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(2022)

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Accounting Review, 97 (5). pp. 275-299. ISSN 0001-4826

DOI: <https://doi.org/10.2308/TAR-2020-0386>

American Accounting Association

<https://meridian.allenpress.com/accounting-review/...>

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Spillover Effects in Disclosure-Related Securities Litigation

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Abstract

Securities litigation is relatively rare but can significantly affect sued firms. We extend this research by examining the spillover effect of securities litigation on industry peers using a sample of disclosure-related litigation—distinct from events such as restatements and SEC enforcement. We find investors respond immediately as peers exhibit negative abnormal returns before and after case filings. Additionally, peers provide more voluntary earnings and sales forecasts. Notably, investors and peers respond primarily to cases that eventually settle, where litigation costs are concentrated. Further, disclosure results are concentrated in growth firms, where voluntary disclosure is most important, and in low litigation industries, where litigation is more noteworthy. Peers also adjust attributes of mandatory disclosures: disclosures become shorter, more readable, and contain fewer litigation-related terms. These changes appear successful as peers have lower future litigation incidence. Collectively, our findings indicate securities litigation has significant effects beyond the firms that directly face litigation.

Key words: Securities Litigation; Peer Firm Spillover; Forecasts; Disclosure

JEL Codes: D82; G30; H26; K22; K41; M41

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We thank Daniel Taylor (editor), two anonymous reviewers, Anwer Ahmed, Daniel Cohen, Christian Hutzler, Antonis Kartapanis, Young Kim, John Schomburger, conference participants at the 2020 AAA Annual Meeting, and workshop participants at Texas A&M and Florida International University. We gratefully acknowledge research support provided by the Tippie College of Business and the Mays Business School. All errors are our own.

I. INTRODUCTION

Private securities litigation serves an important governance role in capital markets but is relatively rare, with less than 2 percent of firms targeted in securities class actions (SCAs) annually (Kim and Skinner 2012). As a result, litigation events are often covered by the financial press (Griffin, Grundfest, and Perino 2004; Ramos 2007; Simmons 2011) and may result in spillover effects beyond the sued firm, particularly because firms follow the news of industry peers (Beatty, Liao, and Yu 2013). This study examines how securities litigation at one firm affects industry peers, a question that is important because private securities litigation can constrain managerial behavior and increase transparency.

Bad news events can lead to information spillovers from one firm to its peers (e.g., Gande and Lewis 2009; Gleason, Jenkins, and Johnson 2008) and influence the real behavior of other firms in the industry (e.g., Arena and Julio 2015; Baginski and Hinson 2016; Beatty et al. 2013). We predict that when investors and managers observe industry litigation, it is a salient reminder of the peer firm's exposure to litigation and may indicate litigation costs and exposure are increasing—even though the firm itself was not sued. For example, litigation over disclosures (e.g., earnings forecasts) at one firm may suggest that similar information for peers was also incorrect, causing investors to question the valuation of those firms. In response, peer firms may increase disclosures to justify their previous information or choose to remain silent due to disclosure costs (or, specific to litigation, to avoid attracting scrutiny from plaintiffs' lawyers). Thus, any spillover effect provides insight into not only the reach of litigation but also the determinants of managerial decisions.

For clarity, we define the “focal” firm as the firm targeted in the SCA (i.e., the sued firm) and treated “peers” as firms facing high ex-ante litigation risk in the same industry (i.e., firms in

the top tercile of litigation risk). Firms with high litigation risk in the same industry are the most likely firms to be targeted in related SCAs, so they are a powerful group to examine the spillover effects of litigation. To isolate the effect of litigation from other confounding events that may also trigger spillover, we exclude focal firm litigation accompanied by a restatement, SEC comment letter, or SEC investigation (see Gleason et al. 2008; Brown, Tian, and Tucker 2018). Thus, our sample of SCAs primarily involves disclosure-related litigation.

We begin our analyses by examining spillovers in market reactions. Because peers are in the same industry as the focal firm and have high litigation risk, investors may expect them to be targeted in similar future litigation. This expectation may be rational as litigation is clustered by industry and occurs in waves (Gande and Lewis 2009; Kim and Skinner 2012). However, given the rarity of litigation, investors may irrationally over-adjust their expectations due to availability bias, the tendency to overweight the probability of recent events due to the vividness with which one recalls examples (Feller 1968; Kahneman and Tversky 1973). Consistent with a change in investor beliefs of litigation costs, we find that peer firms have negative abnormal returns in both the days preceding and following the filing date for the focal firm SCA. Thus, investors anticipate the litigation but require time to assess case merits and potential spillover effects.

