Wall Street's reaction to jury verdicts involving publicly-traded litigants

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For most technology, pharmaceutical and healthcare firms, patents and copyrights are the direct result of their research and development efforts and are vital to their revenues. The stock performance of these companies can be directly linked to the quality of their intellectual property portfolio (Dang, Lev, & Darin, 1999). To protect their intellectual property, many of these firms use litigation as means for obtaining licensing revenues or to prevent other competitors from bringing products to market. Defendants in these lawsuits may be enjoined from offering certain products and also pay substantial damages. Accordingly, the outcome of litigation involving important intellectual property may substantially raise or lower publicly-traded companies' revenue prospects and impact their stock prices.

Companies that win or lose other types of litigation may also affect shareholder value. The resolution of antitrust lawsuits potentially alters the market in a particular industry. The outcome of contract disputes may change a firm's prospects, and compensatory and punitive damages awarded in product liability lawsuits could cripple a company. Because of the stakes involved, the investment community reacts considerably to jury verdicts in these bet-the-company cases causing firms' stock prices to soar or plummet.

In this article, we assess the immediate effect of jury verdicts on stock prices. We assessed 35 jury verdicts from January 2005 to June 2010 that impacted the shareholder value of 40 litigants (22 plaintiffs and 18 defendants). In each of these cases, one or more litigants were publicly traded and had a market capitalization of $200M or more. Most of the jury verdicts in our research involved patent infringement and validity issues (28 cases). Jury verdicts in three product liability, two contract, one trademark and one copyright case were also included. As a comparison, we also evaluated stock price changes of 27 publicly-traded companies that settled significant litigation during this time frame.

Plaintiff Wins / Defense Losses

Plaintiff Wins

Not surprisingly, the market reacts very positively to plaintiffs who prevail at trial. The average stock price increased +18.9%[1] following the jury verdict for the 18 plaintiffs in our sample. The stock price changes of these litigants ranged from +2.4% to +99.4%.

Defense Losses

For defendants involved in material litigation (15 litigants), the stock performance of these companies declined an average of -21.6% after the verdict was reached, with a range of -6.0% to -67.8%. Although these defendants state their intent to appeal the jury's verdict, the sting of the unfavorable decision and uncertainty of any appellate court ruling tend to keep their stock prices at depressed levels.

For both plaintiffs that won and defendants that lost at trial, smaller companies tended to have greater stock price changes post-verdict. For these companies, the litigation tended to reflect a greater proportion of their current and prospective revenues.

Plaintiff Losses / Defense Wins

Plaintiff Losses

In contrast, the stock prices of the four plaintiffs in our research that lost at trial tend to remain at depressed levels over time, with an average initial decline of -38.3%, with stock price changes ranging from -4.8% to -73.2%. In two of the four cases in our research in which the plaintiffs lost at trial, these litigants' business models were based on deriving revenues through patent licensing. These plaintiffs' stock prices declined substantially after receiving an unfavorable verdict.

Defense Wins

Defendants' best-case scenario is to avoid losing any litigation. In our research, the market did not generally react to most defense wins and we found only two material cases in which the defendants' stock performance increased when they prevailed at trial. The stock prices of these litigants had modest gains of +9.2%. With the threat of an unfavorable ruling lifted pending any appellate reversal, the market may react somewhat favorably to winning at trial. However, for most publicly-traded defendants, winning their cases may prevent stock price losses rather than provide any gains.

Settlement Outcomes

Plaintiff Settlements

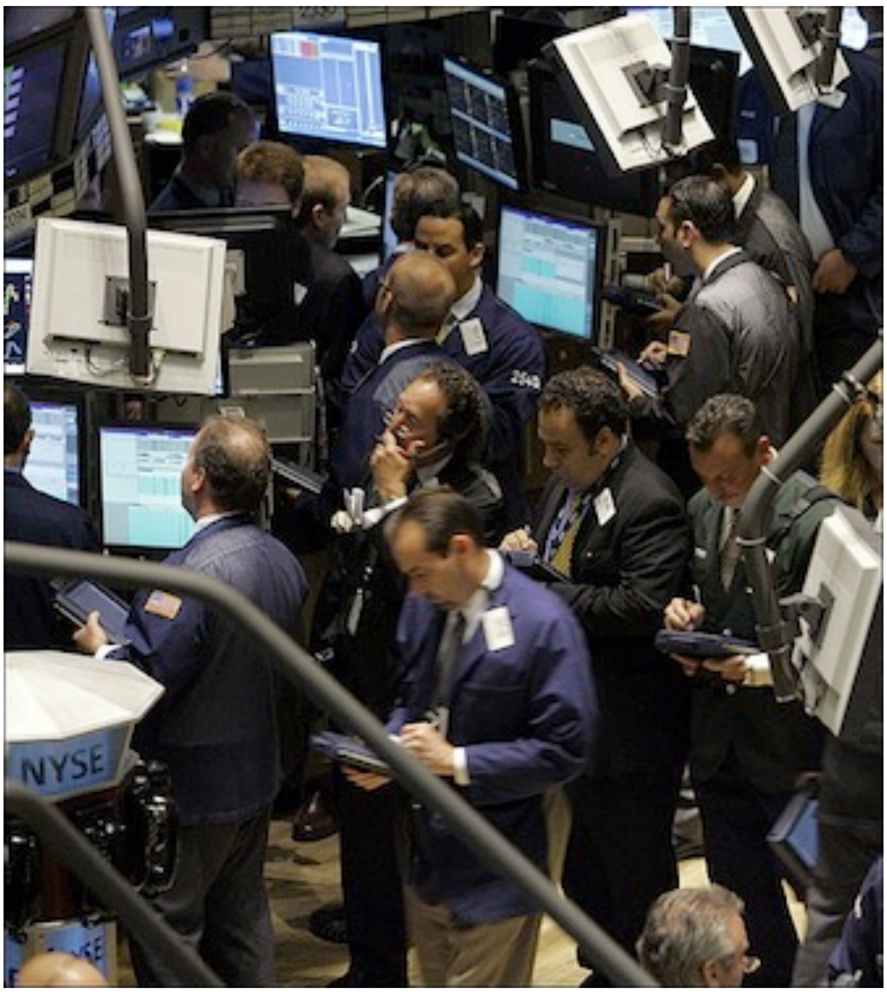
On average, plaintiffs that settled had an average closing price of +24.3% after the agreement was announced (20 plaintiffs), with stock price changes ranging from -15.3% to +70.5%. The market reacted favorably to many of these settlements as the terms of the agreement enabled the plaintiffs to successfully protect their intellectual property and/or provided additional revenues. However, for other plaintiffs, the investment community was disappointed by the terms of the settlement and its stock prices declined.

