Governance by Litigation*

Ian Appel†

January 2015

Abstract

This paper studies the role of shareholder litigation rights in corporate governance. To empirically identify the effects of shareholder lawsuits, I use the staggered adoption of universal demand (UD) laws in 23 states between 1989 and 2005. These laws impose a significant obstacle to lawsuits against directors and officers for breach of fiduciary duty. UD laws are associated with increased use of governance provisions (e.g., classified boards) that entrench managers or otherwise limit shareholder voice. I also document fewer institutional blockholders, changes to financial policies and CEO compensation, and impaired performance for firms subject to UD. Overall, my findings cast doubt on the notion that shareholder lawsuits primarily benefit attorneys rather than corporations or their shareholders.

JEL Classification: G34, G38, K22, K41

*I thank the members of my dissertation committee: Todd Gormley, Donald Keim, and Michael Roberts. I also thank Christine Dobridge, Erik Gilje, Itay Goldstein, Jessica Jeffers, Doron Levit, Hao Liang, Michael Lee, Jonathan Karpoff, Michelle Lowry, Jillian Popadak, Sang Byung Seo, Eric Talley as well as seminar participants at Wharton, Financial Research Association, Conference on Empirical Legal Studies at Berkeley, Olin Corporate Finance Conference, Academic Conference on Corporate Governance at Drexel, and LBS Trans-Atlantic Doctoral Conference. I thank Moshe Cohen and Todd Gormley for sharing data used in this paper. Grace Chung and Jeyhun Park provided research assistance. I gratefully acknowledge financial support from the Jacobs Levy Equity Management Center for Quantitative Financial Research. The title of this paper is borrowed from Chapter 10 of *Corporate Governance: Promises Kept, Promises Broken* by Jonathan Macey. All errors are, of course, my own.

†The Wharton School, University of Pennsylvania. ianappel@wharton.upenn.edu

A rich literature in financial economics studies inefficiencies arising from the separation of ownership and control. Factors that help to resolve agency problems include managerial labor markets (Fama (1980)), legal protections (La Porta, López de Silanes, Shleifer, and Vishny (1998)), and the market for corporate control (Grossman and Hart (1980)). However, shareholders generally exert little influence over these aspects of corporate governance. Rather, they are primarily confined to three fundamental rights associated with equity ownership: voice, exit, and litigation. While the voice and exit have recently received considerable attention in the literature (Edmans (2014)), the role of litigation in corporate governance remains unclear. In this paper, I study the effects of shareholder litigation rights on governance and other corporate policies.

I focus on a particular type of shareholder lawsuit, known as a derivative action, that alleges a breach of fiduciary duty by directors or officers.[1] Corporate law in the U.S. requires fiduciaries to exhibit prudent judgment (the duty of care) and refrain from self-serving conduct (the duty of loyalty). Derivative lawsuits serve as an *ex post* enforcement mechanism for these duties. Between 2000 and 2009, over 13% of firms in my sample were involved with derivative litigation. Yet, there are several reasons why the effects of these lawsuits on firms may be minimal, if not negative. First, shareholders may be able to adequately exert governance through alternative mechanisms (e.g., voice and exit), making litigation rights redundant. In addition, the "business judgment rule" largely shields managers from liability for corporate decisions. Even when not protected by this legal doctrine, directors and officers face a very small chance of personal liability due to the pervasive use of exculpatory charter provisions, indemnification contracts, and directors and officers (D&O) insurance (Black, Cheffins, and Klausner (2006)). Finally, financial recoveries from derivative lawsuits tend to be low while legal fees are often high. In fact, some critics maintain that the primary beneficiaries of litigation are lawyers rather than corporations or shareholders (Romano (1991)).

Others argue derivative lawsuits confer benefits that potentially outweigh their costs. First, most settlements include reform of corporate governance practices. In fact, such reforms are often the primary goal of litigation (Erickson (2010)). For example, a 2008 settlement from a derivative lawsuit against the directors of Schering-Plough implemented

[1]These lawsuits are called "derivative" because shareholders sue directors or officers on behalf of the corporation. Further institutional background is provided in the next section.

annual director elections and removed supermajority voting requirements, while a 2005 settlement involving OM Group featured the termination of the CEO and appointment of two shareholder-nominated directors. In addition to settlements, derivative lawsuits may confer the benefit of future deterrence by imposing non-pecuniary costs (e.g., reputational penalties) on directors and officers.[2] Such costs may, in turn, discourage certain behaviors by managers.

Quantitatively assessing the effects of derivative litigation poses a significant challenge. One possible empirical strategy is to match firms facing litigation to a control group. This approach suffers from two main drawbacks. First, lawsuits are not randomly assigned. While a matching strategy minimizes *ex ante* observable differences between groups, breaches of fiduciary duties are also inextricably linked to unobservable characteristics of managers (e.g., value of private benefits, sensitivity to reputational risk, etc.). Second, and perhaps more importantly, the matching strategy limits analysis to the realization of a lawsuit and cannot account for variation attributable to the deterrence function of litigation.

In this paper, I empirically identify the effects of litigation using variation generated by universal demand (UD) laws at the state of incorporation level. These laws impose a significant hurdle to derivative lawsuits. Specifically, UD laws require shareholders to seek board approval prior to initiating derivative litigation. The board rarely grants this approval, however, because lawsuits typically name the directors themselves as defendants. I use UD laws as the "treatment" in a difference-in-differences framework. The main specification includes firm, industry-year, and state-of-location-year fixed effects to control for time-invariant heterogeneity across firms and time-varying differences across industries (e.g., demand shocks) and headquarters locations (e.g., local economic conditions). This identification strategy addresses the two main shortcomings of the matching strategy. First, because UD laws are adopted at the state of incorporation level, they are largely unrelated to the characteristics of individual firms. Second, UD laws decrease the threat of future litigation and therefore account for deterrence effects.

I first show UD laws affect the incidence of derivative litigation. To do so, I assemble a database of over 900 derivative lawsuits involving public corporations using SEC filings

[2]Brochet and Srinivasan (2014), Ferris et al. (2007), Fich and Shivdasani (2007), Karpoff, Lee, and Martin (2008) provide empirical evidence of indirect costs associated with litigation. Helland (2006) finds contrasting results.

and other sources. I find UD laws are associated with a decrease in derivative litigation of approximately 0.7 percentage points, a drop of over one third relative to the sample mean. The magnitude of this effect is consistent with anecdotal evidence on the effect of UD laws discussed in the next section. I argue this estimate is, if anything, a lower bound on the change to the threat of future litigation.

Next, I turn attention to the effect of UD laws on the governance structures of firms. I use the entrenchment index proposed by Bebchuk, Cohen, and Ferrell (2009) as the primary governance outcome. I find UD laws are associated with about a 10% increase in the entrenchment index, indicating increased use of antitakeover provisions relative to the control group. The change in governance structures is largely driven by increased use of poison pills, supermajority voting requirements, and classified boards. I obtain qualitatively similar results for the GIM index (Gompers, Ishii, and Metrick (2003)), which considers a wider array of governance provisions. UD laws are also associated with a drop in the presence of large institutional blockholders. Additional evidence points to this being a consequence of the increased use of antitakeover provisions.

I also consider the effect of litigation on different corporate policies that are potentially sensitive to agency conflicts. First, UD laws are associated with a shift in the composition of CEO pay that reduces sensitivity to firm performance. Specifically, the ratio of cash compensation to total compensation increases by approximately 6%. However, this is offset by a decline in equity-linked compensation, leaving total pay unchanged. Second, I find evidence of a decline in share repurchases following UD, but no change in cash dividends. While this result may support the idea that managers retain cash to engage in "empire building," there is no change to measures of firm size or investment. Rather, I find lower debt issuance and book leverage, consistent with managers either attempting to reduce firm risk or otherwise lessen the disciplining effects of debt.

Finally, I show UD laws are associated with weaker accounting performance. Specifically, ROA declines by approximately 0.8 percentage points for firms subject to UD. Consistent with the idea that shareholder voice and exit may substitute for litigation rights, I find the drop in profitability is driven by firms with low institutional ownership. The effect is also stronger for small firms, which may have weaker external governance mechanisms (e.g., monitoring by regulators) and firms with high cash flows, which may be more prone to agency conflicts (Jensen (1986)).

The interpretation of the results rests on the assumption that the adoption of UD laws is independent of unobserved variables that influence corporate policies and outcomes. Political economy factors are of particular concern in this regard. For instance, it may be the case that firms incorporated in a particular state lobbied for the statutes in response to heightened risk of litigation. To address this concern, I restrict the sample of treated firms to Pennsylvania, where UD was implemented by the state supreme court in *Cuker v. Mikalauskas* (1997). The effects of lobbying are likely muted for this sample of firms since UD was not enacted by legislators as a matter of public policy, but by the courts for the sake of consistency with judicial precedent. This test yields results similar to the main analysis.

This paper builds on the literature that studies the effects of shareholder litigation. The bulk of this literature focuses on class action lawsuits (e.g., DuCharme, Malatesta, and Sefcik (2004); Hanley and Hoberg (2012); Hopkins (2014); Arena and Julio (2014); Lowry and Shu (2002)). Derivative litigation is the specific focus of Ferris et al. (2007). A related line of literature considers the effects of fiduciary duties and director liability on firm policies and stock returns (e.g., Becker and Strömberg (2012); Donelson and Yust (2014); Grinstein and Rossi (2014)). I contribute to this literature by offering a novel identification strategy to study litigation that accounts for its deterrence effects. My results suggest such effects influence multiple dimensions of corporate behavior and ultimately impair performance.

I also offer new insights into the broader literature on corporate governance. A voluminous literature studies the relation between governance indices and different corporate policies and outcomes (e.g., Bebchuk, Cohen, and Ferrell (2009); Chava, Livdan, and Purnanandam (2009); Cremers and Nair (2005); Gompers, Ishii, and Metrick (2003)). Other papers study factors that lead to firms implementing anti-takeover provisions in the first place (e.g., Schoar and Washington (2011); Field and Karpoff (2002)). I complement these papers by showing that the threat of litigation can also shape the governance structures of firms by restraining the adoption of provisions that entrench managers or otherwise limit shareholder voice.

Finally, this paper is related to previous work on the effects of antitakeover laws. In their seminal paper, Bertrand and Mullainathan (2003) argue business combination (BC) laws reveal managerial preferences to "enjoy the quiet life." Other papers have

analyzed the effect of BC laws on innovation (Atanassov (2013)), use of debt (Francis et al. (2010); Garvey and Hanka (1999)), executive compensation (Bertrand and Mullainathan (1999)), diversifying acquisitions (Gormley and Matsa (2014b)), payout policy (Francis et al. (2011)), and differential effects based on industry competition (Giroud and Mueller (2010)). This paper provides a new environment to study the nature of agency conflicts that arise from shocks to corporate governance. One advantage of UD laws is that their relatively recent enactment allows researchers to test the implications of different agency theories using datasets that do not overlap with the period most BC laws were adopted.

1 Institutional Background

A. Derivative Lawsuits

From a legal perspective, a corporation is a creature of statute that exists independently of its shareholders. Thus, if directors or officers engage in behavior that harms the corporation, the corporate entity itself can initiate litigation. A derivative lawsuit entails shareholders suing directors and officers on *behalf of the corporation* to address a breach of fiduciary duty. By way of example, suppose a manager wastes corporate assets by overpaying for an acquisition after failing to perform adequate due diligence. The primary recipient of harm from this action is the corporation because it (not the shareholders) was the owner of the wasted assets. Shareholders may be injured as well (e.g., by a lower stock price), but this injury is indirect in nature since it results from damage to the corporation. Therefore, in order to seek redress for this breach of fiduciary duty, shareholders can sue the manager derivatively on the corporation's behalf.[3] Derivative lawsuits address a wide range of transgressions by directors and officers. In a sample of lawsuits filed between 1982 and 1999, Ferris et al. (2007) find the most common allegations pertain to the duty of care (41%), the duty of loyalty (26%), mishandling corporate information (16%), and issues related to M&A (7%).[4] In Appendix B, I provide specific examples of derivative

[3]Allegations made in *In re Hewlett Packard Shareholder Derivative Litigation* related to HP's $10.3 billion acquisition of Autonomy match this general fact pattern. See: http://www.bloomberg.com/news/2014-02-19/hp-said-to-be-in-settlement-talks-over-autonomy-lawsuits.html.

[4]The authors note this is not necessarily representative of the composition of lawsuits in more recent years. Specifically, the "high water mark" for duty of care allegations came in the wake of the *Smith v. Van Gorkom* decision by the Delaware Supreme Court in 1985.

lawsuits from SEC filings.