To provide more insight into the sophistication of investors' responses, we partition tests on the eventual SCA outcome, that is, whether it is ultimately settled (dismissed) and thus relatively meritorious (nonmeritorious). From a valuation perspective, investors should be most concerned about the potential that a peer firm may face meritorious litigation as most costs of litigation are restricted to cases that eventually settle (Donelson and Yust 2019). While it may take several years for a case outcome to be finalized, many merit-based factors that predict litigation outcomes are observable when the litigation is filed, and market participants can

differentiate quickly between cases that will settle or be dismissed (Biggerstaff and Moser 2019; Donelson, Kartapanis, and Yust 2021). Further, Johnson, Nelson, and Pritchard (2007) and Choi, Nelson, and Pritchard (2009) find dismissal decisions and settlement amounts are related to case merit proxies, consistent with settled (dismissed) litigation being relatively meritorious (nonmeritorious). Thus, meritorious cases are the most informative regarding peer litigation costs and likely cause the largest spillover effects.

Consistent with our predictions, in the days leading up to the SCA filing, abnormal returns are significantly negative only for peer firms with meritorious focal firm SCAs. Moreover, over the sixty days following the litigation filing, peers with meritorious focal firm SCAs have abnormal returns that remain significantly negative (-4.21 percent) while peers with nonmeritorious focal firm SCAs are insignificantly negative (-0.38 percent).¹ Collectively, these tests show investors are both able to (a) assess the relative merits of a focal firm's SCA and then (b) identify similar peers that may be targets of costly related future litigation.

It is likely that these initial negative spillover effects in returns help spur responses by firms, particularly for the firms with the most negative returns, as they attempt to minimize investor concerns and recoup market losses (see Chakravarthy, deHaan, and Rajgopal 2014). Thus, in our second set of analyses, we examine how peer firms change their disclosures after observing the focal firm SCA (and related market reaction). Managers have strong incentives to respond if they perceive their exposure to litigation is heightened. In the near term, the abnormal negative market reaction that we document likely motivates peer firms to respond, as managers'

¹ We ensure results are not simply due to the minority of peer firms that are later sued and obtain similar results when we exclude these firms. We also continue to find significant negative abnormal returns after SCA filings if we exclude SCAs with class period ends (when stock price drops are concentrated) near our measurement windows to ensure results capture spillover from the litigation itself, rather than factors that triggered the litigation (untabulated).

personal capital is highly invested in their firm through equity holdings. Additionally, there are long-term reputational risks to litigation, which can affect managers' future careers (Black, Cheffins, and Klausner 2006; Helland 2006).

Voluntary disclosures, such as earnings and sales forecasts, are a powerful setting to observe this managerial response. To recoup market losses from the spillover effect of litigation, managers may turn to voluntary disclosure as a tool to attract investment (Fishman and Hagerty 1989; Park, Schrand, and Zhou 2019). Shareholder litigation is also a primary determinant of voluntary disclosure (Beyer, Cohen, Lys, and Walther 2010; Rogers and Stocken 2005), and a majority of disclosure-related litigation complaints specifically reference earnings or sales forecasts (Cazier, Merkley, and Treu 2020). Litigation may prompt peer firm managers to increase disclosure, potentially reducing future litigation probability (Skinner 1994; Field, Lowry, and Shu 2005). However, given the frequency of industry litigation waves, managers may also reduce disclosure due to concerns that disclosures will draw attention from plaintiffs' lawyers who may be monitoring the firm (Gande and Lewis 2009). Thus, whether and how managers adjust disclosures in the face of an industry litigation event are empirical questions.

Notably, firms' disclosure strategies may also be affected by economic factors or industry news that helped trigger the focal firm SCA. To enhance identification, we use a difference-in-differences design to compare changes in behavior of these peers relative to control firms in the same industry. We select control firms with low ex-ante litigation risk (i.e., firms in the bottom tercile of industry litigation risk). Control firms are thus subject to the same industry economic factors and regulatory environment that may have helped trigger the litigation, allowing us to hold these factors constant. However, control firms should be less likely to respond to the focal firm SCA as they are unlikely to be sued (see Nelson and Pritchard 2016).

We find that peer firms provide significantly more voluntary management earnings and sales forecasts following an industry litigation event. Disclosure involves a tradeoff between its costs and benefits (Verrecchia 1983), so we expect managers will assess disclosure to have the greatest benefits in response to the costliest litigation. Thus, we expect spillover effects to be strongest for meritorious focal firm SCAs. While the increased earnings forecasts are driven by meritorious litigation, the increase in sales forecasts does not differ based on case merits.

To provide more insight into the spillover mechanism, we test whether peer firms' responses differ based on two firm characteristics that should affect how noteworthy disclosure-related litigation is to the peer firm and its investors. We first examine whether a peer firm is a growth or value firm in its industry (based on market-to-book ratios). Growth firms face greater demand for information from investors and consumers, so they are more likely to issue guidance (Brochet, Faurel, and McVay 2011; Ertimur, Livnat, and Martikainen 2003). Growth firms also have more negative responses to earnings and revenue surprises (Brown 2001; Ertimur et al. 2003; Skinner and Sloan 2002), and a significant stock price decline from such a surprise significantly increases litigation incidence (Kim and Skinner 2012). Given a heightened perception of litigation costs, managers of growth firms may use voluntary disclosure to guide the market towards beatable expectations (Brochet et al. 2011), lowering the risk of a negative stock drop that could draw litigation. Thus, after growth firms observe the focal firm SCA, they likely have stronger incentives to respond than value firms.² Consistent with our expectations,

² Compounding these effects, growth firms have higher levels of insider sales, particularly before bad news (Ke, Huddart, and Petroni 2003), and these insider sales increase litigation risk absent voluntary disclosure (Billings and Cedergren 2015).

the increases in both earnings and sales forecasts are driven by peers that are growth firms.

