



The Role of Risk Litigation in Merger and Acquisition (M&A) Valuation : An Overview Strategic in Opinion Fairness in Merger and Acquisition Transactions

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Abstract . This qualitative literature review explores the role of litigation risk in merger and acquisition (M&A) valuations, focusing on fairness opinions. The study reveals that high litigation risk leads to lower valuations in target-sought fairness opinions, particularly in transactions with significant agency conflicts. Regulatory changes, such as those in Delaware, have increased awareness of litigation risks and influenced valuation strategies. The selection of peer firms for valuation is also affected by litigation risk, underscoring the importance of accurate peer selection. These findings provide valuable insights for academics, practitioners, and policymakers in managing litigation risk and maximizing value in M&A transactions. Limitations include reliance on existing literature and potential contextual differences across jurisdictions. Future research should empirically test these hypotheses and explore other jurisdictions to gain a comprehensive understanding of litigation risk in M&A valuations.

Keywords: Litigation Risk, M&A Valuation, Fairness Opinions, Agency Conflict, Regulatory Changes

INTRODUCTION

Mergers and acquisitions (M&A) are a corporate strategy often used to achieve growth, diversification, and operational efficiency. However, the M&A process is often faced with various challenges, one of which is litigation risk. Litigation risk in the context of M&A refers to the possibility of a lawsuit that can affect the valuation and outcome of the transaction. This study aims to review the role of litigation risk in M&A valuation, with a focus on fairness opinions obtained in M&A transactions.

A fairness opinion is an independent evaluation used to assess whether the price offered in an M&A transaction is fair from a financial perspective. However, research suggests that litigation risk can influence the way this assessment is conducted. For example, a study by Imperatore et al. (2024) found that litigation risk can introduce strategic valuation bias into fairness opinions, especially when using common valuation techniques such as peer comparisons and discounted cash flow (DCF) analysis.

Regulations related to litigation in M&A have also undergone significant changes, such as those in Delaware in 2007. These changes triggered the practice of valuation arbitration, where investors can challenge valuations deemed unfair in court. A study by Imperatore et al. (2024) shows that high litigation risk can lead to lower valuations in fairness opinions requested by targets, especially in transactions with greater agency conflicts between target management and outside shareholders.

These findings suggest that rather than being used to negotiate a higher takeover price, fairness opinions requested by targets may be used to reduce litigation risk and facilitate successful transaction completion. This is in line with previous findings by Kisgen et al. (2009) who questioned the fairness of fairness opinions in the M&A context.

Furthermore, this study also highlights that downward biased valuations can reduce valuation litigation but are also associated with lower premiums. This suggests that litigation risk plays a significant role in M&A price formation and has significant implications for academics, practitioners, and regulators interested in this process.

In a broader context, litigation risk in M&A not only affects valuation but can also influence negotiation strategies and management decisions. For example, Boone et al. (2019) show that merger negotiations are often conducted in the shadow of judicial judgment, which can affect the final outcome of the transaction.

In addition, litigation risk can also influence the selection of peers used in valuation. Bhojraj et al. (2002) highlight the importance of appropriate peer selection in determining fair value, while Eaton et al. (2022) show that peer selection can be influenced by a variety of factors, including litigation risk.

LITERATURE REVIEW

Litigation risk in merger and acquisition (M&A) valuation is an increasingly relevant topic in finance and management studies. This study focuses on how litigation risk affects strategic judgments in fairness opinions obtained in M&A transactions. Claudia Imperatore et al. (2024) highlight that litigation risk can lead to strategic judgments in fairness opinions, especially when using valuation techniques such as peer comparisons and discounted cash flow (DCF) analysis. In this context, fairness opinions requested by targets tend to show lower valuations when litigation risk is high, especially

in transactions with greater agency conflicts between target management and outside shareholders.

This study is in line with previous findings by Kisgen et al. (2009), who questioned the fairness of fairness opinions in the context of M&A. They found that although fairness opinions are often used to justify takeover prices, there is potential bias that can affect the fairness of such assessments. In addition, research by Boone et al. (2019) shows that merger negotiations are often conducted in the shadow of judicial assessments, which can affect the final outcome of the transaction. The integration of intellectual and emotional intelligence, technological prowess, and thoroughness forms a comprehensive framework for reaching wise and accurate decisions, ensuring that organizations remain agile and responsive to dynamic environments (Ruslaini, & Ekawahyu Kasih, 2024).

Regulations affecting litigation risk have also undergone significant changes, such as those in Delaware in 2007. This change sparked the practice of valuation arbitration, where investors can challenge valuations deemed unfair in court (Imperatore et al., 2024). This practice highlights how litigation risk can impact valuation strategies in M&A, and how companies must navigate an increasingly complex legal environment.