Any financial recovery from a derivative lawsuit is paid to the corporate treasury; shareholders do not directly receive a payment. However, corporations typically provide directors and officers with D&O insurance policies that (in most cases) cover payouts related to shareholder litigation. Settlements are therefore circular in nature: they are paid on behalf of the directors and officers by the corporation's insurance policy back to the corporation. The benefit of such a settlement is potentially offset by higher future premiums. In addition, most states allow firms to adopt charter provisions that limit (or eliminate entirely) financial penalties for transgressions related to the duty of care. Thus, lawsuits alleging (gross) negligence by directors or officers are unlikely to result in a meaningful financial recovery.

Governance reform is also a key aspect of derivative lawsuit settlements. Erickson (2010) finds that over 80% of settlements include changes to governance practices, about half of which consist solely of governance reform without a cash payment to the corporation. Ferris et al. (2007) also document changes to the structure of boards (e.g., higher outside representation) following derivative lawsuits. In theory, such reforms may mitigate agency conflicts and outweigh the costs associated with litigation. It is unclear if this is the case in practice; Romano (1991) argues governance settlements are largely "cosmetic" in nature and simply serve as a way for the plaintiffs' bar to justify large fees.

While derivative lawsuits address harm to the corporate entity, class action lawsuits address direct harm to shareholders. Specifically, these lawsuits allege a violation of rights associated with equity ownership. For example, interference with the shareholder franchise constitutes direct harm to shareholders and would likely be grounds for class action litigation. Class actions often involve only a subset of all shareholders (e.g., those who purchased shares during some period) and are a response to a sudden drop in stock price. In contrast to derivative lawsuits, any financial recovery is paid to shareholders since they are the primary recipient of harm. Allegations related to acquisitions and federal securities laws are usually brought as class action lawsuits, though shareholders can (and often do) initiate parallel derivative claims. While there is a "gray" area between class action and derivative lawsuits, plaintiffs almost always prefer the former. This stems from the fact that derivative lawsuits involve a number of procedural hurdles, the most important of which (the "demand requirement") I discuss next.

B. Initiating a Derivative Claim

The "fundamental tenet" of corporate law holds that the board of directors manages the business and affairs of a corporation (Swanson (1992)). Under normal circumstances, the board alone has the power to initiate litigation on behalf of the corporation. Thus, prior to commencing a derivative action, shareholders must first demand that the board take corrective action (through litigation or other means) to address the alleged wrongdoing. This is known as the "demand requirement."[5] The board can, in turn, either accept or refuse the shareholder demand. However, this decision often poses a clear conflict of interest for directors. Specifically, derivative lawsuits usually name some (if not all) members of the board as defendants, so directors "almost inevitably" decide against proceeding with litigation (Swanson (1992)). While shareholders take control of the lawsuit if the board of directors wrongly refuses demand, courts generally review this decision under the deferential business judgment rule and rarely second guess the board's decision.

The futility exception to the demand requirement allows shareholders to usurp the board's power and initiate a derivative action without the approval of directors if the board cannot fairly evaluate the demand. The circumstances under which courts deem demand to be futile vary between states. Delaware courts use a two-prong test, articulated in *Aronson v. Lewis* (1984), requiring shareholders to allege "particularized facts" that cast a reasonable doubt on the directors being disinterested and independent or the challenged transaction being a valid exercise of business judgment. The fact that plaintiffs are not entitled to discovery at this point in the proceedings hinders these efforts. However, courts permit discovery once plaintiffs establish standing through demand futility. This, in turn, compels most boards to consider settling the claim. Shareholders almost always prefer to argue demand futility rather than make a demand because of courts' reluctance to overturn demand refusal.

Critics note several shortcomings of the demand futility doctrine. First, corporate law provides mechanisms to help conflicted boards maintain objectivity. For example, boards can appoint special litigation committees (SLCs) consisting of independent and disinterested directors to evaluate demand requests and determine whether litigation be-

[5]While derivative lawsuits can be filed in both state and federal courts, the Supreme Court has ruled that the demand requirement for cases filed in federal court is determined by a firm's state of incorporation (*Kamen v. Kemper Financial Services* (1991)).

hooves the corporation. Second, the demand requirement allows boards to take corrective action rather than immediately proceed with litigation. The exhaustion of intra-corporate remedies therefore serves as a "safeguard against strike suits" (*Aronson v. Lewis* (1984)). Finally, the futility exception propagates inefficiency from the perspective of judicial economy. Due to its ambiguous nature, demand futility engenders "gobs of litigation" (*Kamen v. Kemper Financial Services* (1991)). Most of this litigation focuses on the issue of demand futility rather than the alleged breach of fiduciary duty by directors or officers of the corporation (Swanson (1992)).

C. Universal Demand Laws

In response to criticisms over the demand futility doctrine, 23 states have implemented UD: the earliest were Georgia and Michigan in 1989, and the two most recent were Rhode Island and South Dakota in 2005. Table 1 reports the full list of states of incorporation along with corresponding effective year and statute reference. Most of these states adopted the UD concept from a proposal offered by the American Bar Association (ABA) in the Model Business Corporation Act (MBCA), a model set of corporate laws followed (at least in part) by many states. The MBCA requires shareholders to make demand in every case unless irreparable harm to the corporation would ensue. If demand is refused by the board, courts can only review whether this decision constituted valid business judgment (Pinto and Branson (2013)).[6] Kinney (1994) notes "the effect of the MBCA approach is that if a majority of the board or committee is independent - and the corporation is likely to have ensured that it is - then the court will dismiss the derivative suit." Thus, commentators widely regard UD as a significant obstacle to derivative litigation. In a case study of 3 states that adopted UD, Davis (2008) concludes that the provision weakens the deterrence function of derivative litigation. Others use stronger language. For instance, some declared UD would "probably make derivative litigation impossible to maintain in all cases" (*NY Times*, 11/29/93), while others called it "a death knell" for derivative lawsuits (*ABA Journal,* March 1994).

[6]The American Law Institute (ALI) proposed a different UD standard. Specifically, the judicial standard (and deference afforded to the decision of directors) depends on the nature of allegations. Pinto and Branson (2013) state this approach is less pro-defendant than the MBCA rule, yet still stricter than the approaches used in Delaware and other states without UD. In addition, the language in Florida's statute differs from the MBCA but has similar implications.

UD is largely a nonpartisan issue: of the 23 states with UD, ten had Democratic majorities in both houses of the legislature at the time of adoption, seven had Republican majorities in both houses, four had a mixed legislature, and one (Nebraska) has a nonpartisan legislature. In the final state (Pennsylvania), UD was implemented by the state supreme court. One potential concern for this analysis is confounding policies that may be correlated with UD laws. The relatively uniform distribution of legislator ideologies allays such concerns. However, firms and other interest groups did lobby for the laws as a means to curb frivolous litigation. For instance, New York Governor Mario Cuomo only supported UD "after getting a personal lobbying pitch from Jack Welch, Chairman of General Electric." But, members of the New York State Assembly "put off action on the bill. . . after consumer advocate Ralph Nader attacked the measure" (*ABA Journal*, March 1994). These anecdotes suggest the passage of UD laws may be endogenously related to lobbying efforts by firms or other interest groups. Throughout the paper, I take a number of steps to address this issue.

Davis (2008) provides evidence that UD laws affect conduct (self-dealing) that could be targeted by derivative litigation. Specifically, in a sample of 77 corporations, median CEO compensation increased 22% and related party transactions increased 19% in the two years following the enactment of universal demand laws relative to the prior two years. Examples of transactions documented in this study include the following:

> *Opening a corporate office in Pakistan, the residence of the company's chairman and controlling shareholder (Burke Mills Inc.); the $4.5 million sale of a company to an entity controlled by the chairman of the board (Cash America International); regularly housing management trainees and other employees at hotels co-owned by the CEO (Food Lion Corp.); cash advances to the controlling shareholder and a diverse range of business dealing with his son in law (Ingles Markets, Inc.); and $200,000 in payments for using a controlling shareholder's aircraft.* (Davis (2008))

The author notes these transactions are not necessarily improper and perhaps even benefit the respective corporations. However, the findings suggest UD laws have a discernible effect on aspects of managerial behavior that may be deterred by derivative litigation.

2 Hypothesis Development and Methodology

2.1 Hypothesis Development

From a theoretical perspective, the role of shareholder litigation rights in corporate governance is unclear. One possibility is that alternative governance mechanisms serve as substitutes for derivative litigation, muting (if not eliminating entirely) its effects. For example, recent papers show blockholders can exert governance through both "voice" and "exit" (Edmans (2014)). This line of literature argues direct intervention (e.g., a proxy fight) and the credible threat of selling shares are important mechanisms for disciplining managers. However, engaging in voice and exit can be costly. For example, Gantchev (2013) estimates the costs of a campaign ending in a proxy fight to be over $10 million. In addition, selling a large bloc of shares may entail significant transaction costs. Theories of voice and exit are also predicated on the presence of at least one large shareholder in the first place, and their effectiveness may be limited if ownership is more dispersed. If these mechanisms are either too costly or otherwise ineffective, litigation may be a viable recourse for shareholders to enforce fiduciary duties. This idea is further supported by the fact that plaintiffs' attorneys generally work on a contingent fee basis, thereby limiting the costs borne by shareholders and reducing free-rider problems that may otherwise discourage direct intervention.

Firms are also subject to various external governance forces that may substitute for derivative lawsuits' role in enforcing fiduciary duties. A particularly important mechanism for the purpose of this paper is oversight by outside entities. In the U.S., the Securities and Exchange Commission (SEC), Department of Justice (DOJ), stock exchanges, and the press all play a role in policing the behavior of managers. The penalties imposed by these organizations may serve as a substitute for private litigation. However, there are reasons to suspect that this substitution effect is imperfect. Specifically, the incentives and abilities of external organizations to monitor managerial behavior are likely lower than that of shareholders. This is particularly true for smaller firms, which are less likely to be closely monitored by the press and regulators (Davis (2008)).

If alternative mechanisms are not perfect substitutes, derivative lawsuits may help to enforce fiduciary duties and thereby affect different dimensions of corporate behavior. Many of these behaviors (e.g., shirking by managers) are not directly observable. However,

one dimension that is observable is the governance structures of firms. Derivative lawsuit settlements largely center on governance reforms, so one may naturally expect litigation to be associated with future changes to governance. However, litigation may also affect governance through indirect channels. Specifically, derivative lawsuits may serve a deterrence function if they impose non-pecuniary costs (e.g., reputational penalties) on directors and officers. This function potentially operates through two different channels. First, because governance reform is often one of the main goals of derivative litigation, shareholders may be less likely to initiate litigation (all else equal) if a firm already has "best practice" governance policies in place. This may lead managers (especially those facing a high risk of litigation) to implement such policies in an attempt to preempt lawsuits over unrelated matters.[7] Second, while the corporate codes of every state permit the use of defensive governance provisions, directors are not afforded unlimited discretion in their use. If governance provisions are deployed with the primary goal of entrenching directors and officers rather than defending the corporation's interests, shareholders may have cause to initiate litigation.[8] Thus, the use of these provisions may be discouraged if heightened litigation risk is costly for directors or officers.

Changes to the governance structures of firms may influence other dimensions of corporate behavior. For example, Bertrand and Mullainathan (1999) argue that managers have some discretion over their wages, and the compensation of uncontrolled managers will increase beyond competitive levels. In addition, a number of theories posit that managers prefer to reduce payouts to shareholders so as to increase cash at their disposal (e.g., Easterbrook (1984); Jensen (1986); Zwiebel (1996)). The motives for reducing payouts could result from several different agency conflicts. For example, managers may want to undertake unproductive investments from which they derive personal benefit (i.e., engage in "empire building"), decrease the risk associated with their undiversified human capital,

[7]Anecdotal evidence supports this claim. For instance, in the 2008 "What Directors Think" survey from Corporate Board Member and PricewaterhouseCoopers 56% of directors of public companies state they think good corporate governance affects the likelihood they will be named in litigation, and 66% believe it affects the odds they will be exonerated. In contrast, just 27% of directors think good corporate governance has an effect on stock price.

[8]Mathias et al. (2014) note that that in derivative lawsuits a common "entrenchment-type claim involves an attack on the adoption or refusal to modify 'poison-pill' plans or director retention plans that make it difficult for a hostile takeover attempt to succeed, or other defensive actions taken by the board of directors... The relief sought in these types of cases is the nullification or modification of the challenged takeover defense mechanism." See *Crandon Capital Partners (derivatively on behalf of Willamette Industries) v. Shelk* (2005) for an example of such allegations.

or to lessen the disciplining effects of debt.

While the direct and deterrence effects of derivative lawsuits may help to align the incentives of shareholders and managers, it is not necessarily the case that they improve corporate performance. This stems from the fact that litigation imposes direct costs on firms (e.g., D&O insurance premiums, legal fees, distraction to managers). In addition, lawsuits may impose indirect costs such as deterring managers from pursuing risky ventures that increase litigation risk. Thus, the effect of shareholder litigation rights on firm performance is ultimately an empirical question. In any case, the role of alternative governance mechanisms discussed above suggests that the benefits of derivative lawsuits may be most apparent for firms in which voice and exit are weaker mechanisms or which are subject to less scrutiny from outside entities.