We also consider the litigation dynamics of the industry.³ In relatively high litigation industries, firms are already cognizant that they operate under a high risk of litigation. They regularly observe peer firm litigation and may have already adjusted their actions accordingly, limiting any spillover effects. However, the occurrence of litigation in industries with relatively low litigation incidence is more likely to surprise peer firms and provide new information regarding litigation costs, resulting in stronger spillover effects. Consistent with our predictions, we find increases in voluntary disclosure are driven by low litigation industries.

In additional analyses, we directly examine whether the peer firms with the largest negative market reactions from the spillover are more likely to subsequently increase their disclosure. We find that they are, consistent with peer firms using disclosure in an attempt to recoup market losses or prevent further declines. We also examine discretionary characteristics of mandatory disclosure. As these disclosures are subject to managerial judgment, they face a portion of the same tension as voluntary disclosure. That is, managers may adjust disclosures with the primary goal of increasing information quality (e.g., increased readability) or with the primary goal of evading attention (e.g., decreased readability) (Li 2008). We find that peer firm disclosures become more readable after meritorious focal firm SCAs, as they have fewer words (Loughran and McDonald 2014) and lower Bog Index (Bonsall, Leone, Miller, and Rennekamp, 2017). Also, peer firms attempt to indicate that they have less litigation risk as they reduce the use of litigation-related terms. Collectively, the evidence suggests that peer firms differentially

³ We define value and growth firms by ranking each firm's book-to-market ratio within industry, so our measures of growth firms and industry litigation risk are uncorrelated. Thus, results in one split cannot be explained mechanically by the other.

change both voluntary and mandatory disclosures following focal firm litigation.

Finally, we examine future securities litigation against peer firms. One may expect that peer firms are more likely to face litigation after a lawsuit against an industry peer, just as peer firms are more likely to have a restatement after one is announced in their industry (Gleason et al. 2008). However, given that increased disclosure can reduce the incidence of litigation (e.g., Skinner 1994; Donelson, McInnis, Mergenthaler, and Yu 2012), the increased voluntary disclosures we observe may offset heightened exposure to litigation. We find peer firms have a lower rate of future litigation than control firms, suggesting peer firm disclosure adjustments may be successful at mitigating the spread of litigation.

Our study makes several contributions to the literature. First, we provide evidence that investors update their industry valuations following an industry litigation event. Gande and Lewis (2009) find that shareholders partially anticipate future SCAs based on cases against firms in the same industry, leading to a stock price drop before the ultimate lawsuit is filed. We contribute beyond prior research by identifying spillover effects on a broad group of (largely unsued) peer returns, as well as partitioning the sample based on case merits to demonstrate the sophistication of investor responses to industry litigation events.

Second, our finding that peer firms experience externalities based on the legal environment of other industry firms enhances our understanding of the reach of securities litigation. SCAs affect the behavior of the sued firm (e.g., Rogers and Van Buskirk 2009), and we are aware of one study that shows an association between SCAs and policies of industry peers (Arena and Julio 2015). Building on these studies, we hypothesize and find that peers alter and improve the quality of their information environments through increased voluntary disclosures and more readable mandatory disclosures after an industry litigation event. We also

show how peer firm responses vary with the case outcome and firm characteristics that affect how noteworthy the litigation is to the peer firm.

Finally, we contribute to the literature on the relation between securities litigation and voluntary disclosure. Currently, in part due to endogeneity challenges, there are conflicting views on the nature of this relation: firms may increase (e.g., Field et al. 2005) or decrease (e.g., Rogers and Van Buskirk 2009) disclosure to reduce litigation. Both research streams show managers change their disclosures in response to information on changing litigation costs, albeit in different ways. Using a spillover design, our study shows that managers also change their disclosure behavior after another similar industry firm is sued, and this response differs based on the merits of the focal firm's litigation, peer firm characteristics, and industry dynamics.

II. BACKGROUND

Securities litigation

SCAs are most commonly brought under Rule 10b-5, which requires “(1) a misstatement or omission of (2) a material fact (3) made with intent (4) that the plaintiff justifiably relied on (5) causing injury in connection with the purchase or sale of a security” (Skinner 1994, 41). Importantly, the plaintiff must show that their injury—a loss of market value—is due to firm-specific factors, rather than broader industry or economic effects (Donelson and Hopkins 2016). Thus, the very definition of Rule 10b-5 requires that the lawsuit be related to individual firm behavior, not a general market event that affects other firms.

