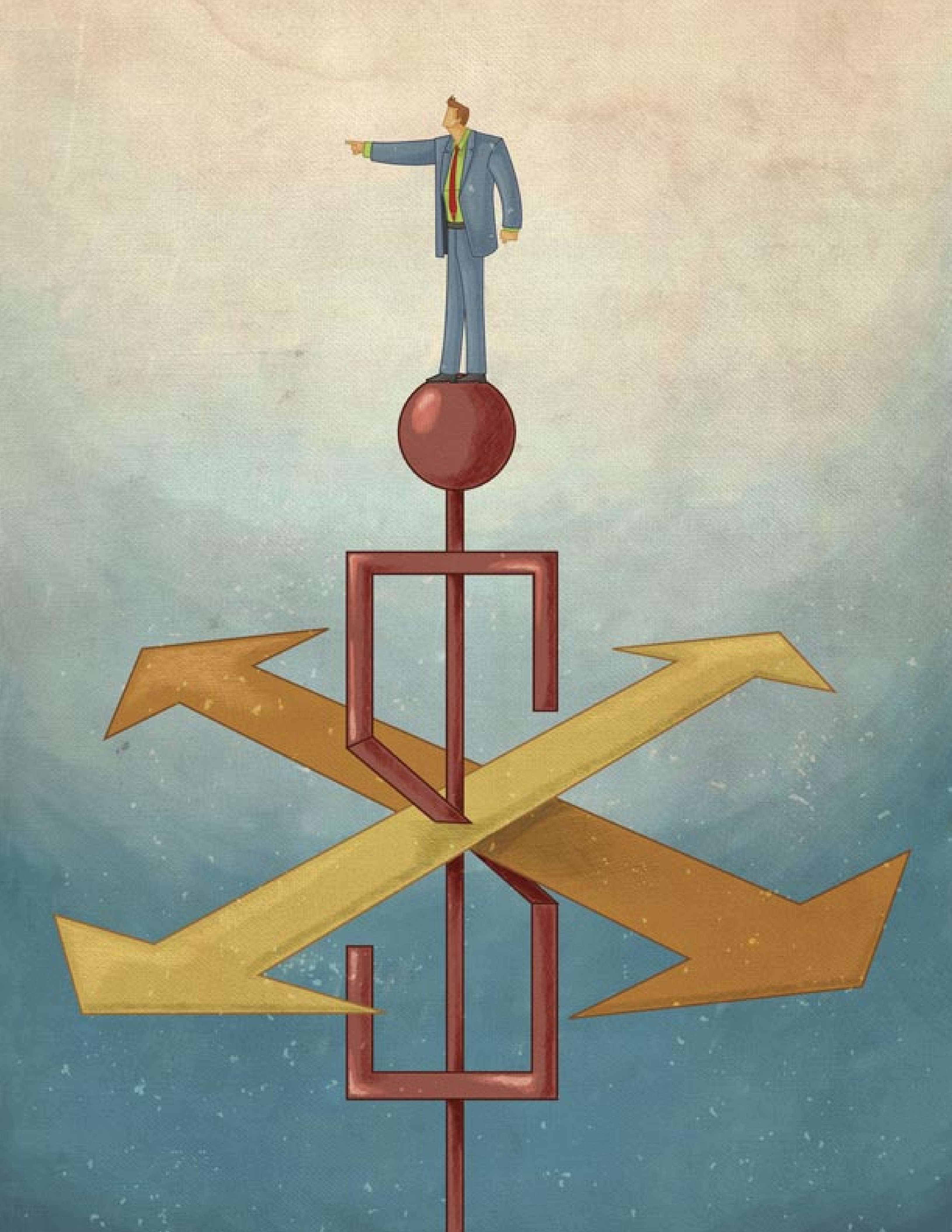
By David Webber

This article is based on Boston University School of Law Professor David Webber's study "Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions," (available online at http://ssrn.com/abstract=1879647; and to be published in the Delaware Journal of Corporate Law*).*

Mergers and Acquisitions litigation ("M&A litigation") typically involves the shareholders of a target company (i.e., the company being purchased) suing the boards of the target and acquiring companies for failing to maximize the price for the target's shares – and for misleading shareholders along the way. M&A litigation is designed to police a broad range of managerial misconduct and, when it works properly, can result in substantial investor gains. My empirical research suggests that the court-appointed lead plaintiffs in M&A litigation can affect at least two critical outcomes for shareholders: monetary rewards and attorneys' fees.

Before 2000, lead plaintiffs in M&A litigation were determined by agreement between lead plaintiff applicants and their law firms. But in 2000, courts in Delaware, the most common venue for M&A litigation, decided that change was needed and reformed the lead plaintiff appointment process. A series of Delaware Chancery Court decisions set forth new criteria for the selection of a lead plaintiff, which favored institutional (instead of individual) investors with the largest "relative economic stakes." The theory was that institutional investors would be motivated and sophisticated monitors of legal counsel – in contrast to individual investors, who may be more inclined to surrender control of the litigation to their lawyers. It was believed that institutional investors' comparatively large economic stakes would incentivize them to most effectively and skillfully monitor legal counsel.

In seeking to determine whether these Delaware reforms have actually worked, I have conducted extensive research to assess several empirical questions. Among them, I have asked whether institutions accepted Delaware's invitation to serve as lead plaintiffs in M&A litigation.