2.2 Empirical Methodology

I use UD laws as a quasi-natural experiment to study the effects of derivative lawsuits. The difference-in-differences specification is given as follows:

$$y_{ijkst} = \beta UDLaw_{st} + \theta_i + \gamma_{jt} + \delta_{kt} + u_{ijkst}.$$

The dependent variables for firm i in industry j, state of location k, state of incorporation s, and year t are denoted by y_{ijkst}. $UDLaw_{st}$ is an indicator for whether a firm is incorporated in a state that has a UD law at time t. The coefficient on the indicator (β) is the difference-in-differences estimate (i.e., the average effect of UD laws for the treated group relative to the control). I include firm (θ_i), industry-year (γ_{jt}), and state-of-location-year (δ_{kt}) fixed effects in the main specification to control unobserved heterogeneity. The treatment group in this experimental design consists of firm incorporated in states with UD laws. One benefit of this setting is that the "events" are staggered over time. Thus, the control group consists of both firms in states that never have UD laws as well as firms incorporated in states that eventually have UD. For example, when firms in North Carolina are treated in 1995, firms in Pennsylvania (treated in 1997) serve as a control. This structure helps to reduces noise and biases that may be present when drawing inferences from a single event (Roberts and Whited (2010)).

As a falsification test, I examine whether UD laws have an "effect" prior to their implementation. Specifically, I use the following specification to examine dynamic coefficient trends::

$$y_{ijkst} = \beta_1 UDLaw(-1)_{st} + \beta_2 UDLaw(0)_{st} + \beta_3 UDLaw(+1)_{st} + \beta_4 UDLaw(2+)_{st} + \theta_i + \gamma_{jt} + \delta_{kt} + u_{ijkst}.$$

Here $UDLaw(-1)_{st}$ is an indicator for one year prior to the effective year, $UDLaw(0)_{st}$ is an indicator for the effective year, etc. If UD laws have a causal effect on different firm policies and outcomes, the effect should occur following the implementation of the law, not before. In other words, the coefficient for $UDLaw(-1)_{st}$ should be statistically indistinguishable from zero and the effect should be driven by later years.[9]

I do not include industry adjusted variables in the above specifications because such controls lead to inconsistent estimates (Gormley and Matsa (2014)). Rather, I use fixed effects to control for time-invariant unobserved heterogeneity within firms and time-varying heterogeneity across industries (e.g., demand shocks) and headquarters location (e.g., local economic conditions, political economy factors). Industry-year fixed effects are constructed using 3-digit SIC codes. For convenience, I refer to state-of-location-year fixed effects simply by state-year. It is important to note that it is not possible to include state-of-incorporation-year fixed effects in the above specifications as this would be perfectly collinear with $UDLaw_{st}$. I report multiple specifications for the main results, including firm fixed effects with year fixed effects and firm fixed effects with industry-year fixed effects. The small sample sizes for some robustness tests in this paper make using higher dimensional fixed effects impractical. These instances will be noted as they arise.

I do not control for firm level characteristics (e.g., accounting variables) in the regressions. Such controls may be affected by UD laws, and including them would result in an inconsistent estimate of treatment effect. However, in unreported analysis I find qualitatively similar results when standard firm-level controls are included in the specification. Following Bertrand and Mullainathan (2003), I use robust standard errors clustered at the state of incorporation level.

[9]It should be noted that, in most cases, the effective year is the same as the enactment year for UD laws. However, in a few cases the enactment year comes after the effective year.In these cases, UD laws may affect firm behavior prior to implementation. However, the results reported in Section 4 suggest this is not a significant concern for my analysis.

3 Data and Summary Statistics

3.1 Data

A. Main Sample and Construction of Independent Variable

The sample consists of firms in the Compustat-CRSP merged database between 1985 and 2009. I omit financials (SIC 6000 – 6999), utilities (SIC 4900 – 4999), and public administration/non-classifiable firms (SIC 9000 – 9999). I drop firms with missing or zero values for sales or market capitalization. In addition, I limit the sample to firms with greater than $20 million in assets to mitigate the effects of small firms on outcome variables normalized by total assets. The final sample consists of 79,049 firm-year observations. I use Compustat-CRSP to construct a number of variables related to corporate policies and outcomes. These measures are defined in Table A.1. All accounting variables are winsorized at the 1/99% levels.

The main explanatory variable in this paper is an indicator for whether a firm is incorporated in a state that has a UD law. However, using the incorporation state reported by Compustat introduces measurement error into the empirical design because only the most recent state of incorporation is reported. Thus, firms will be incorrectly classified into the "treatment" group if they recently re-incorporated to a state with UD from one without. The measurement error induced by this misclassification will not result in biased or inconsistent estimates as long as it is not correlated with the explanatory variables. However, this assumption may not hold if some firms endogenously choose to re-incorporate to states that offer a higher level of protection from shareholder litigation. To address this problem, I use the historical state of incorporation as determined by Gormley and Matsa (2014b) to construct the independent variable. The historical state of incorporation is identified using data from Cohen (2012), SEC Analytics, and a legacy version of Compustat. I use the current state of incorporation for post-2006 observations not covered by this dataset. While I do not find strong evidence of UD laws influencing re-incorporation decisions, I drop observations for firms that change states of incorporation to account for the possibility that heightened protection from litigation may influence this decision for some firms. This has little effect on the main results; consistent with previous findings (e.g., Bertrand and Mullainathan (2003); Gormley and Matsa (2014b)),

the current state of incorporation differs from the historical state of incorporation for fewer than 5 percent of firm-year observations in my sample.

B. Litigation Variables

An important aspect of this paper is measuring the incidence of derivative litigation. One institutional factor that complicates this task is the fact that such actions can be initiated in both state and federal courts. Although there are centralized databases for cases filed in federal court, this is not the case for state courts. Furthermore, electronic databases for individual state courts often do not extend far back into the sample (e.g., Delaware Chancery filings can be searched from 2000 onwards). One potential solution offered by the literature is to use legal databases to search for cases that resulted in a written judicial opinion. However, this potentially imposes a bias as some courts (most notably, federal courts and the Delaware Chancery) issue more written opinions than others (Armour, Black, and Cheffins (2012)).

I assemble a database of derivative lawsuits using two sources: Audit Analytics and SEC filings. The Audit Analytics litigation database contains derivative lawsuits filed in federal courts after 2000. I require lawsuits to be classified as both "derivative" and "stockholder suits" to be included in my final sample. After merging with the main sample, this yields a total of over 300 derivative lawsuits filed in federal courts for firms in my sample. Approximately two-thirds of these cases are between 2005 and 2007, consistent with the observation by Erickson (2010) that derivative lawsuits pertaining to option backdating during this period were often filed in federal courts.

There are two shortcomings of relying solely on Audit Analytics to measure derivative litigation. First, the sample starts in 2000, after the majority of states implemented UD. This is problematic since the difference-in-differences methodology used in this paper requires both "pre-treatment" and "post-treatment" periods. Second, Audit Analytics is limited to cases brought in federal courts and significantly underestimates the prevalence of derivative lawsuits. To address these shortcomings, I perform a keyword search of SEC filings using the WRDS SEC Analytics Suite starting in 1994 to identify annual reports, quarterly reports, proxy statements that discuss derivative litigation. Specifically, I search for the terms "derivative lawsuit", "derivative action", "derivative litigation", and "derivative suit." I then read each document to find the date litigation was filed on

behalf of the firm and to exclude uses of these terms in contexts besides the filing of a lawsuit. Firms provide varying degrees of additional information about derivative cases in SEC filings. While some detail specific allegations and settlement agreements, others only vaguely reference allegations and do not provide details on case outcomes. For this reason, I do not attempt systematically collect additional information on the allegations or outcomes of individual cases. Firms often use ambiguous terms (e.g., "shareholder lawsuit") rather than specify the exact nature of the claim in SEC filings. I do not include these instances in the sample. Combining with the Audit Analytics sample yields a total sample of over 900 derivative lawsuits involving firms in my sample.

Data on class action suits are from the Stanford Securities Class Action Clearinghouse, which includes records for all class action lawsuits filed by shareholders after 1995. I use this database to construct an indicator variable that equals one when a class action lawsuit is filed against a firm.

C. Corporate Governance Variables

Measuring corporate governance is another challenging aspect of this paper. The influence afforded to shareholders to control managerial decisions is based on a confluence of internal and external factors and cannot be fully captured by a single measure. The use of antitakeover provisions is one dimension of corporate governance that is both quantifiable and indicative of an agency conflict. Thus, following the governance literature, I use the GIM (Gompers, Ishii, and Metrick (2003)) and entrenchment (Bebchuk, Cohen, and Ferrell (2009)) indices as measures of corporate governance. The GIM index consists of 24 governance provisions, while the entrenchment index consists of a subset of six provisions most frequently targeted by nonbinding shareholder resolutions. The data are obtained from Riskmetrics (ISS). Due to methodological changes in the updated version of database, I restrict attention to the legacy version, which (approximately) covers S&P 1500 firms in alternating years between 1990 and 2006. Following standard practice in the literature, I fill in missing entries with the previous observation to facilitate the analysis of dynamic coefficient trends.

Previous papers (e.g., Bhagat, Bolton, and Romano (2008); Klausner (2013)) express skepticism regarding whether some governance provisions have a meaningful impact on managerial entrenchment. For instance, Klausner (2013) argues that several governance

provisions contained in the GIM index either have no effect on managerial entrenchment or do so only under very limited circumstances. However, by construction, the entrenchment index contains the provisions which "have systematically drawn substantial opposition from institutional investors" (Bebchuk, Cohen, and Ferrell (2009)). Adopting these provisions is therefore costly for managers and indicative of an agency conflict. For this reason, I use the entrenchment index as the primary measure of corporate governance in this study, though I show the GIM index yields qualitatively similar results.

The entrenchment index consists of indicators for six governance provisions that shareholders most frequently target through non-binding shareholder resolutions. Two of these provisions – poison pills and golden parachutes – are regarded as defenses against hostile takeovers. Poison pills allow shareholders to purchase shares at a discount if the holdings of a blockholder exceed a specified threshold. Golden parachutes provide payouts to management in the event of a change in control. The board of directors can normally implement these governance provisions without shareholder approval. The other four provisions set limits on shareholder voting rights. First, classified boards have varying term lengths for directors. This provision may entrench directors since a dissident shareholder cannot gain control of the board in a single election. Second, supermajority voting for mergers moves the threshold of shareholder votes to approve a merger above the normal 50%. Similarly, limits on shareholder amendments to the bylaws and charter require shareholder votes to exceed a threshold above 50% to change these corporate documents. The provisions related to shareholder voting rights are often stipulated in the corporate charter, thus requiring a shareholder vote to amend.

D. Other Outcomes

Institutional ownership data are firm from the Thomson Reuters 13F stock ownership summary. Specifically, this database provides the percentage of outstanding shares owned by institutional investors and the holdings of the largest institutional investor. I drop observations for which the total institutional ownership is greater than one. I create a blockholder indicator that equals one if the holdings of the largest institutional owner exceed 10% of shares outstanding. In addition, I create an indicator for blockholder entry that equals 1 if a firm does not have a blockholder at time *t-1* but does at time *t.* The indicator for blockholder exit is analogous. I restrict the sample for blockholder entry

and exit to five years after the adoption of UD laws for treated firms because, over long periods, blockholder entry rates will necessarily influence blockholder exit. However, this is less of a concern over a shorter time frame.

CEO compensation data is from Execucomp. The data are available annually for S&P 1500 firms starting in 1992. I identify CEOs in Execucomp using a combination of the "ceoann" variable and the provided start/end years for firm CEOs. If "ceoann" and start/end years identify multiple CEOs for a given firm-year observation, I defer to the Execucomp classification. I calculate CEO cash compensation as the sum of salary, bonus, long-term incentive pay (LTIP), and other compensation (e.g., tax reimbursements, severance payments, etc.).[10]

3.2 Summary Statistics

Summary statistics for the main outcomes analyzed in this study are reported in Table 2. Panel A provides the number of observations, mean, standard deviation, and 25th/50th/75th percentile values. Of particular interest in this table is the prevalence of derivative litigation. Derivative lawsuits are filed in approximately 1.9% of all firm-year observations. The incidence of class action lawsuits is higher on average (2.8%). There is some overlap between the filing of derivative and class action suits; 36% of firms subject to a derivative lawsuit are also subject to a class action lawsuit in the same year. This statistic is consistent with the idea that there is often a "gray" area between derivative and class action lawsuits, and certain forms of corporate malfeasance may engender both forms of litigation.