While allegations are relatively easy to make, they are difficult to prove, particularly after the passage of the Private Securities Litigation Reform Act (PSLRA) in 1995. Among other things, the PSLRA prevented discovery from occurring until after a case survives a motion to dismiss and required the plaintiff to provide specific factual allegations that yield a strong

inference of scienter (i.e., intent). As a result, because plaintiffs' lawyers must rely on largely public information to build their case, detailed public information about potential misconduct at one firm is particularly useful. In addition, the PSLRA provides a safe harbor for forward-looking statements if the firm provides meaningful cautionary language (Choi et al. 2009). Nevertheless, SCAs involving allegedly false forward-looking statements (i.e., disclosures such as earnings and/or sales forecasts) are still among the most common cases, comprising between 45 and 82 percent of filings (Cornerstone 2009, 2011, 2015, 2020).⁴

Litigation and voluntary disclosure

The relation between litigation and voluntary disclosure has been the focus of most prior accounting research on litigation (e.g., Skinner 1994; Field et al. 2005; Houston, Lin, Liu, and Wei 2019). Managers must weigh the costs and benefits of disclosing information (Verrecchia 1983), and the likelihood of litigation influences managers' voluntary disclosure decisions (Beyer et al. 2010; Rogers and Stocken 2005). The risk of litigation affects both sides of the decision to issue forecasts. On one hand, litigation can increase disclosure costs, resulting in a negative relation between litigation and disclosure. For example, Baginski, Hassell, and Kimbrough (2002) examine earnings forecasts for U.S. and Canadian firms and find fewer forecasts in the U.S., which has a higher frequency of litigation. Further, Rogers and Van Buskirk (2009) find managers reduce the frequency of their earnings forecasts after being sued.

On the other hand, litigation can increase the benefits of disclosure, resulting in a positive relation with disclosure. Skinner (1994) argues that U.S. securities laws contribute to an

⁴ The percentage of cases with allegedly misleading forward-looking allegations has remained relatively steady over the past decade, with an average of 51%, while the number of such cases has been increasing, with an average of 99 annual cases.

asymmetric reward function, so “bad news” disclosure may reduce litigation. Empirically, Cao and Narayanamoorthy (2011) use D&O insurance premiums and find managers are more likely to release timely earnings forecasts when litigation risk is higher, while Houston et al. (2019) use exogenous variation in litigation risk from legal events to document a positive relation between litigation risk and earnings forecasts. Further, such voluntary disclosure appears rational, as Donelson et al. (2012) find that timely disclosure of bad news reduces litigation.

Our setting differs from these prior studies on litigation and voluntary disclosure in two important ways. First, much of the prior research on litigation and disclosure examines litigation risk using ex-ante measures or singular changes in regulatory environments, whereas we examine litigation events that are staggered across industries and time. Second, prior research on voluntary disclosure and litigation events has generally focused on the effects on the sued firm itself, whereas our study considers the response of industry peers. These differences allow us to partially mitigate the endogeneity issues in prior research (Arena and Julio 2015).

Peer spillover effects

Baginski (1987) and Han, Wild, and Ramesh (1989) find information transfer effects in voluntary disclosure, whereby a firm’s share price benefits from its peers’ disclosure. Building on this research, Baginski and Hinson (2016) examine the behavior of these “free riders” when a peer firm stops providing guidance and find that free-riding firms are more likely to begin issuing guidance, suggesting that firms are aware of the disclosure practices of peer firms and how they affect their own firm. Relatedly, Shroff, Verdi, and Yost (2017) show that the peer information environment is negatively associated with cost of capital in newly issuing firms.

A related stream of literature investigates spillover effects in financial misreporting. Gleason et al. (2008) find accounting restatements at one firm prompt investors in peer firms to

reassess the credibility of those firms' financial statements, resulting in market value declines. Beatty et al. (2013) find that peers respond to fraudulent financial reporting by increasing capital expenditures during the fraud period. However, we are only aware of one prior study that examines changes in corporate policies following an industry litigation event. As part of a study on litigation risk, liquidity, and investments, Arena and Julio (2015) find SCAs are associated with an increase in peer firms' cash holdings and a reduction in peer firms' capital expenditures. Ai, Bai, Chen, Sun, and Wan (2020) examine a related, but fundamentally different, question on whether there is a spillover of ex ante litigation risk. That is, they estimate the ex-ante litigation risk of firms similar to Kim and Skinner (2012) and then construct a weighted measure of the predicted litigation risk of a firm's peers. They find this measure is negatively associated with voluntary disclosure. In contrast, we use a difference-in-differences design to examine how firm' disclosures change following high-profile securities litigation against an industry peer.

III. SAMPLE AND RESEARCH DESIGN

Sample construction

To investigate our research questions, we examine securities litigation for U.S. public companies from 1997–2014. Our sample begins with all SCAs brought under Rule 10b-5 over our sample period. Following Kim and Skinner (2012), we drop SCAs related to IPOs. We then merge in focal firms' ex-ante litigation risk, as calculated in Kim and Skinner (2012), and litigation risk ranking among all firms with data, dropping SCAs against firms that lack CRSP and Compustat identifiers and the information needed to calculate litigation risk. To focus on the litigation most likely to incite spillover, we drop SCAs against firms that are not in the highest tercile of litigation risk for the population industry-year. Thus, the sued focal firms in our sample

tend to be large, well-known, and prominent in their industries (see Kim and Skinner 2012).⁵