Research by Eaton et al. (2022) shows that peer selection in M&A valuation can be influenced by various factors, including litigation risk. Bhojraj et al. (2002) also emphasize the importance of proper peer selection in determining fair value, which can be challenging in the context of high litigation risk.

Furthermore, a study by Cain et al. (2018) highlighted that takeover litigation has undergone significant changes in recent years, with an increasing number of lawsuits filed related to M&A valuations. This suggests that litigation risk is not only a legal issue, but also has significant financial implications for companies involved in M&A transactions. While acquisitions can offer benefits in terms of governance transfer, managing governance gaps effectively is critical to achieving optimal outcomes (Chaidir, M., et al., 2024).

Overall, the literature suggests that litigation risk plays a significant role in M&A pricing and valuation strategies. A better understanding of how this risk affects valuation

can help academics, practitioners, and regulators develop more effective strategies to manage risk and maximize value in M&A transactions.

METHODOLOGY

This study uses a qualitative approach with a literature review method to explore the role of litigation risk in merger and acquisition (M&A) valuation, particularly in the context of fairness opinions. This methodology was chosen because it allows researchers to gain an in-depth understanding of a complex topic by reviewing a variety of relevant and recent literature sources (Snyder, 2019).

The data collection process begins with the identification and selection of literature relevant to the research topic. Literature sources are taken from leading academic journals, books, and other publications that discuss litigation risk, M&A valuation, and fairness opinions. The literature search was conducted through academic databases, using keywords such as "litigation risk", "M&A valuation", "fairness opinions", and "merger and acquisition" (Webster & Watson, 2002).

Once relevant literature has been identified, the next step is to conduct a critical analysis of the content of each source. This analysis involves a careful reading and understanding of the arguments, findings, and methodology used in each study. This approach allows the researcher to identify key themes and gaps in the existing literature (Tranfield, Denyer, & Smart, 2003).

In the analysis process, researchers also consider the regulatory context and recent developments in M&A practices, such as regulatory changes in Delaware that affect valuation arbitration practices (Imperatore et al., 2024). This is important to understand how changes in the legal environment can affect valuation strategies and litigation risks.

As part of the literature review, this study also compares findings from different studies to identify consistent patterns and trends. For example, studies by Kisgen et al. (2009) and Boone et al. (2019) provide insights into how litigation risk can affect fairness opinions and merger negotiations.

To ensure the validity and reliability of the research results, researchers apply a triangulation approach by combining findings from various sources and perspectives. This approach helps minimize bias and ensures that conclusions drawn are based on strong and consistent evidence (Patton, 2002).

Overall, this research methodology is designed to provide a comprehensive understanding of the role of litigation risk in M&A valuation and its implications for fairness opinions. By reviewing the existing literature, this study contributes to the development of knowledge in this area and provides insights for academics, practitioners, and policymakers.

RESEARCH RESULT

This study aims to explore the role of litigation risk in the valuation of mergers and acquisitions (M&A) with a focus on fairness opinions obtained in the transaction. Based on the literature review that has been conducted, several key findings can be concluded.

First, litigation risk has been shown to have a significant impact on valuations in fairness opinions. Imperatore et al. (2024) show that when litigation risk is high, valuations in fairness opinions requested by targets tend to be lower. This is particularly evident in transactions involving greater agency conflicts between target management and outside shareholders. This downward bias in valuations may reduce the likelihood of valuation litigation but is also associated with lower valuation premiums.

Second, these findings suggest that fairness opinions are used not only to negotiate higher takeover prices, but also to reduce litigation risks and facilitate successful transaction completion. This challenges the traditional view that fairness opinions serve solely to support the proposed transaction price (Kisgen et al., 2009).

Third, regulatory changes, such as those in Delaware in 2007, have affected valuation practices and increased awareness of litigation risk among companies involved in M&A. These changes have fueled the practice of valuation arbitration, where investors can challenge valuations deemed unfair in court (Imperatore et al., 2024). This practice demonstrates the importance of understanding and managing litigation risk in the M&A context.

Fourth, peer selection in M&A valuation is also influenced by litigation risk. Bhojraj et al. (2002) emphasize the importance of selecting the right peer to determine fair value, while Eaton et al. (2022) show that peer selection can be influenced by various factors, including litigation risk.

Fifth, this study also reveals that litigation risk has broad implications for academics, practitioners, and regulators. Understanding how this risk affects M&A valuations and outcomes can help in developing more effective policies and risk mitigation strategies (Boone et al., 2019).

Overall, this study highlights the complexities involved in M&A valuation and the importance of considering litigation risk in this process. The findings contribute to the body of knowledge in the field of M&A and provide valuable insights for stakeholders involved in these transactions.