Institutional investors have stepped forward in substantial numbers to obtain lead plaintiff appointments in M&A litigation. It is also clear that public pension funds and labor union funds have become the dominant institutional players in M&A litigation, even though these types of investors played almost no role ten years ago.

I have also asked whether institutional lead plaintiffs quantifiably improve case outcomes for shareholders. As discussed below, the answer to the first question is yes. And while the answer to the second question is more complicated, I have found that when public pension funds serve as court-appointed lead plaintiffs in M&A litigation, it correlates with an increase in the offer price and also lowers attorneys' fees.

First, I have found that institutional investors have in fact stepped forward in substantial numbers to obtain lead plaintiff appointments in M&A litigation. It is also clear that public pension funds and labor union funds have become the dominant institutional players in M&A litigation, even though these types of investors played almost no role ten years ago. Specifically, my research found that institutional investors served as lead plaintiffs in over 40 percent of the 290 M&A matters filed in the Delaware Chancery Court between November 1, 2003 and December 31, 2009.

There are a host of likely reasons for the increased participation of institutional investors in M&A litigation. While some skeptics have attributed this increase to political contributions from special interest groups (a possibility that cannot be ruled out), my research indicates other likely explanations. Public pension funds and labor unions may be increasingly willing to serve as lead plaintiffs as a result of, among other things, their success in obtaining better results for investors in these cases and in securities fraud class actions in federal court. Indeed, many of the largest-ever M&A litigation (and securities fraud) recoveries have been obtained in cases where a public pension fund served as the court-appointed lead plaintiff. In addition, institutional investors' increased participation is also likely attributable to the fact that law firms have made it much easier for them to identify matters that warrant involvement through portfolio monitoring. Finally, the spike in institutional investor participation may reflect investor activism in response to the most recent global financial crisis.

My research has also shown that, not only is public pension fund participation up, but it is associated with better bottom-line results in M&A litigation. There is a statistically significant correlation between the outcomes of greatest interest to shareholders — offer price increases and lower attorneys' fees — and the service of public pension funds as lead plaintiff. The favorable outcomes associated with public pension funds may be because they are better legal representatives. They are well versed in the roles of fiduciaries. They also have significant experience as repeat consumers of legal services with established industry relationships and, in many instances, securities portfolio monitoring arrangements with law firms that specialize in prosecuting M&A litigation. Public pension funds may also enhance the final outcome of a case by preventing lead counsel from expending too little effort, settling too quickly, or underinvesting in the litigation.

The comparatively stronger results in M&A litigation led by public pension funds may also result from the fact that law firms may work hard to satisfy public pension fund clients, with an eye to repeat business or a credible source for referrals. Public pension funds may also have the political clout to attract attention to a case, the media savvy to raise a case's profile, or exercise other power levers to compel the defendants in a case to increase an unreasonably low offer price. Nevertheless, it is also possible that public pension funds just cherry-pick the best cases, although I find evidence cutting against this view. Indeed, the correlation between public pension funds and offer price increases in M&A litigation persists even when controlling for factors such as the premium, the number of bidders, the role of controlling shareholders, pre-bid price changes, and whether a deal is hostile or friendly. Overall, the results of my analysis are consistent with the view that public pension funds outperform traditional individual lead plaintiffs as monitors of legal counsel by reducing the costs associated with M&A litigation — including attorneys' fees — and by increasing the offer price or other monetary payment in a particular action. ◆

The author's research suggests that the court-appointed lead plaintiffs in M&A litigation can affect at least two critical outcomes for shareholders in these lawsuits: monetary rewards and attorneys' fees.

About the Author

David H. Webber is Associate Professor of Law at Boston University School of Law. He teaches civil procedure, securities regulation, and a seminar on shareholder activism. His research focuses on shareholder activism and corporate governance, with a particular emphasis on shareholder rights and shareholder litigation. Webber's work has been cited numerous times by other academics and has been anthologized in *Securities Law Review* and *Corporate Practice Commentator*. He has presented his research at several international academic conferences, including the Conference on Empirical Legal Studies and the American Law and Economics Association conference, and published in leading scholarly journals including the *Northwestern University Law Review*, the *Delaware Journal of Corporate Law*, and the *Boston University Law Review*. Webber's work has also been cited in leading federal cases arising out of the financial crisis, including *Richman v. Goldman Sachs* and *In re Countrywide Securities Litigation*, and by the Delaware Chancery Court in *In re Del Monte Foods*, a leading case on mergers and acquisitions.

Webber has been interviewed on a range of corporate governance and securities law issues by *Nightly Business Report*, NPR's *Marketplace*, Agence France-Presse, Reuters, and others. He has testified about pension governance issues in California and New Hampshire, and has spoken at numerous practitioner-oriented conferences. He is a founding member of the Boston University Center for Finance, Law & Policy.

Webber joined BU Law from New York University Law School and the NYU Stern School of Business, where he was a Wagner Fellow at the Pollack Center for Law and Business. Prior to his fellowship, he litigated corporate and securities cases at BLB&G and clerked for Judge Harold A. Ackerman of the United States District Court for the District of New Jersey. Webber holds a B.A., *magna cum laude*, from Columbia University and a J.D. from the New York University School of Law, where he was a Lederman/Milbank Fellow in Law & Business and an editor for the *NYU Law Review*.

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