Similar to the process in Gleason et al. (2008), to minimize confounding effects from subsequent litigation, we retain only the first SCA in an industry-year. Given our focus on the peers of the sued firm, we remove cases that lack peer firms with sufficient data to run our primary analyses. Finally, to ensure that we capture spillover from the focal firm SCA, rather than other factors that may be associated with litigation and also cause spillover, we remove SCAs associated with restatements or SEC comment letters in the 90 days preceding the filing, as well as SCAs that are related to an SEC investigation (see Gleason et al. 2008; Brown et al. 2018).⁶ As a result of these exclusions, our sample primarily comprises disclosure-related litigation, which are some of the most common types of cases. Table 1 provides the details of our selection process, which results in a sample of 265 SCAs against focal firms in our sample.

Appendix B presents the distribution of SCAs by industry and year. A key strength of our sample is that, unlike many studies of litigation shocks, it includes a large cross-section of industries and is staggered over time, minimizing concerns of correlated, omitted variables. Specifically, our litigation sample has cases in 43 of the Fama-French 49 industries and all 18 years in the sample. Further, no industry (year) contains more than 5.3 percent (9.1 percent) of the cases in the sample, limiting the risk that results are due to a certain industry or year.

⁵ We examine the robustness of our results to this design choice and find similar inferences if we permit litigation targeting low litigation risk focal firms into the sample (untabulated).

⁶ We find similar inferences if we retain SCAs with these potential contaminating events and instead control for them in our multiple regression analyses. Additionally, while our 90-day screen likely identifies all litigation for which the restatement was a material event, because some litigation may reference firm restatements from earlier periods, we rely on Advisen coding and identify an additional 16 cases that reference firm restatements. We obtain similar inferences if we exclude these additional focal firm SCAs from the sample (untabulated).

To identify the peer firms that would be most expected to have their litigation risk “treated” due to the focal firm SCA, we match the focal firm to peers in the same Fama-French 49 industry and highest tercile of litigation risk. This design ensures that focal firms and peer firms are similar in business operations and litigation environments. We exclude potential peers that have been sued in the past two years since they may already be making disclosure changes (Rogers and Van Buskirk 2009).⁷ Finally, we obtain a control sample to use a difference-in-differences design for our disclosure analyses to rule out alternative explanations that the focal firm SCA is due to some industry or other macroeconomic factor that may also affect peer firm disclosure independent of the litigation (e.g., concurrent changes in SEC enforcement or media coverage). We match focal firms to control firms in the same industry but the lowest tercile of litigation risk.⁸ Thus, control firms share similar business environments to the focal firm but, because they have no substantive expected litigation risk, are unlikely to respond to the focal firm SCA filing. Thus, we believe this is the most effective design to identify any litigation spillover effects that exist (see Burgstahler and Chuk 2015).⁹

We gather litigation data from Advisen, accounting data from Compustat, market data from CRSP, and management forecasts and analyst coverage data from IBES.¹⁰ We obtain 10-K qualitative characteristics from Bill McDonald’s website and measures of the Bog Index from

⁷ To maximize statistical power and generalizability, we do not remove financial and utilities firms from our sample. However, we obtain similar inferences when we remove these firms from the sample. Additionally, we obtain similar inferences if we require at least five firms in each peer group or if we do not exclude industry peers sued in the prior two years, but rather control for peer firms’ own prior litigation (untabulated).

⁸ We discuss robustness of our results to alternative definitions of industry and litigation risk rankings in Section V.

⁹ To ensure our results are not due to any concurrent changes to SEC enforcement that may differentially affect treatment and control firms, we re-perform our tests after excluding all peer firms that have any SEC AAERs or comment letters in the two years following the focal firm SCA and find similar inferences (untabulated).

¹⁰ While less common than the Stanford Securities Class Action Clearinghouse (SCAC), Advisen is a commercial comprehensive litigation dataset used in prior research (e.g., Donelson, Hopkins, and Yust 2015, 2018; Singha, Hillmer, and Shenoy 2017).

Brian Miller's website. We require firms be present and have necessary data to calculate control variables for two years before and after the peer litigation date to ensure results are not due to changes in sample composition. Our final sample comprises 86,456 firm-years for 10,820 (10,794) unique SCA-treatment (control) firms. Because firms can be treated multiple times over our 18-year sample, there are 3,458 (3,676) unique treatment (control) firms in the sample.

Research design

Market reaction

In our first set of analyses, we examine the market reaction to focal firm litigation on our treated peer firms using standard event study methodology and cumulative abnormal returns (Brown and Warner 1985). To estimate expected returns, we use the Fama-French 3-factor model (Fama and French 1993) and the Carhart (1997) momentum factor. We estimate returns over four windows: nine trading days preceding the litigation event window [-10,-2], three trading days centered on the focal firm litigation filing date [-1,+1], nine trading days following the litigation event window [+2,+10], and the following fifty days [+11,+60]. The longer windows allow for delayed responses as investors must both assess the relative merits of the focal firm litigation and assess the likelihood and magnitude of potential litigation costs for the affected peer firms. The window before the SCA filing allows for investor anticipation as they partially anticipate litigation, at least for firms that are ultimately sued (Gande and Lewis 2009).