Figure 1 plots the fraction of firms subject to derivative and class action lawsuits between 1996 and 2009. The higher frequency of class action lawsuits is primarily driven by a flurry of securities lawsuits in 2001. In that year alone, class action suits were filed against almost 8% of the firms in my sample. In contrast, derivative lawsuits peaked at approximately 5% of the sample in 2006, with over 150 derivative actions relating to options backdating practices (Armour, Black, and Cheffins (2012)). Class action lawsuits

[10]Due to a methodological change in Execucomp, I follow the standard practice of setting options equal to "option_awards_blk_value" pre-2006 and "option_awards_fv" post-2006. Similarly, stock awards are given by "rstkgrnt" pre-2006 and "stock_awards_fv" post-2006. The variables related to cash compensation do not change across time periods.

do not see a corresponding increase stemming from backdating allegations. Rather, the figure indicates a nadir in class action litigation in 2006.

Panel B compares the pre-treatment values for firms incorporated in UD states ("eventually treated") and those incorporated elsewhere ("never treated"). Specifically, the panel reports the mean value for each group for the first three years data are available during the sample. Any firm-year observations treated before or during this period (as is the case when the data do not span the entire period of analysis) are excluded. The first column restricts the sample to firms incorporated in states that do not have UD at any point during the sample. Column (2) restricts the sample to firms incorporated in states that have UD at some point during the sample. Column (3) reports the p-value from the paired t-test comparing these values, adjusted for clustering at the state of incorporation level. Standard deviations are reported in parenthesis. Overall, firms in the two groups are similar along a number of observable dimensions prior to treatment. In particular, both treated and control firms are subject to similar levels of class action and derivative lawsuits. The firms in both groups also have similar governance structures prior to treatment; the mean value of the entrenchment and GIM indices are not statistically different (p-values for the paired t-test are 0.22 and 0.84, respectively). The mean values for the blockholder indicator, CEO compensation, and accounting variables (ROA, capex, log(PP&E), net debt issuance etc.) are also similar across both groups. Overall, these statistics suggest the treated and control firms are similar along a number of observable dimensions prior to UD laws. In the robustness section, I perform additional tests to assuage concerns regarding unobservable differences between the groups that could pose a challenge for empirical inference.

4 Results

4.1 Litigation

Anecdotal evidence suggests UD presents a significant obstacle to derivative litigation and may discourage the use of this legal mechanism. The difference-in-differences results reported in Table 3 confirm this intuition. The dependent variable in this table is an

indicator for derivative litigation. This variable is available starting in 1994 (the first year electronic SEC filings are available), so the sample of treated firms consists of those incorporated in states treated after this year. The specification in column (1) includes the UD indicator along with firm and year fixed effects. Column (2) uses firm and industry-year fixed effects. Finally, column (3) reports results for the specification that includes firm, state-year, and industry-year fixed effects. The estimated coefficients range from -0.68 to -0.76 percentage points and are statistically significant at the 5% level or lower. In terms of economic magnitude, UD laws are associated with a decline in derivative lawsuits of approximately one third relative to the sample mean. Column (4) reports the coefficient trend. The coefficients for UD(-1) and UD(0) are statistically indistinguishable from zero. Consistent with a causal interpretation of the results, the estimates one and two or more years after the effective date are negative and statistically significant at the 10% and 1% levels, respectively.

In some respects, these estimates may serve as a lower bound on the threat of derivative litigation. Anecdotal evidence suggests that many lawsuits initiated in UD states are either dismissed for failure to make a demand if the plaintiffs argue demand futility, or refused by the board if a demand is made. Some commentators speculate that judges may be more lenient in allowing other forms of shareholder litigation because of this. However, in unreported results, I do not find evidence of such an effect. Specifically, I use an indicator for class action litigation as the dependent variable for the main specification with firm, industry-year, and state-year fixed effects. The coefficient of -0.001 (standard error=0.005) is neither statistically nor economically significant. This is consistent with the idea that shareholders prefer to launch class action lawsuits if this is a viable alternative, so restrictions on shareholder derivative litigation have little relevance for class actions.

4.2 Governance

A. Governance Indices

Table 4 report the effect of universal demand on the entrenchment index. The estimated coefficients range from approximately 0.22 to 0.29, implying an increase (i.e., higher use of antitakeover provisions) of over 10% relative to the sample mean. Column (4) reports the dynamic coefficient trend. The bulk of the effect occurs in the year following the

effective date. However, the timing of this increase should be viewed with caution because governance data from Riskmetrics is only available for alternating years; the increase in the entrenchment index may (at least partially) have occurred during the effective year. Figure 2 shows the coefficient trend for 4 years before and after treatment. Each point in this figure can be interpreted relative to year zero (the omitted year). While the "parallel trends" assumption cannot be proven, this figure suggests the documented results are not driven by an upward trend in the variable in the years before UD.

Table A.2 reports results for the GIM index. The coefficients range from 0.32 to 0.48, implying an increase of about 4% relative to the sample mean. Consistent with the notion that the GIM index contains some provisions subject to less opposition from shareholders, the estimates reported in this table are statistically noisier, and the specification in column (3) is not significant at conventional levels. The smaller economic magnitude of this effect also may partially stem from the inclusion of some variables in the GIM index that are not plausibly affected by UD (e.g., previously enacted state laws).

Table 5 reports estimates for the individual governance provisions in the entrenchment index, as well as for the use of blank check stock. The results indicate significantly higher use of poison pills (11 percentage points) following the adoption of a UD law. This result is significant at the 10% level, and accounts for over a third of the increase in the entrenchment index. In column (2), I also find an increase in the use of blank check stock, a variable not included in the entrenchment index. The presence of these shares allows boards to implement a poison pill without shareholder approval, and is arguably a more meaningful outcome than the actual presence of a pill (Cremers and Nair (2005)). The results for classified boards and supermajority voting requirements are also positive and statistically significant at the 10% and 5% levels, respectively. Although economically significant (6 percentage points), the estimated increase in golden parachutes is statistically noisy. Interestingly, the point estimates for provisions that limit shareholders' ability to change the corporate bylaws or charter are negative, though both are not statistically significant. The increased use of some provisions (e.g., classified boards) may seem inconsistent with the fact that they require ratification from shareholders and cannot be adopted unilaterally by the board. It is important to remember, however, that the changes are interpreted relative to the control group and may reflect a lower likelihood of removing a provision rather than actively implementing it. Consistent with this, in unreported anal-

ysis I find that the change in classified boards is driven a drop in declassifications rather than an increase in the implementation of new classified boards for firms incorporated in UD states. The effect is particularly strong for the second half of the sample, which coincides with the period when shareholders began to push firms to implement annual elections for directors.

As discussed in Section 2, UD laws may affect the use of antitakeover provisions through two channels. First, the drop in the prevalence of litigation may lead to fewer settlements containing governance reforms. Second, weakened deterrence effects may lead managers to deploy governance provisions for the purpose of entrenchment or otherwise limiting shareholder voice. While it is not clear how to empirically disentangle these effects, evidence suggests the findings can at least partially be attributed to the deterrence function of litigation. Specifically, Figure 2 shows that there is an abrupt jump in the use of antitakeover provisions in the first 2 years of UD. It is unclear if this effect is driven by behavior in the effective year, the year after, or some combination of the two because governance data is only available in alternate years during the sample period. However, because derivative lawsuits are relatively rare (about 2% of firm-year observations) and not all suits end with settlements containing governance reforms, it is unlikely that the observed effect can be entirely attributed to the lower incidence of derivative litigation after the adoption of UD.

B. Blockholders

Next, I turn attention to the effect of UD laws on the presence of large blockholders, an important component of corporate governance due to their incentives to monitor and ability to exert governance through voice and exit. The direction of the effect of UD on blockholders is ambiguous. On the one hand, derivative lawsuits help to mitigate free-rider problems that traditionally arise with shareholder interventions because attorneys usually take these cases on a contingency fee basis. Thus, restrictions on shareholder litigation rights may increase incentives to monitor and form large blocks. On the other hand, the use antitakeover provisions documented above may directly affect the ability of shareholders to accumulate large blocks, or otherwise discourage the formation of large stakes by making an eventual takeover more costly.

The dependent variable in Panel A of Table 6 is an indicator for the presence of

an institutional blockholder owning more than 10% of outstanding shares. UD laws are associated with a decline in blockholders of approximately 4 percentage points. Column (4) shows the dynamic coefficient trend. The coefficient for one year prior to the effective year is small and not statistically different from zero, but the coefficients corresponding to $UDLaw(0)$ and $UDLaw(+1)$ are economically large (approximately 7 percentage points) and statistically significant at the 1% level. The point estimate for $UDLaw(2+)$ is smaller in magnitude but remains statistically significant at the 5% level. From a theoretical standpoint, however, the 10% threshold used to define blockholders is arbitrary. Thus, in Table A.3 I examine the effect for alternative variables pertaining to institutional ownership. The dependent variable in columns (1) - (3) is the size of the largest shareholder (as a percentage of shares outstanding). The estimates suggest a drop of about 0.5 percentage points, or 6% relative to the sample mean. However, columns (4) - (6) report no change in total institutional ownership, suggesting the effect is concentrated amongst large shareholders.

The decrease in blockholders could plausibly result from an increase in exit or a decrease in entry. Specifically, the elevated use of antitakeover provisions documented above may make future takeovers more costly for blockholders owning "toe-holds" in firms and lead to an increase in exit. This effect may also discourage blockholder entry by reducing the option value of a potential takeover. Further, the use of poison pills may mechanically affect blockholder entry by effectively barring the formation of new stakes above a specified level. Panel B of Table 6 sheds light on whether this result stems from blockholder entry or exit. The dependent variable in columns (1) - (3) and (4) - (6) are indicators for blockholder entry and blockholder exit, respectively. I restrict observations to 5 years after the implementation of UD laws for treated firms because, in the long-run, changes in blockholder entry will mechanically affect blockholder exit. The results indicate the drop in blockholders is driven by a decrease in blockholder entry. This, combined with the fact that there is no change in institutional ownership, suggests a potential link to the use of poison pills. Specifically, Bebchuk and Jackson (2012) report that most poison pills have thresholds of 10% or 15% and effectively bar the formation of new blocks above these levels but have no effect on smaller blocks. Thus, the results suggest the deployment of antitakeover provisions may affect the ownership structures of firms.

In sum, UD laws are associated with changes to two important dimensions of corpo-

rate governance. First, I document an increase in the use of antitakeover provisions that are generally opposed by shareholders. In addition, I find UD laws are associated with a decrease in large blockholders. Given that incentives to monitor are increasing in block size, this suggests weaker oversight by at least some shareholders.

4.3 Corporate Policies

A. CEO Compensation

I next consider the effect of UD laws on CEO compensation. Previous papers (e.g., Bertrand and Mullainathan (1999, 2003)) document an effect of governance shocks on the level of CEO compensation. In contrast to this, I find a change in the composition of pay but not the level. The results are reported in Panel A of Table 7, where the dependent variable is the ratio of cash compensation (defined as the sum of salary, bonus, long-term incentive pay, and other pay) to total compensation. Because Execucomp starts coverage in 1992, the treated sample consists of firms incorporated in states that implement UD after this year. I find that UD laws are associated with an increase of 2.5-3.9 percentage points in cash compensation, or about 6% relative to the sample mean. The estimates are significant at the 5% level or lower for specifications (2) and (3), but not statistically significant at conventional levels for the first specification (p=11%). This increase is offset by a decline in equity-based compensation, and the level of total pay is unchanged. Panel B reports the estimates for the individual components of pay normalized by total compensation. While these point estimates are statistically noisy, they paint a consistent picture. In particular, the coefficients for different types of cash compensation are all positive, while those for stock based and options based compensation are negative, with the effect on options statistically significant at the 10% level.

Previous research indicates that cash-based compensation, even forms nominally linked to firm performance (e.g., bonuses), exhibits less sensitivity to changes in shareholder wealth than equity-based compensation (e.g., Murphy (1999)). Thus, the results suggest boards implement weaker incentives for CEOs following the adoption of UD laws. While I cannot disentangle whether this results stems directly from lower risk of litigation or increased use of antitakeover provisions, this finding is consistent with the view that weaker governance arrangements provide leeway for executives to influence aspects of their

own pay. Specifically, risk averse CEOs prefer higher cash compensation because their human capital is tied to firms (Bebchuk and Fried (2003)). Thus, the results are consistent with worsening agency conflicts associated with UD laws.

B. Financial Policies

An extensive literature studies the effects of agency conflicts on payout policy (e.g., Easterbrook (1984); Jensen (1986); Zwiebel (1996)). These theories posit that managers want to reduce payouts to shareholders in order to increase cash at their disposal. Evidence of behavior consistent with this is presented in Table 8. The dependent variables are share repurchases (defined as total share purchases minus changes in preferred stock) and cash dividends. Both variables are normalized by total assets. The effect on repurchases is negative and statistically significant at the 5% level for the specifications in columns (1) and (2), respectively. The point estimate for the specification including industry-year and state-year effects is smaller in magnitude and statistically noisier (p=16%). The estimates (approximately -0.003) are economically large relative to the sample mean (0.014), and economically small relatively to the sample standard deviation of (0.041). This stems from the fact that share repurchases are zero for over half of the firm-year observations in the sample. The point estimates for cash dividends in columns (3) - (6) are an order of magnitude smaller and statistically indistinguishable from zero.