Defense Settlements

The stock price gains of defendants that settled were comparable to plaintiffs, with an average increase of +26.5% following the settlement (seven defendants). The stock price changes of these defendants ranged from +9.6% to +84.8%. In some cases, these gains are misleading as the defendants who settled had had substantial stock price declines after losing at trial and the settlement represented a sliver of good news.

Conclusion

For publicly-traded companies engaged in high-stakes litigation, the market reacts significantly to the outcome of jury trials. Although we screened for litigation that was material to the litigant(s), there may be a self-selection bias as only verdicts that impacted stock prices were analyzed. Nonetheless, in many of these cases, the litigants stock prices changed +/-10%, reflecting, on average, tens of millions of dollars in shareholder value gained or lost based solely on juries' decisions.



When engaged in high-stakes litigation, it is important for counsel to consider how the investment community may react to winning and losing jury trials. The stock prices of companies who win at trial tend to increase, but the shareholder value of plaintiffs that lose can decline substantially, particularly companies that derive most of their revenues from patent licensing. In contrast, the best-case scenario for many defendants is winning at trial and avoiding stock price losses. For defendants who receive unfavorable jury verdicts, their shareholder value may decline considerably, on average more than the corresponding stock price increases of plaintiffs.

Because the sting of a loss is generally experienced more acutely than the satisfaction of any gains (e.g., Kahneman & Tversky, 1979), defendants may be eager to settle their litigation at less-than-favorable terms. In contrast, plaintiffs may look to hold out for more desirable concessions before settling. Many defendants are especially inclined to settle after receiving an unfavorable jury verdict. Defendants in this situation will have much less negotiating leverage than they had prior to losing at trial. Although the market reaction is positive to such settlements, the stock prices of these defendants tend to be below the prices traded prior to the verdict. The market is generally positive to plaintiffs who settle their litigation at optimal terms. However, if the settlement is below the market's expectations, the plaintiff may have been better off going to trial.

As the market reacts considerably to the outcome of jury trials, plaintiffs and defendants need to conduct pre-trial jury research to determine their case strengths and weaknesses and gauge the likelihood of winning and losing at trial. For both plaintiffs and defendants, this research will help inform whether potential jury verdicts are above or below market expectations and settlement offers. Importantly, jury research and consulting may be invaluable for providing companies engaged in critical litigation with the best opportunity to preserve or enhance shareholder value.

[1] Stock price changes are based on the closing price traded after the verdict was reached. For jury verdicts that were announced after market hours, stock prices were based on the closing price the following day. The stock price change was then determined based on the difference between the closing prices prior to- and post-verdict.

References

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Editor's Note

It's the dog days of summer here in the heart of Texas but this issue is sure to keep you glued to your computer screen! Once again, we have a variety of pieces that are thought-provoking and provocative but also carefully researched and written. To start us off, Sam Sommers reviews the research he's done over the past ten years and sets the record straight on what we know (and what we don't know) about race and jurors. All of our stock portfolios have taken hits and been on something of a stomach-wrenching course for the past while but Eric Rudich has been watching something odd: how Wall Street reacts to the litigation verdicts of publicly traded litigants. Read and learn. Daniel Denis has an eye toward numbers as well but his focus is on how to talk to jurors about probability so they "get it".

Doug Keene and I review the literature (the real literature) on the Millennials (also known as Generation Y) and discuss how you can use this knowledge to inform your litigation advocacy (and learn a bit about tattoos along the way). Alexis Robinson looks at the phenomenon of white guilt and how it plays into jury deliberations. Thaddeus Hoffmeister examines the impact of the Skilling verdict and what we need to consider as we move forward in a changed litigation arena. And finally, Desiree Griffin and Emily Patty take a look at the need for affect (aka emotion) in jury decision-making. Why even go outside? Make some coffee (or maybe a cool drink) and sit down to read the July issue of The Jury Expert! And, as always, please comment on our website so we know what you're thinking and what you're especially interested in and intrigued by.

Rita R. Handrich, Ph.D., Editor

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