To investigate if investors respond differently based on case merits since litigation costs are largely restricted to meritorious cases (Donelson and Yust 2019), we also examine returns separately based on the outcome of the focal firm SCA (where settled cases are considered meritorious). Finally, to further distinguish our results from Gande and Lewis (2009), we also report results after removing peer firms sued in the one year following focal firm litigation.

Firm voluntary disclosure reaction

Next, we examine changes to voluntary disclosure following litigation against a focal firm. In our setting, peer firms must determine whether or not to voluntarily disclose after a loss of market value from the focal firm litigation, with the likely goal of recovering the losses in market value or preventing further declines given the apparent damage to their own reputations following the announcement of the focal firm litigation (see Chakravarthy et al. 2014). We also expect peers may change disclosures since the majority of focal firm cases that we examine are disclosure-related and allege misleading forward-looking information. The peer firms' decision involves a tradeoff between the costs and benefits of disclosure (Verrecchia 1983), and the focal firm SCA may be viewed as a signal that litigation costs have increased for the peer firms (Arena and Julio 2015). To test how managers alter voluntary disclosure after litigation against a focal firm, we estimate the following OLS regression:

$$VDisclosure_{i,t} = \beta_1 Treat_{i,t} + \beta_2 Post_{i,t} + \beta_3 Treat_{i,t} \times Post_{i,t} + \beta_4 LitigationRisk_{i,t} + \beta_5 Stop_j \\ + \beta_6 Loss_{i,t} + \beta_7 LnMVE_{i,t-1} + \beta_8 BTM_{i,t-1} + \beta_9 AnalystFollowing_{i,t} + \alpha_k + \theta_t + \varepsilon_{i,t} \quad (1)$$

where $VDisclosure$ is equal to (1) the natural log of management quarterly earnings forecasts ($QtrEPS$), (2) the natural log of management annual earnings forecasts ($AnnEPS$), (3) the natural log of management quarterly sales forecasts ($QtrSales$), or (4) the natural log of management annual sales forecasts ($AnnSales$). Cazier et al. (2020) note that over 60 percent of litigation complaints that allege misleading forward-looking statements reference specific earnings or sales forecasts, illustrating their collective importance to shareholders in the litigation process. We use both quarterly and annual forecasts for two reasons. First, quarterly forecasts are often criticized for incentivizing managerial myopia, but annual forecasts are less prone to this criticism (Choi, Myers, Zang, and Ziebart 2011). Second, prior research has found that firms behave differently

with respect to quarterly and annual earnings forecasts (e.g., Houston, Lev, and Tucker 2010). We also examine sales forecasts, which have become more prevalent than earnings forecasts (Boone, Lewis, Starkweather, and White 2020), but have been excluded from most prior papers on litigation and disclosure (e.g., Field et al. 2005; Cao and Narayanamoorthy 2011; Billings and Cedergren 2015; Houston et al. 2019).¹¹ Additionally, law firms advise audit committees to particularly scrutinize revenue-related information which has “traditionally attracted the attention of the plaintiffs bar” (Baker McKenzie 2018). *Treat* is an indicator variable set equal to one for our peer firms and zero otherwise. *Post* is an indicator variable set equal to one in years subsequent to the focal firm litigation and zero otherwise. Our focus is β_3 on the interaction of *Treat* \times *Post*, and higher values indicate increased voluntary disclosure.

We control for characteristics that may be correlated with our variables of interest. First, we control for the firm’s ex-ante litigation risk (*LitigationRisk*) to ensure we capture spillover effects incremental to a firm’s existing litigation risk. Since litigation against a focal firm may affect its own disclosure strategy (Rogers and Van Buskirk 2009), we control for a reduction in management guidance by the focal firm (*Stop*) since that also may affect peer firms’ disclosure (Baginski and Hinson 2016). We also control for several other factors associated with litigation and disclosure choices: an indicator variable for loss years (*Loss*), market value of equity (*LnMVE*), book-to-market (*BTM*), and analyst following (*AnalystFollowing*). Finally, α_k represents industry fixed effects, and θ_t represents year fixed effects. Throughout our tests, we cluster standard errors by peer firm. Variables are defined in detail in Appendix A.

¹¹ Johnson, Kasznik, and Nelson (2001) is a notable exception. They find an increase in earnings and sales forecasts after the passage of the PSLRA.

Cross-sectional tests

Voluntary disclosure conditioned on case merits

We next consider factors that may influence the peer firm response to focal litigation to provide more insight into the mechanism for the spillover. We predict that changes in voluntary disclosure will be stronger when the focal SCA is eventually settled (i.e., more meritorious) as such litigation is a stronger signal of potential litigation costs to peer firms. Thus, we split the sample based on the outcome of the focal firm litigation and re-estimate Equation (1).