The above results are consistent with theories that view payout policy in light of agency conflicts. However, it is not theoretically clear what managers will do with these funds. Table 9 reports the effects of UD laws on firm size, investment, and financial policies to shed light on this question. The estimate for PP&E is statistically indistinguishable from zero, suggesting universal demand is not associated with an increase in firm size. Similarly, column (2) indicates there is not an increase in investment associated with UD. Column (3) reports the effect on cash holdings normalized by total assets. The coefficient is positive though not statistically significant at conventional levels (p=16%). Column (4) indicates a drop in net debt issuance of approximately half of a percentage point. While this result is statistically significant at the 5% level, in unreported analysis I find that the estimate is statistically noisier for alternative specifications that exclude state-year fixed effects. Column (5) shows a drop in leverage of approximately 4% relative to the sample mean. There are several potential economic explanations for the decrease in debt issuance

and leverage. For example, the results may reflect a revealed preference of managers to decrease risk associated with their undiversified human capital or lessen the disciplining effects of debt.

4.4 Corporate Performance

Finally, I analyze the effect of universal demand laws on accounting performance. One justification for UD is that frivolous litigation wastes corporate assets (e.g., funds for legal expenses, the attention of directors, etc.) and potentially discourages risky ventures that may increase litigation risk. If this is the case, UD laws may be associated with improved performance. However, the deterrence effects of litigation may also mitigate agency conflicts and ultimately lead to a positive effect on performance. My findings are consistent with the latter view.

Table 10 reports the effect of UD laws on return on assets. UD laws are associated with a decline in ROA of about 0.08 percentage points. The effect is statistically significant at the 10% level or lower for each of the specifications. The magnitude of this estimate is similar to that found by Bertrand and Mullainathan (2003) for BC laws. Column (4) reports the coefficient trends. Consistent with a causal interpretation, the coefficient for UD(-1) is statistically indistinguishable from zero while the coefficients for $UDLaw(+1)$ and $UDLaw(2+)$ are larger in magnitude, and the coefficient for $UDLaw(2+)$ is statistically significant at the 10% level.

Next, I investigate heterogeneous effects on ROA. Specifically, I test whether the effect is driven by firms with weaker alternative governance mechanisms or those that are particularly prone to agency conflicts. However, such analysis is complicated by the fact that variables such as institutional ownership, firm size, and cash flow may be affected by UD laws (at least for some subsets of firms). Thus, interacting the measures directly with the UD indicator may result in inconsistent estimates of the treatment effect. Hence, I follow Gormley and Matsa (2011) and slightly alter the basic methodology to accommodate the use of pre-measured values in a triple difference framework with staggered events (i.e., I use values based on the year before treatment). Specifically, for each "event" I construct a cohort consisting of the observations for firms treated in that year and all other untreated observations in the sample. By way of example, consider the 2004 cohort. The treatment

group consists of firms incorporated in Massachusetts, the only treated state in that year. I exclude all other previously treated observations from other states to form the control group. I generate the final sample by pooling the cohorts associated with each event. I then run the main specification on different subsets of the sample based on the pre-treatment value of the variables of interest. As before, the regressions include includes firm, industry-year, and state-year fixed effects with robust standard errors clustered at the state of incorporation. Each cohort consists of observations from 5 years before and after the adoption of the UD law. I limit the analysis to cohorts with over 300 treated firm-year observations in the full sample to avoid unnecessary bias from cohorts with few treated observations.[11]

Table 11 reports the results of this analysis. The top half of column (1) shows the point estimate of the effect on firm performance is slightly positive (though statistically indistinguishable from zero) for firms with above the median institutional ownership in the year prior to treatment. However, the effect is negative and significant at the 10% level for firms with below median institutional ownership. This result suggest that the ability of institutional investors to monitors managers and exert governance through voice and exit can mitigate the negative effects of UD laws on firms. Column (2) reports similar results when firms are split based on size. In particular, the negative effect on performance is entirely driven by small firms. This finding is consistent with the idea that large firms have stronger external monitoring mechanisms (e.g., scrutiny from capital markets, regulators) which can substitute for the attenuation of shareholder litigation rights. Finally, column (3) shows the results are driven by firms with high cash flows, consistent with the idea that such firms are more prone to agency conflicts (Jensen (1986)). In each case the difference between groups is statistically significant at the 10% level.

[11]Specifically, I limit the analysis to the cohorts treated in 1989, 1990, 1991, 1992, 1995, 1997, and 2004.

5 Robustness

5.1 The Political Economy Hypothesis

A potential concern with the interpretation of the results is the effect of lobbying. If firms incorporated in some states stood to benefit comparatively more from universal demand (e.g., due to threat of litigation), they may have lobbied politicians more aggressively to pass legislation. Legislators may respond to lobbying if they fear doing otherwise would impair their ability to secure future campaign contributions from executives, trade groups, etc. This, in turn, would suggest UD laws are endogenous to corporate outcomes. State-of-location-by-year fixed effects mitigate these concerns to an extent since they control for common shocks to firms located in a particular state (e.g., local economic conditions). To further address this issue, I confine the treated sample to an environment with weaker incentives to respond to lobbying. Specifically, in Pennsylvania the ALI formulation of universal demand was implemented by the Supreme Court of Pennsylvania (SCOPA) in *Cuker v. Mikalauskas* (1997). In justifying this action, the court noted the inherent contradiction between the demand futility doctrine and the business judgment rule:

> *Delaware law permits a court in some cases ("demand excused" cases) to apply its own business judgment in the review process when deciding to honor the directors' decision to terminate derivative litigation. In our view, this is a defect which could eviscerate the business judgment rule and contradict a long line of Pennsylvania precedents* (*Cuker v. Mikalauskas* (1997)).

This suggests universal demand in Pennsylvania was not a response to public policy concerns. Rather, courts instituted the rule for the sake of consistency with judicial precedent.

Although SCOPA justices are elected, they have relatively weak incentives to pander to corporate interests. This stems from the use of retention elections for justices on SCOPA as well as two lower appellate courts in in Pennsylvania. Since 1969, the state has used traditional, partisan elections to fill open seats on these courts. However, once elected, justices face retention elections (requiring 50% "yes" votes) every 10 years until reaching the age of mandatory retirement. Retention elections are unopposed and non-partisan. Goodman and Marks (2006) note the elections in Pennsylvania are traditionally "foregone conclusions," and jurists do not run extensive campaigns or seek outside contri-

butions. In fact, between 1969 and 2005 incumbents succeeded in every retention election (Goodman and Marks (2006)).[12] Thus, while legislators potentially implement policies to court corporate campaign contributions, this was unlikely the case for SCOPA justices when UD was adopted.

In Table 12, I restrict the sample of treated firms to those incorporated in Pennsylvania. The control group consists of firms incorporated in states without UD laws. The specification includes firm and industry-year fixed effects. The magnitude of the effect on the entrenchment index is slightly larger than the estimate in Table 4 and significant at the 1% level. The estimates for blockholders, CEO compensation, share buybacks, and ROA also are also similar in magnitude to the main analysis and statistically significant at the 5% level or lower. Overall, this analysis suggests the effects documented in this paper are not primarily driven by lobbying or other political economy factors.

5.2 Additional Robustness Tests

Additional robustness tests are reported in the appendix. First, following Karpoff and Wittry (2014), I consider whether other widely studied legal changes confound my analysis. Specifically, I control for business combination laws, control share acquisition laws, fair price laws, directors' duties laws, poison pill laws, and the 1995 Unitrin court decision in Delaware.[13] The results are reported in Table A.4. The estimated effects of UD laws are similar in magnitude to the main analysis and statistically significant at the 10% level or lower. The regression specification used for this test includes firm and industry-year fixed effects. Including state-year fixed effects yields similar results (both in magnitude and statistical significance) for the entrenchment index, blockholders, cash compensation, and ROA. The point estimate for share repurchases remains negative but is statistically noisier, as is the case with the main analysis. Overall, this test provides assurance that other widely studied legal changes do not confound my analysis.

Next, I limit the sample of control firms to those incorporated in states that closely follow the Model Business Corporation Act (MBCA) but do not have a UD statute.[14] As

[12]This has arguably changed in recent years due to the involvement of various interest groups in retention elections. In fact, in 2005 the first (and only) appellate judge failed to win a retention election.

[13]See Karpoff and Wittry (2014) for further discussion of these legal changes.

[14]Specifically, control firms are those incorporated in AL, CO, IL. KY, MD, NM, ND, OR, SC, TN, and WA. The list of these states is from Lyon (2014). The treated firms are the same as the main analysis.

noted in the background section, many states that have UD adopted a version of the rule from the MBCA, a model set of legal rules created by the American Bar Association. This test addresses the possibility that my findings are driven by a spurious correlation resulting from incorporation in a state that closely follows the MBCA. A number of large incorporation states (e.g., Delaware, New York, California) are excluded from this analysis. I include firm and year fixed effects in the regression specification; higher-dimensional fixed effects are impractical in this setting due to the relatively small sample size. The results, reported in Table A.5, serve as further confirmation of the main analysis. Specifically, the estimates for the entrenchment index, blockholders, CEO cash compensation, and share repurchases remain statistically significant. The effect of UD on firm profitability is similar in magnitude to the main analysis (-0.0075), but not significant at traditional levels (p=12.5%). These results also suggest that the findings are not driven by a "Delaware effect" because firms incorporated in Delaware are not included in this analysis. In unreported analysis, I find that the results are also robust to dropping firms incorporated in any single state that has UD.

6 Conclusion

Shareholder lawsuits are a controversial issue in both legal and policy circles. Many academics and corporate insiders bemoan the ubiquity of strike suits and argue litigation primarily serves to enrich the plaintiffs' bar at the expense of corporations and shareholders. Others contend litigation conveys benefits through both settlements and its deterrence function.

In this paper, I use UD laws as a quasi-natural experiment to study the effects of shareholder litigation rights on corporate behavior. My findings highlight the important role of litigation in shaping the governance structures of firms. Specifically, I document an increase in the use of antitakeover provisions after a state has adopted UD. This finding likely stems from both a direct effect of fewer settlements as well as weaker deterrence under UD. In addition, I find that firms have fewer institutional blockholders, potentially resulting from the use of antitakeover provisions. UD laws are also associated with changes to compensation and financial policies. Specifically, CEO cash compensation

increases, while share repurchases and book leverage decline. Ultimately, I find that weaker shareholder litigation rights are associated with a decrease in firm performance, though alternative governance mechanisms (e.g., institutional ownership) mute this effect.

The findings of this paper suggest a number of avenues for future work. First, while I show UD laws are associated with a number of changes to corporate behavior and outcomes, the welfare implications are not obvious. In addition, a better understanding of the nature of the agency conflict that leads to these effects may have important implications for the design of managerial incentives.

References

Arena, Matteo, and Brandon Julio, 2014, The effects of securities class action litigation on corporate liquidity and investment policy, *Journal of Financial and Quantitative Analysis* forthcoming.

Armour, John, Bernard Black, and Brian Cheffins, 2012, Is Delaware losing its cases?, *Journal of Empirical Legal Studies* 9, 605–656.

Atanassov, Julian, 2013, Do hostile takeovers stifle innovation? Evidence from antitakeover legislation and corporate patenting, *The Journal of Finance* 68, 1097–1131.

Bebchuk, Lucian, Alma Cohen, and Allen Ferrell, 2009, What matters in corporate governance?, *Review of Financial Studies* 22, 783–827.

Bebchuk, Lucian, and Jesse Fried, 2003, Executive compensation as an agency problem, *Journal of Economic Perspectives* 17, 71–92.

Bebchuk, Lucian, and Robert Jackson, 2012, The law and economics of blockholder disclosure, *Harvard Business Law Review* 2, 39–60.

Becker, Bo, and Per Strömberg, 2012, Fiduciary duties and equity-debtholder conflicts, *Review of Financial Studies* 25, 1931–1969.

Bertrand, Marianne, and Sendhil Mullainathan, 1999, Is there discretion in wage setting? A test using takeover legislation, *The Rand Journal of Economics* 30, 535–554.

Bertrand, Marianne, and Sendhil Mullainathan, 2003, Enjoying the quiet life? Corporate governance and managerial preferences, *Journal of Political Economy* 111, 1043–1075.

Bhagat, Sanjai, Brian Bolton, and Roberta Romano, 2008, The promise and peril of corporate governance indices, *Columbia Law Review* 108, 1803–1882.