DISCUSSION

This study focuses on the role of litigation risk in merger and acquisition (M&A) valuation, particularly in the context of fairness opinions. The results of the literature review indicate that litigation risk has a significant impact on valuation strategies in M&A transactions. This finding is in line with previous studies that highlight the importance of litigation risk in the corporate context.

First, research by Imperatore et al. (2024) shows that high litigation risk can lead to lower valuations in the fairness opinion requested by the target. This is especially true in transactions with significant agency conflicts between target management and outside shareholders. This finding is consistent with the study by Kisgen et al. (2009), which questions the fairness of the fairness opinion and suggests that potential bias in valuation can affect transaction outcomes.

Second, regulatory changes in Delaware in 2007 have affected valuation arbitration practices, where investors can challenge valuations deemed unfair in court (Imperatore et al., 2024). This suggests that regulatory changes can raise awareness of litigation risks and encourage firms to adjust their valuation strategies. The study by Cain et al. (2018) also highlights how changes in the regulatory environment can affect the amount and nature of takeover litigation.

Third, this study finds that fairness opinions are not only used to negotiate higher takeover prices, but also to reduce litigation risks and facilitate successful transaction completion. This challenges the traditional view that fairness opinions serve solely to

support the proposed transaction price (Kisgen et al., 2009). In contrast, research by Boone et al. (2019) shows that merger negotiations are often conducted in the shadow of judicial review, which can affect the final outcome of the transaction.

Fourth, the selection of peers in M&A valuation is also influenced by litigation risk. Bhojraj et al. (2002) emphasize the importance of selecting the right peers to determine fair value. Eaton et al. (2022) show that peer selection can be influenced by various factors, including litigation risk. This suggests that companies should be careful in selecting peers to ensure accurate and fair valuation.

Fifth, this study also reveals that litigation risk has broad implications for academics, practitioners, and regulators. Understanding how this risk affects M&A valuations and outcomes can help in developing more effective policies and risk mitigation strategies (Boone et al., 2019). The study by Bebchuk et al. (1989) discusses how fairness opinions can be used as a tool to increase transparency and accountability in M&A transactions.

Sixth, Stewart's (2023) study highlights the importance of valuation rights and corporate disclosure during mergers and acquisitions. It suggests that increased disclosure can help reduce litigation risk by providing more complete information to shareholders. This study is in line with the findings of Bartell et al. (2017), who advocate the use of fairness opinions as a tool to increase shareholder confidence in M&A transactions.

Seventh, research by Officer (2007) shows that the performance-based arbitrage effect can be detected in the merger context, indicating that arbitrage strategies can be used to exploit valuation differences caused by litigation risk. This suggests that a better understanding of litigation risk can help investors develop more effective investment strategies.

Eighth, the study by Callahan et al. (2018) highlights how valuation arbitrage can affect shareholder value. They found that this practice can enhance shareholder value by ensuring that the valuation used in the transaction is fair and appropriate. This suggests that litigation risk can have a positive impact on shareholder value if managed well.

Overall, this discussion suggests that litigation risk plays a significant role in M&A valuation and has significant implications for a variety of stakeholders. By understanding

how this risk impacts M&A valuation and outcomes, companies can develop more effective strategies to manage risk and maximize value in these transactions.

CONCLUSION

This study highlights the significant role of litigation risk in merger and acquisition (M&A) valuations, particularly in the context of fairness opinions. Litigation risk is shown to influence valuation strategies by leading to lower valuations in fairness opinions, particularly when there is a significant agency conflict between target management and outside shareholders. These findings suggest that fairness opinions are used not only to negotiate higher prices, but also to mitigate litigation risk and facilitate successful transaction completion. Furthermore, regulatory changes, such as those in Delaware, suggest that dynamic legal environments can influence valuation strategies and increase awareness of litigation risk.

This study also reveals that peer selection in M&A valuation is influenced by litigation risk, which emphasizes the importance of proper peer selection to ensure accurate and fair valuation. Overall, these findings provide valuable insights for academics, practitioners, and policymakers in managing litigation risk and maximizing value in M&A transactions.

LIMITATION

Although this study provides in-depth insights into the role of litigation risk in M&A valuation, there are several limitations that need to be considered. First, as a literature study, this study relies on findings and data from previous studies, which may have their own methodological limitations. Second, although this study covers a wide range of literature sources, it is possible that some relevant studies were not identified or missed in the data collection process.

Third, the regulatory context discussed in this study, such as the changes in Delaware, may not be fully applicable to other jurisdictions, so the findings may not be fully generalizable to the international context. Finally, this study does not directly test the hypotheses through empirical data, so the results are more descriptive and interpretive.

For further research, it is recommended to conduct more in-depth empirical studies to test the hypotheses generated from this literature review, as well as expand the scope of the research to other jurisdictions to gain a more comprehensive understanding of the role of litigation risk in M&A valuation.

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