Voluntary disclosure conditioned on peer firm characteristics

We also expect that the voluntary disclosure spillover will be stronger when the focal firm SCA is more noteworthy to the peer firm and its investors. We first predict that changes in voluntary disclosure will be stronger when the peer firm is a growth firm. Information on earnings and sales is particularly important to these firms, and they have stronger incentives to respond to an increase in litigation costs (Brochet et al. 2011; Ertimur et al. 2003; Kim and Skinner 2012). Thus, we split the sample into growth and value firms and re-estimate Equation (1). We define firms as “value” firms if the firms’ book-to-market ratios are above the median in an industry-year, and “growth” firms if they are below the median.¹²

We next predict that firms in industries with a low incidence of litigation risk will react more strongly to litigation against a focal firm, as litigation in those industries is a rare event that is likely to catch managers’ attention. We split the sample into industries with high litigation

¹² In an untabulated robustness test, we classify value and growth firms using the top and bottom terciles of book-to-market in an industry-year. Our results are robust to this alternative definition.

incidence and industries with low litigation incidence and re-estimate Equation (1). We follow Kim and Skinner (2012) and define healthcare, services, technology, and financial services as high litigation industries.^{13, 14}

IV. EMPIRICAL RESULTS

Descriptive statistics and correlations

Table 2 provides descriptive statistics for the treatment and control firms in our sample. For treated peer firms (Panel A), the univariate evidence indicates an average increase in quarterly EPS guidance (*QtrEPS*), annual EPS guidance (*AnnEPS*), quarterly sales guidance (*QtrSales*), and annual sales guidance (*AnnSales*) in the post period ($p < 0.01$). Control firms (Panel B) also have increases in these variables, though the magnitude of the increase is less than half that of the treated firms. Thus, the univariate evidence indicates that peer firms may differentially respond to focal firm SCA by increasing voluntary disclosure. However, several other characteristics of the peer firms (e.g., size and litigation risk) also change, so it is important to control for these variables in our analyses as they may also be correlated with our variables of interest. Consistent with findings that firms respond to litigation with reduced disclosure (Rogers and Van Buskirk 2009), we find that the sued focal firms reduce their guidance post-litigation (*Stop*). Validating our sample construction, ex-ante litigation risk for our peer treatment firms is approximately four times larger than that of our peer control firms, allowing us to examine the

¹³ Specifically, we define the following Fama-French 49 industries as high litigation incidence industries: healthcare, medical equipment, pharmaceutical products, personal services, business services, computers, computer software, electronic equipment, banking, insurance, real estate, and trading. In our sample, these industries also experience the highest rate of litigation along with the retail industry. When we add the retail industry to the list of high litigation industries in our analysis, we continue to find similar results (untabulated).

¹⁴ In untabulated analyses, we also examine whether common auditors, institutional investors, or board interlocks are mechanisms for our results but find no evidence that our spillover differs significantly based on these factors.

effect of focal firm litigation differentially on firms with high versus low litigation risk.

Table 3 presents Pearson correlations between the variables of interest and controls for the treated firms in our analysis. We find similar inferences to Table 2, Panel A, as *Post* is positive and significantly related to *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales*. However, *Post* is also significantly related to many control variables, many of which are also correlated with each other (e.g., *LnMVE* is significantly correlated with all variables at $p < 0.01$ levels), so it is important to examine our research questions in a multiple variable regression framework.

Market reaction tests

We first examine the market reaction to litigation against a focal firm. Results are presented in Table 4. As shown in Table 4, Panel A, treated peer firms experience a negative and insignificant abnormal return at the announcement of focal firm litigation. However, this lack of reaction around the filing may be due to the significant investor anticipation we observe prior to the filing, similar to Gande and Lewis (2009). That is, in the nine trading days leading up to the announcement of focal firm litigation, peer firms experience negative and significant abnormal returns (-0.33 percent, $p < 0.01$). This decrease is economically significant as it corresponds to approximately negative 9 percent on an annualized basis. Additionally, abnormal returns continue to remain negative and economically significant through 60 days after the focal firm SCA filing ($p < 0.01$). These results are particularly economically significant in the aggregate to the economy as we have an average of 41 treated peer firms for each focal firm SCA.

Next, we partition the sample on case outcomes and examine returns separately by outcome. We find large negative abnormal returns for cases that settle both before (-0.60 percent) and after the filing (-4.21 percent, $p < 0.01$), collectively corresponding to approximately a negative 16 percent abnormal return on an annualized basis. In contrast, we find

no significant evidence that peer investors significantly respond to dismissed focal litigation, which suggests that investors are able to identify meritorious cases relatively early. Thus, the negative investor response is concentrated in firms when the focal firms face meritorious litigation. In untabulated tests, we also confirm that control firms do not experience a loss of market value in any of the return windows that we examine, validating our assertion that investors do not view litigation as a substantial risk for these firms.