Black, Bernard, Brian Cheffins, and Michael Klausner, 2006, Outside director liability, *Stanford Law Review* 58, 1055–1159.

Brochet, Francois, and Suraj Srinivasan, 2014, Accountability of independent directors: Evidence from firms subject to securities litigation, *Journal of Financial Economics* 111, 430–449.

Chava, Sudheer, Dmitry Livdan, and Amiyatosh Purnanandam, 2009, Do shareholder rights affect the cost of bank loans?, *Review of Financial Studies* 22, 2973–3004.

Cohen, Moshe, 2012, Corporate governance law: Firm heterogeneity and the market for corporate domicile, working paper.

Cremers, K.J. Martijn, and Vinay Nair, 2005, Governance mechanisms and equity prices, *The Journal of Finance* 60, 2859–2894.

Davis, Kenneth, 2008, The forgotten derivative suit, *Vanderbilt Law Review* 61, 387–451.

Donelson, Dain, and Christopher Yust, 2014, Litigation risk and agency costs: Evidence from nevada corporate law, *Journal of Law and Economics* forthcoming.

DuCharme, Larry, Paul Malatesta, and Stephan Sefcik, 2004, Earnings management, stock issues, and shareholder lawsuits, *Journal of Financial Economics* 71, 27–49.

Easterbrook, Frank, 1984, Two agency-cost explanations of dividends, *The American Economic Review* 74, 650–659.

Edmans, Alex, 2014, Blockholders and corporate governance, *Annual Review of Financial Economics* 6, 23–50.

Erickson, Jessica, 2010, Corporate governance in the courtroom: An empirical analysis, *William & Mary Law Review* 51, 1749–1831.

Fama, Eugene, 1980, Agency problems and the theory of the firm, *The Journal of Political Economy* 88, 288–307.

Ferris, Stephen, Tomas Jandik, Robert Lawless, and Anil Makhija, 2007, Derivative lawsuits as a corporate governance mechanism: Empirical evidence on board changes surrounding filings, *Journal of Financial and Quantitative Analysis* 42, 143–165.

Fich, Eliezer, and Anil Shivdasani, 2007, Financial fraud, director reputation, and shareholder wealth, *Journal of Financial Economics* 86, 306–336.

Field, Laura Casares, and Jonathan Karpoff, 2002, Takeover defenses of IPO firms, *The Journal of Finance* 57, 1857–1889.

Francis, Bill, Iftekhar Hasan, Kose John, and Liang Song, 2011, Corporate governance and dividend payout policy: A test using antitakeover legislation, *Financial Management* 40, 83–112.

Francis, Bill, Iftekhar Hasan, Kose John, and Maya Waisman, 2010, The effect of state antitakeover laws on the firm's bondholders, *Journal of Financial Economics* 96, 127–154.

Gantchev, Nickolay, 2013, The costs of shareholder activism: Evidence from a sequential decision model, *Journal of Financial Economics* 107, 610–631.

Garvey, Gerald, and Gordon Hanka, 1999, Capital structure and corporate control: The effect of antitakeover statutes on firm leverage, *The Journal of Finance* 54, 519–546.

Giroud, Xavier, and Holger Mueller, 2010, Does corporate governance matter in competitive industries?, *Journal of Financial Economics* 95, 312–331.

Gompers, Paul, Joy Ishii, and Andrew Metrick, 2003, Corporate governance and equity prices, *The Quarterly Journal of Economics* 118, 107–156.

Goodman, Shira, and Lynn Marks, 2006, Lessons from an unusual retention election, *Court Review* 42, 6–34.

Gormley, Todd, and David Matsa, 2011, Growing out of trouble? Corporate responses to liability risk, *Review of Financial Studies* 24, 2781–2821.

Gormley, Todd, and David Matsa, 2014, Common errors: How to (and not to) control for unobserved heterogeneity, *Review of Financial Studies* 27, 617–661.

Gormley, Todd, and David Matsa, 2014b, Playing it safe? Managerial preferences, risk, and agency conflicts, working paper.

Grinstein, Yaniv, and Stefano Rossi, 2014, Good monitoring, bad monitoring, working paper.

Grossman, Sanford, and Oliver Hart, 1980, Takeover bids, the free-rider problem, and the theory of the corporation, *The Bell Journal of Economics* 11, 42–64.

Hanley, Kathleen Weiss, and Gerard Hoberg, 2012, Litigation risk, strategic disclosure and the underpricing of initial public offerings, *Journal of Financial Economics* 103, 235–254.

Helland, Eric, 2006, Reputational penalties and the merits of class-action securities litigation, *Journal of Law and Economics* 49, 365–395.

Hopkins, Justin, 2014, Does the threat of securities litigation deter earnings management?, working paper.

Jensen, Michael, 1986, Agency costs of free cash flow, corporate finance, and takeovers, *American Economic Review* 76, 323–329.

Karpoff, Jonathan, Scott Lee, and Gerald Martin, 2008, The cost to firms of cooking the books, *Journal of Financial and Quantitative Analysis* 43, 581–611.

Karpoff, Jonathan, and Michael Wittry, 2014, Test identification with legal changes: The case of state antitakeover laws, working paper.

Kinney, Thomas, 1994, Stockholder derivative suits: Demand and futility where the board fails to stop wrongdoers, *Marquette Law Review* 78, 172–189.

Klausner, Michael, 2013, Fact and fiction in corporate law and governance, *Stanford Law Review* 65, 1325–1371.

La Porta, Rafael, Florencio López de Silanes, Andrei Shleifer, and Robert Vishny, 1998, Law and finance, *Journal of Political Economy* 106, 1113–1155.

Lowry, Michelle, and Susan Shu, 2002, Litigation risk and IPO underpricing, *Journal of Financial Economics* 65, 309–335.

Lyon, Mathew, 2014, The MBCA's universal demand requirement at twenty-five: Has it worked as intended?, Fifth Annual National Business Law Scholars Conference.

Mathias, John, David Kroeger, Matthew Neumeier, and Jerry Burgdoerfer, 2014, *Directors and Officers Liability: Prevention, Insurance, and Indemnification* (Law Journal Press).

Murphy, Kevin, 1999, Executive compensation, *Handbook of Labor Economics* 3, 2485–2563.

Pinto, Arthur, and Douglas Branson, 2013, *Understanding Corporate Law* (Matthew Bender and Company).

Roberts, Michael, and Toni Whited, 2010, Endogeneity in empirical corporate finance, *Handbook of the Economics of Finance* 2, 493–572.

Romano, Roberta, 1991, The shareholder suit: Litigation without foundation?, *Journal of Law, Economics, & Organization* 7, 55–87.

Schoar, Antoinette, and Ebonya Washington, 2011, Are the seeds of bad governance sown in good times?, NBER working paper 17061.

Swanson, Carol, 1992, Juggling shareholder rights and strike suits in derivative litigation: The ALI drops the ball, *Minnesota Law Review* 77, 1339–1392.

Zwiebel, Jeffrey, 1996, Dynamic capital structure under managerial entrenchment, *The American Economic Review* 86, 1197–1215.

Figure 1: Derivative and Class Action Lawsuit Time Series

This figure shows the fraction of firm-year observations in the sample subject to new derivative or class action lawsuits between 1996 and 2009. Derivative lawsuit data are from SEC filings and Audit Analytics. Class action data are from the Stanford Securities Class Action Database.

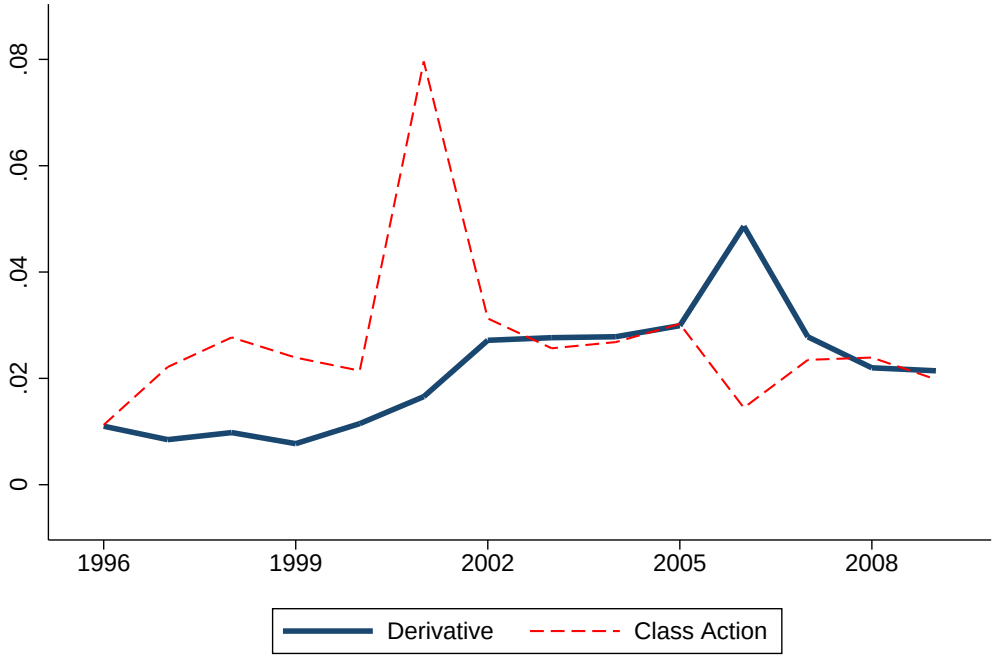

Figure 2: Entrenchment Index Coefficient Dynamics

This figure shows the coefficient dynamics for the effect of universal demand (UD) laws on the entrenchment index. The regression specification includes firm, industry-year, and state-of-location-year fixed effects, where industry is defined using 3-digit SIC and state-of-location is based on headquarters location. Each point estimate is relative to the effective year (i.e., year zero). The dashed lines show the 90% confidence interval.

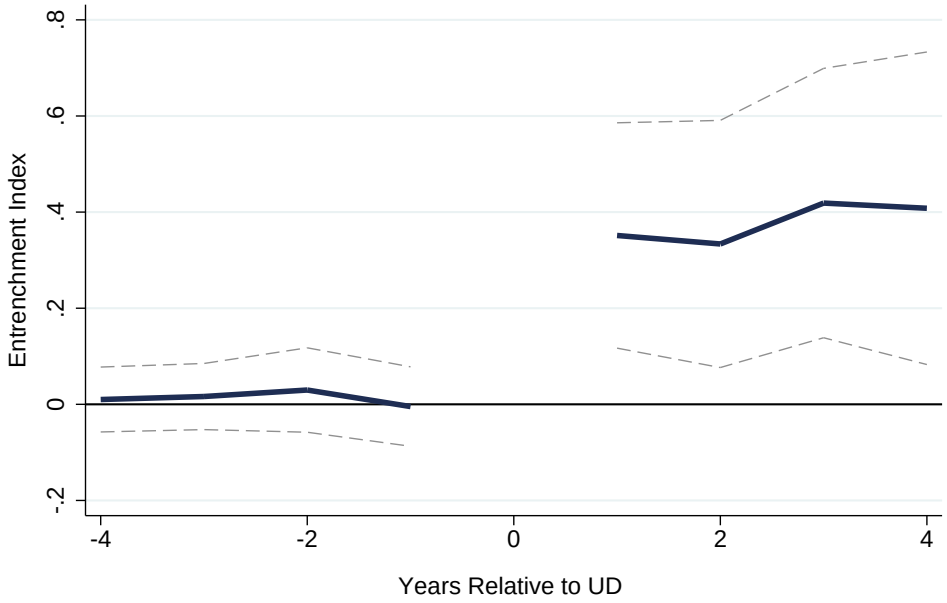

Table 1: Universal Demand Legislation

This table lists the states of incorporation with universal demand (UD) laws and the corresponding effective year and statute reference. The final column reports the number of firm-year observations in the sample. Source: Model Business Corporation Act Annotated (2013) and state statutes/session laws.

