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Corporate Litigation and Debt

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Corporate Litigation and Debt

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Abstract

This study examines the effect of litigation risk and litigation costs on firms' credit ratings and debt financing. The results show that litigation affects a firm's creditworthiness and debt costs in two stages. Before a lawsuit filing, firms at higher risk of litigation have lower credit ratings, are more likely to be rated speculative grade, pay higher yields on loans and bonds, and are less likely to rely on debt financing. At the time of the lawsuit resolution, settlement costs have an additional effect on firm credit quality. Companies facing larger settlement disbursements in relation to their available cash experience a decline in credit ratings and an increase in yield spread. The results are robust to endogeneity concerns and different proxies of litigation risk.

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