Year	State	Citation	Firm-Year Observations
1989	GA	Ga. Code Ann. § 14-2-742	1,083
	MI	Mich. Comp. Laws Ann. § 450.1493a	981
1990	FL	Fla. Stat. Ann. § 607.07401	1,528
1991	WI	Wis. Stat. Ann. § 180.742	812
1992	MT	Mont. Code. Ann. § 35-1-543	17
	VA	Va. Code Ann § 13.1-672.1B	1,025
	UT	Utah Code. Ann. § 16-10a-740(3)	322
1993	NH	N.H. Rev. Stat. Ann. § 293-A:7.42	6
	MS	Miss. Code Ann. § 79-4-7.42	65
1995	NC	N.C. Gen. Stat. § 55-7-42	679
1996	AZ	Ariz. Rev. Stat. Ann. § 10-742	143
	NE	Neb. Rev. Stat. § 21-2072	79
1997	CT	Conn. Gen. Stat. Ann. § 33-722	338
	ME	Me. Rev. Stat. Ann. 13-C, § 753	65
	PA	*Cuker v. Mikalauskas* (547 Pa. 600, 692 A.2d 1042)	1,921
	TX	Tex. Bus. Org. Code. Ann. 607.07401	1,666
	WY	Wyo. Stat. § 17-16-742	48
1998	ID	Idaho Code § 30-1-742	30
2001	HI	Haw. Rev. Stat. § 414-173	71
2003	IA	Iowa Code Ann. § 490.742	215
2004	MA	Mass. Gen. Laws. Ann. Ch. 156D, § 7.42	1,819
2005	RI	R.I. Gen. Laws. § 7-1.2-710(C)	113
	SD	S.D. Codified Laws 47-1A-742	54
			Total = 13,080 (16.6%)

Table 2: Summary Statistics

Panel A reports summary statistics for the full sample. All accounting variables (except those in logs) are normalized by total assets. CEO cash compensation is normalized by total compensation. Panel B reports *ex ante* firm characteristics for the first 3 years data are available prior to UD. Column (1) restricts observations to firms incorporated in states that do not enact UD during the sample period (i.e., "never treated"). Column (2) restricts observations to firms incorporated in states that enact UD at some point during the sample period (i.e., "eventually treated"). Column (3) reports the p-value (adjusted for clustering at the state of incorporation level) from the paired t-test comparing these values. Standard deviations are reported in parenthesis.

Panel A - Full Sample

Variable	Obs	Mean	SD	25%	50%	75%
𝟙(Derivative Lawsuit)	50190	0.019	0.137	0	0	0
𝟙(Class Action Lawsuit)	42938	0.028	0.165	0	0	0
Entrenchment Index	17064	2.091	1.327	1	2	3
GIM Index	17064	9.005	2.798	7	9	11
Poison Pill	17064	0.556	0.497	0	1	1
Blank Check Stock	17064	0.861	0.346	1	1	1
Classified Board	17064	0.573	0.495	0	1	1
Supermajority Voting	17064	0.172	0.377	0	0	0
Golden Parachute	17064	0.586	0.493	0	1	1
Limit Bylaw	17064	0.181	0.385	0	0	0
Limit Charter	17064	0.023	0.151	0	0	0
𝟙(Blockholder)	76382	0.273	0.446	0	0	1
𝟙(Blockholder Entry)	74779	0.056	0.23	0	0	0
𝟙(Blockholder Exit)	74779	0.034	0.18	0	0	0
Max Inst. Size (%)	76382	8.227	6.973	4.482	7.250	10.384
Inst. Ownership (%)	76382	40.535	26.436	17.672	37.615	61.547
CEO Cash Comp./Total	20666	0.558	0.311	0.287	0.529	0.853
Repurchases	79049	0.014	0.042	0	0	0.007
Dividends	79049	0.008	0.019	0	0	0.009
Log(PP&E)	78747	3.883	2.105	2.343	3.693	5.295
Capex	78123	0.066	0.068	0.023	0.045	0.083
Cash	79037	0.17	0.21	0.022	0.078	0.241
Net Debt Iss.	73949	0.012	0.099	-0.019	0	0.027
Book Leverage	78714	0.241	0.219	0.041	0.206	0.371
ROA	78836	0.094	0.153	0.054	0.118	0.176

Panel B - *Ex Ante* Characteristics

Variable	Never Treated	Eventually Treated	Difference p-value
𝟙(Derivative Lawsuit)	0.013	0.008	0.212
	(0.079)	(0.072)	
Entrenchment Index	1.946	2.196	0.224
	(1.391)	(1.456)	
GIM Index	9.012	9.225	0.839
	(2.938)	(3.291)	
𝟙(Blockholder)	0.148	0.179	0.167
	(0.309)	(0.332)	
Inst. Ownership (%)	29.541	28.837	0.648
	(18.981)	(18.001)	
CEO Cash Comp.	0.707	0.727	0.353
	(0.214)	(0.211)	
Repurchases	0.012	0.012	0.9433
	(0.026)	(0.027)	
ROA	0.117	0.123	0.524
	(0.104)	(0.100)	
Capex	0.075	0.076	0.886
	(0.061)	(0.059)	
Log(PP&E)	3.870	3.714	0.360
	(1.901)	(1.734)	
Cash	0.120	0.107	0.127
	(0.139)	(0.125)	
Net Debt Iss.	0.018	0.016	0.696
	(0.082)	(0.066)	

Table 3: Derivative Litigation

The dependent variable is an indicator for if a derivative litigation is initiated in a given year. Lawsuit data are from Audit Analytics and SEC filings. The sample runs from 1994 to 2009. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. The fixed effects included in each specification are noted in the table. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. Column (4) reports the coefficient trend. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. *, ** and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

	$\mathbb{1}$(Derivative Lawsuit)			
	(1)	(2)	(3)	(4)
UDLaw	-0.00703***	-0.00762***	-0.00682**	
	(0.00208)	(0.00238)	(0.00332)	
UDLaw(-1)				-0.00768
				(0.00560)
UDLaw(0)				0.000329
				(0.00501)
UDLaw(+1)				-0.0114*
				(0.00611)
UDLaw(2+)				-0.0121***
				(0.00403)
Firm FE	yes	yes	yes	yes
Year FE	yes	no	no	no
State-Year FE	no	no	yes	yes
Ind-Year FE	no	yes	yes	yes
Observations	50,190	50,190	50,190	50,190
R-squared	0.156	0.221	0.236	0.236

Table 4: Entrenchment Index

This table reports the effect of universal demand (UD) laws on the entrenchment index (Bebchuk, Cohen, and Ferrell (2009)). Governance data are from Riskmetrics, and the sample runs from 1990 to 2006. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. The fixed effects included in each specification are noted in the table. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. Column (4) reports the coefficient trend. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. ** and *** denote statistical significance at the 5% and 1% levels, respectively.

	Entrenchment Index			
	(1)	(2)	(3)	(4)
UDLaw	0.215***	0.289***	0.242**	
	(0.0648)	(0.0906)	(0.118)	
UDLaw(-1)				-0.0532
				(0.0535)
UDLaw(0)				-0.0363
				(0.0504)
UDLaw(+1)				0.235**
				(0.109)
UDLaw(2+)				0.368**
				(0.161)
Firm FE	yes	yes	yes	yes
Year FE	yes	no	no	no
State-Year FE	no	no	yes	yes
Ind-Year FE	no	yes	yes	yes
Observations	17,064	17,064	17,064	17,064
R-squared	0.889	0.914	0.923	0.923

Table 5: Individual Governance Provisions

The dependent variables are the six provisions contained in the entrenchment index, as well as an indicator for blank check preferred stock. Governance data are from Riskmetrics, and the sample runs from 1990 to 2006. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. Each specification includes firm, industry-year, and state-of-location-year fixed effects. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. * and ** denote statistical significance at the 10% and 5% levels, respectively.

	Poison Pill	Blank Check Stock	Classified Board	Supermajority Voting	Golden Parachute	Bylaw Limits	Charter Limits
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
UDLaw	0.107*	0.0689**	0.0454*	0.0425**	0.0591	-0.00766	-0.00472
	(0.0589)	(0.0273)	(0.0225)	(0.0207)	(0.0601)	(0.0170)	(0.00699)
Firm FE	yes	yes	yes	yes	yes	yes	yes
State-Year FE	yes	yes	yes	yes	yes	yes	yes
Ind-Year FE	yes	yes	yes	yes	yes	yes	yes
Observations	17,064	17,064	17,064	17,064	17,064	17,064	17,064
R-squared	0.860	0.911	0.948	0.934	0.806	0.932	0.928

Table 6: Blockholders

The dependent variable in Panel A is an indicator for a 10% institutional blockholder. The dependent variable in columns (1)-(3) of Panel B is an indicator for blockholder entry in the 5 year period after treatment. The indicator for blockholder exit in columns (4)-(6) is defined analogously. Blockholder data are from Thomson. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. The fixed effects included in each specification are noted in the table. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. ** and *** denote statistical significance at the 5% and 1% levels, respectively.

Panel A

	𝟙(Blockholder)			
	(1)	(2)	(3)	(4)
UDLaw	-0.0367**	-0.0398**	-0.0464***	
	(0.0142)	(0.0150)	(0.0155)	
UDLaw(-1)				-0.0192
				(0.0214)
UDLaw(0)				-0.0672***
				(0.0228)
UDLaw(+1)				-0.0786***
				(0.0261)
UDLaw(2+)				-0.0375**
				(0.0179)
Firm FE	yes	yes	yes	yes
Year FE	yes	no	no	no
State-Year FE	no	no	yes	yes
Ind-Year FE	no	yes	yes	yes
Observations	76,382	76,382	76,382	76,382
R-squared	0.383	0.441	0.454	0.454

Panel B

	𝟙(Blockholder Entry)			𝟙(Blockholder Exit)		
	(1)	(2)	(3)	(4)	(5)	(6)
UDLaw	-0.0123**	-0.0128**	-0.0160***	0.00421	0.000630	-0.00665
	(0.00498)	(0.00554)	(0.00550)	(0.00527)	(0.00598)	(0.00528)
Firm FE	yes	yes	yes	yes	yes	yes
Year FE	yes	no	no	yes	no	no
State-Year FE	no	no	yes	no	no	yes
Ind-Year FE	no	yes	yes	no	yes	yes
Observations	74,779	74,779	74,779	74,779	74,779	74,779
R-squared	0.078	0.150	0.167	0.087	0.169	0.185

Table 7: CEO Compensation

The dependent variable in Panel A is the ratio of cash compensation to total compensation for CEOs. The dependent variables in Panel B are the individual components of pay (normalized by total compensation). Compensation data are from Execucomp, and the sample runs from 1992 to 2009. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. The fixed effects included in each specification are noted in the table. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. *, ** and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A

	CEO Cash Comp. / Total			
	(1)	(2)	(3)	(4)
UDLaw	0.0254	0.0284**	0.0394***	
	(0.0155)	(0.0136)	(0.0138)	
UDLaw(-1)				-0.0159
				(0.0204)
UDLaw(0)				0.0272
				(0.0333)
UDLaw(+1)				0.00815
				(0.0275)
UDLaw(2+)				0.0431**
				(0.0173)
Firm FE	yes	yes	yes	yes
Year FE	yes	no	no	no
State-Year FE	no	no	yes	yes
Industry-Year FE	no	yes	yes	yes
Observations	20,666	20,666	20,666	20,666
R-squared	0.439	0.542	0.567	0.567

Panel B

	Salary	Bonus	LTIP	Other	Stock	Options
	(1)	(2)	(3)	(4)	(5)	(6)
UDLaw	0.0152	0.00843	0.00709	0.00869	-0.0135	-0.0321*
	(0.0127)	(0.00700)	(0.00439)	(0.00795)	(0.0127)	(0.0163)
Firm FE	yes	yes	yes	yes	yes	yes
State-Year FE	yes	yes	yes	yes	yes	yes
Ind-Year FE	yes	yes	yes	yes	yes	yes
Observations	20,666	20,666	20,666	20,666	20,666	20,666
R-squared	0.610	0.574	0.548	0.465	0.584	0.538

Table 8: Payout Policy

The dependent variable in columns (1) - (3) is share repurchases. The dependent variable in columns (4) - (6) is cash dividends. Both variables are normalized by total assets. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. The fixed effects included in each specification are noted in the table. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. ** denotes statistical significance at the 5% level.

	Share Repurchases			Cash Dividends		
	(1)	(2)	(3)	(4)	(5)	(6)
UDLaw	-0.00324**	-0.00308**	-0.00231	-0.000252	0.000332	0.000620
	(0.00131)	(0.00116)	(0.00164)	(0.000454)	(0.000635)	(0.000546)
Firm FE	yes	yes	yes	yes	yes	yes
Year FE	yes	no	no	yes	no	no
State-Year FE	no	no	yes	no	no	yes
Ind-Year FE	no	yes	yes	no	yes	yes
Observations	79,049	79,049	79,049	79,049	79,049	79,049
R-squared	0.253	0.321	0.336	0.625	0.670	0.680

Table 9: Firm Size, Investment, and Financial Policies

All variables except log(PP&E) are normalized by total assets. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. Each specification includes firm, industry-year, and state-of-location-year fixed effects, where industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. * and ** denote statistical significance at the 10% and 5% levels, respectively.

	log(PP&E)	Capex	Cash	Debt Issuance	Leverage
	(1)	(2)	(3)	(4)	(5)
UDLaw	-0.00622	0.000738	0.00597	-0.00551**	-0.0112*
	(0.0235)	(0.00207)	(0.00419)	(0.00271)	(0.00665)
Firm FE	yes	yes	yes	yes	yes
State-Year FE	yes	yes	yes	yes	yes
Ind-Year FE	yes	yes	yes	yes	yes
Observations	78,747	78,123	79,037	73,949	78,714
R-squared	0.938	0.691	0.814	0.296	0.753

Table 10: Firm Performance

The dependent variable is return on assets. *UD Law* equals one if a firm is incorporated in a state that has a universal demand requirement. The coefficient for this variable is the difference-in-differences estimate. The fixed effects included in each specification are noted in the table. Industry-year fixed effects use 3-digit SIC, and state-year fixed effects use headquarters location. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. * and ** denote statistical significance at the 10% and 5% levels, respectively.

	ROA			
	(1)	(2)	(3)	(4)
UD Law	-0.00773**	-0.00741*	-0.00822*	
	(0.00306)	(0.00371)	(0.00441)	
UD Law(-1)				-0.00172
				(0.00594)
UD Law(0)				-0.00540
				(0.00500)
UD Law(+1)				-0.00906
				(0.00692)
UD Law(2+)				-0.00890*
				(0.00500)
Firm FE	yes	yes	yes	yes
Year FE	yes	no	no	no
State-Year FE	no	no	yes	yes
Industry-Year FE	no	yes	yes	yes
Observations	78,836	78,836	78,836	78,836
R-squared	0.689	0.729	0.735	0.735

Table 11: Heterogeneous Effects on ROA

This table reports the effect of universal demand laws on ROA for different subsets of firms using the triple differences methodology of Gormley and Matsa (2011). The first column restricts the sample to firms with above/below the median level of institutional ownership the year prior to a UD law. The second column restricts the sample to firms with above/below the median level of assets, and the third restricts the sample to above/below the median level of cash flow normalized by total assets. *UD Law* equals one if a firm is incorporated in a state that has a universal demand requirement. All specifications include firm, industry-year, and state-year fixed effects. Industry-year fixed effects use 3-digit SIC, while state-year fixed effects use headquarters location. Coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level and * and ** denote statistical significance and the 10% and 5% levels, respectively.

	ROA		
	(1)	(2)	(3)
	High Inst. Ownership	***Large Firms***	***Low Cash Flow***
UD Law	0.000469	0.00263	-0.000645
	(0.00522)	(0.00327)	(0.00851)
Observations	89,112	91,286	80,156
R-squared	0.703	0.695	0.679
	Low Inst. Ownership	***Small Firms***	***High Cash Flow***
UD Law	-0.0115*	-0.0112*	-0.0100**
	(0.00671)	(0.00617)	(0.00497)
Observations	76,023	76,518	87,457
R-squared	0.708	0.714	0.608
Firm FE	yes	yes	yes
Industry-Year FE	yes	yes	yes
State-Year FE	yes	yes	yes

Table 12: Pennsylvania Analysis

This table restricts the sample of treated firms to Pennsylvania, where universal demand was implemented by the state supreme court in 1997. *UDLaw* equals one if a firm is incorporated in PA after the adoption of universal demand. The dependent variables are defined in previous tables. Each specification includes firm and industry-year fixed effects. Coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. ** and *** denote statistical significance at the and 5% and 1% levels, respectively.

	E Index	𝟙(Blockholder)	Cash Comp.	Repurchases	ROA
	(1)	(2)	(3)	(4)	(5)
UDLaw	0.334***	-0.0273**	0.0402***	-0.00614***	-0.00523**
	(0.0322)	(0.0120)	(0.0131)	(0.00112)	(0.00201)
Firm FE	yes	yes	yes	yes	yes
Ind-Year FE	yes	yes	yes	yes	yes
Observations	15,785	65,528	19,151	67,890	67,712
R-squared	0.918	0.455	0.545	0.328	0.736

Appendix A

Table A.1: Variable Definitions

The following table contains the name, source, and definition for the variables in this paper. Further information on the litigation and governance variables is provided in the text.

Variable Name	Source	Definition
𝟙(Derivative Lawsuit)	Audit Analytics + SEC Filings	Equals 1 if derivative lawsuit filed against firm
Entrenchment Index	Riskmetrics	Index of 6 governance provisions
GIM Index	Riskmetrics	Index 24 governance provisions
𝟙(Blockholder)	Thomson Reuters 13F Summary	Equals 1 if largest institutional investor owns >10%
𝟙(Blockholder Entry)	Thomson Reuters 13F Summary	Equals 1 if there is blockholder at t but not t-1
𝟙(Blockholder Exit)	Thomson Reuters 13F Summary	Equals 1 if there is a blockholder at t-1 but not t
Max Inst. Ownership (%)	Thomson Reuters 13F Summary	Percentage of shares owned by largest institutional investor
Inst Ownership (%)	Thomson Reuters 13F Summary	Total ownership by institutional investors
CEO Cash Comp.	Execucomp	Ratio of cash (salary, bonus, LTIP, other) to total (tdc1)
ROA	Compustat-CRSP	oibdp/at
Dividends	Compustat-CRSP	dvc/at
Repurchases	Compustat-CRSP	[prstkc-(pstkrv(t)-pstkrv(t-1))]/at
Capex	Compustat-CRSP	capx/at
Net Debt Issuance	Compustat-CRSP	(dltis - dltr)/at
Leverage	Compustat-CRSP	(dlc+dltt)/at
Cash	Compustat-CRSP	che/at

Table A.2: GIM Index

This table reports the effect of universal demand (UD) laws on the GIM index (Gompers, Ishii, and Metrick (2003)). Governance data are from Riskmetrics. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. The fixed effects included in each specification are noted in the table. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. ** denotes statistical significance at the 5% level.

	GIM Index		
	(1)	(2)	(3)
UDLaw	0.380**	0.477**	0.317
	(0.175)	(0.216)	(0.245)
Firm FE	yes	yes	yes
Year FE	yes	no	no
State-Year FE	no	no	yes
Industry-Year FE	no	yes	yes
Observations	17,064	17,064	17,064
R-squared	0.927	0.944	0.949

Table A.3: Alternative Ownership Measures

The dependent variable in columns (1) - (3) is the percentage of shares owned by the largest institutional investor. The dependent variable in columns (4) - (6) is total institutional ownership. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. Ownership data are from Thomson. The fixed effects included in each specification are noted in the table. All coefficients are estimated by OLS. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. *, ** and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

	Max Inst. Size (%)			Inst. Ownership (%)		
	(1)	(2)	(3)	(4)	(5)	(6)
UDLaw	-0.491*	-0.539**	-0.461***	-0.00612	-0.00442	0.00114
	(0.273)	(0.238)	(0.155)	(0.00703)	(0.00685)	(0.00632)
Firm FE	yes	yes	yes	yes	yes	yes
Year FE	yes	no	no	yes	no	no
State-Year FE	no	no	yes	no	no	yes
Industry-Year FE	no	yes	yes	no	yes	yes
Observations	76,382	76,382	76,382	76,382	76,382	76,382
R-squared	0.549	0.599	0.609	0.779	0.804	0.810

Table A.4: Controlling for Potentially Confounding Events

The regression results in this table control for potentially confounding events during the sample period (as identified by Karpoff and Wittry (2014)). In particular, the specification includes controls for control share acquisition laws, business combination laws, fair price laws, directors' duties laws, poison pill laws, and the 1995 Unitrin court decision in Delaware. The dependent variables are defined in previous tables. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. Each specification includes firm and industry-year fixed effects. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. *, ** and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

	E Index	𝟙(Blockholder)	Cash Comp.	Repurchases	ROA
	(1)	(2)	(3)	(4)	(5)
UDLaw	0.238***	-0.0374*	0.0251*	-0.00266**	-.00793*
	(0.0776)	(0.0154)	(0.0138)	(0.00109)	(.00449)
Firm FE	yes	yes	yes	yes	yes
Ind-Year FE	yes	yes	yes	yes	yes
Other Law/Case Controls	yes	yes	yes	yes	yes
Observations	17,064	76,382	20,666	79,049	78,836
R-squared	0.915	0.442	0.542	0.322	0.729

Table A.5: Limiting Sample to MBCA States

This table limits the sample to firms incorporated in states with UD or states that otherwise substantially follow the Model Business Corporation Act (from Lyons (2014)). Specifically, the control sample consists of firms incorporated in AL, CO, IL, KY, MD, NM, ND, OR, SC, TN, and WA. The treatment sample consists of firms incorporated in states that adopt a universal demand requirement during the sample period (see Table 1). The dependent variables are defined in previous tables. *UDLaw* equals one if a firm is incorporated in a state that has a universal demand requirement. Each specification includes firm and year fixed effects. Robust standard errors (in parenthesis) are clustered at the state of incorporation level. *, ** and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

	E Index	𝟙(Blockholder)	Cash Comp.	Repurchases	ROA
	(1)	(2)	(3)	(4)	(5)
UDLaw	0.212***	-0.0460**	0.0350*	-0.00339**	-0.00754
	(0.0706)	(0.0202)	(0.0188)	(0.00132)	(0.00478)
Firm FE	yes	yes	yes	yes	yes
Year FE	yes	yes	yes	yes	yes
Observations	2,734	16,753	3,156	17,265	17,203
R-squared	0.896	0.366	0.462	0.252	0.641

Appendix B

B.1 Derivative Lawsuit Examples

The following excerpts from SEC filings detail allegations and settlements related to shareholder derivative actions against four different corporations.

Broadcom (2011 10-K)

In 2006 a number of purported Broadcom shareholders filed putative shareholder derivative actions in state and federal court against Broadcom, each of the then members of our Board of Directors and certain current or former officers, alleging, among other things, that the defendants improperly dated certain Broadcom employee stock option grants. In August 2009 Broadcom plaintiffs and certain defendants executed a Stipulation and Agreement of Partial Settlement in the federal derivative action, which resolved all claims except those against three individuals: Dr. Henry T. Nicholas, III, our former President and Chief Executive Officer and former Co-Chairman of the Board, William J. Ruehle, our former Chief Financial Officer, and Dr. Henry Samueli, our Chief Technical Officer and member of our Board of Directors.

In March 2011, Broadcom, plaintiffs and the three remaining defendants executed a Stipulation and Agreement of Settlement, or Derivative Settlement, in the federal derivative action. On May 23, 2011, the District Court entered an order granting final approval of the Derivative Settlement. Pursuant to the Derivative Settlement, among other things: (i) Broadcom received a payment from Dr. Nicholas of approximately $27 million, which was recorded as a settlement gain in our consolidated statements of income; (ii) Broadcom cancelled unexercised Broadcom stock options held by Dr. Samueli valued at approximately $14 million, using a Black-Scholes analysis based on the closing price of Broadcom's Class A common stock on the date the settlement was deemed final, which amount was recorded as a settlement gain in our consolidated statements of income...Upon Court approval of the Derivative Settlement, Broadcom paid plaintiffs' counsel $25 million of the settlement proceeds for attorneys' fees, expenses, and costs, which was recorded as an operating expense in the consolidated statements of income.

Johnson and Johnson (2013 10-K)

Starting in April 2010, a number of shareholder derivative lawsuits were filed in the United States District Court for the District of New Jersey against certain current and former directors and officers of Johnson & Johnson. Johnson & Johnson is named as a nominal defendant. These actions were consolidated in

August 2010 into In re Johnson & Johnson Derivative Litigation...Collectively, these shareholder derivative actions assert a variety of alleged breaches of fiduciary duties, including, among other things, that the defendants allegedly engaged in, approved of, or failed to remedy or prevent defective medical devices, improper pharmaceutical rebates, improper off-label marketing of pharmaceutical and medical device products, violations of current good manufacturing practice regulations that resulted in product recalls, and that the defendants failed to disclose the aforementioned alleged misconduct in the Company's filings under the Securities Exchange Act of 1934. Each complaint seeks a variety of relief, including monetary damages and corporate governance reforms. Johnson & Johnson moved to dismiss these actions on the grounds, inter alia, that the plaintiffs failed to make a demand upon the Board of Directors.

News Corp. (2013 8-K)

On February 21, 2011, the Company announced that it planned to acquire Shine Group Ltd. ("Shine"), a television and movie production company based in the U.K. which produces, among other television shows, Got to Dance , The Biggest Loser , Master Chef, and Minute to Win It , for an enterprise value of £415 million, or $670 million (the "Shine Acquisition"). Shine's investors included Sony Entertainment and British Sky Broadcasting, as well as majority owner Elisabeth Murdoch, the daughter of Defendant Rupert Murdoch. The Company's February 21, 2011, announcement also indicated that Rupert Murdoch expected Elisabeth Murdoch to join the News Corp. board of directors.

[The] consolidated shareholder derivative complaint. . . contains five claims. Counts I and II relate to the Shine Acquisition, alleging, among other things, that Defendants breached their fiduciary duties by agreeing to acquire Shine without considering whether the transaction served a legitimate corporate objective and permitting the purchase of Shine at an excessive price. Counts III, IV, and V are Oversight-Related Claims, alleging, among other things, that Defendants breached their fiduciary duties by not investigating, between July 2009 and 2011, the hacking claims at News of the World, and as a result, the Company was harmed.