Given that litigation often occurs in industry waves, to ensure that the effect we find is due to spillover from the focal firm SCA, rather than the peer firm subsequently being sued itself and anticipation thereof (see Gande and Lewis 2009), we drop peer firms if they face a SCA in the year following the focal firm SCA filing. Consistent with litigation being rare and this being unlikely to drive our results, only 443 treated peer firms (approximately 4 percent of the sample) are sued and thus dropped from our returns tests. Results are presented in Table 4, Panel C, and are similar with the results of our full sample.¹⁵

Voluntary disclosure tests

Moving into our multiple regression analyses, we examine the disclosure response of treated peer firms following focal firm litigation. Results are presented in Table 5. In Column (1), we examine changes in *QtrEPS* and find the coefficient on *Treat* × *Post* is 0.025 ($p < 0.01$),

¹⁵ We separately conduct these tests for the small subsample of peers that are later sued similar to Gande and Lewis (2009) to examine if the market is able to identify peer firms with the highest probability of being and find even larger negative abnormal returns for these firms. Given that most peer firms are not sued, one may question whether the negative returns we observe reverse when it appears that any litigation wave has ended. However, we examine returns through 120 or 180 days after the filing date and continue to find negative abnormal returns. We also ensure our disclosure tests are not driven by these sued peers and find similar results when we exclude them (untabulated).

indicating that treated firms increase their quarterly EPS guidance by approximately 3 percent after litigation against a focal firm.¹⁶ In the remaining columns, we similarly observe a positive and significant coefficient on our interaction of interest for *AnnEPS*, *QtrSales*, and *AnnSales* ($p < 0.01$) of similar economic significance. While this increase is relatively modest for each peer firm, it still results in a meaningful increase in disclosure for the economy given that there are, on average, 44 treated peer firms for each instance of focal firm litigation in our sample. Moreover, this treatment effect is likely long-term in nature given the stickiness of voluntary disclosure (Bamber, Jiang, Wang 2010) and the negative market reactions upon ceasing guidance (Chen, Matsumoto, and Rajgopal 2011). These results provide consistent evidence that managers respond to litigation against an industry firm by increasing voluntary disclosure.

Cross-sectional tests

Next, we report the results of cross-sectional tests based on whether spillover results are concentrated in the cases with the highest litigation costs and in the firms that would find the focal firm litigation most noteworthy.

Case merits

Table 6 presents the results of splitting our analysis based on whether the focal firm SCA is settled or dismissed. Columns (1) – (4) present results for settled focal SCAs, and Columns (5) – (8) present results for dismissed cases. We find peers increase *QtrEPS* after both settled and dismissed cases ($p < 0.05$), but the magnitude of the response to settled cases is more than double that of dismissed litigation, and this difference is statistically significant ($p < 0.05$). Relatedly, we find a significant increase to *AnnEPS* for settled litigation (0.035, $p < 0.01$) but no evidence of a

¹⁶ Calculated as $100(\exp(0.025)-1)$.

change for dismissed litigation, and the difference is statistically significant ($p < 0.01$). Thus, changes to earnings forecasts are largely driven by the focal firm SCAs that indicate the most potential litigation costs for the peer firms as predicted.

In contrast, we find similar increases in *QtrSales* and *AnnSales* by peers of both settled and dismissed focal litigation ($p < 0.01$). This result may suggest that revenue guidance is viewed as a less costly form of voluntary disclosure by peer firm managers, consistent with related research showing that revenue guidance has overtaken EPS guidance in recent decades (Boone et al. 2020), and thus exposure to litigation with even minimal costs may induce increases to sales guidance.

Growth versus value firms

Table 7 presents the results of splitting our analysis based on whether the *peer* firm is a growth or value firm. Columns (1) – (4) present peer growth firms, and Columns (5) – (8) present peer value firms. We find that peer growth firms increase *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales* ($p < 0.01$). In contrast, we find that value peer firms only respond to focal firm litigation by increasing *QtrEPS* (0.014, $p < 0.05$) and *QtrSales* (0.017, $p < 0.01$), with no evidence that they increase annual forecasts (*AnnEPS* or *AnnSales*). These differences across subsamples are statistically significant for all four voluntary disclosure proxies ($p < 0.05$). Thus, growth firms respond more strongly to focal firm litigation than value firms as predicted.

Industry litigation frequency

Table 8 presents the results of splitting our analysis based on the litigation incidence within the focal and peer firms' industry. Columns (1) – (4) present peer firms in low litigation industries, and Columns (4) – (8) present peer firms in high litigation industries. While we find that peer firms in both types of industries respond to focal firm litigation by increasing their

voluntary disclosure across all proxies ($p < 0.10$), the magnitude of the increase for three of our four proxies is approximately two to five times larger for firms operating in low litigation industries, and these differences are statistically significant for earnings guidance (*QtrEPS* and *AnnEPS*, $p < 0.01$). Thus, while focal firm litigation appears to provide information about potential litigation costs even to firms that more regularly observe intra-industry litigation, spillover is strongest for the firms that do not regularly observe such litigation.

V. ADDITIONAL ANALYSES AND ROBUSTNESS

Disclosure treatment effect conditional on market reactions

An underlying assumption in our voluntary disclosure tests is that peer firms are motivated to change their disclosures at least in part to recoup or prevent further damage to their own stock price given the strong negative market reactions to the announcement of focal firm litigation. Such a response is similar to the actions taken by firms to rebuild their reputations after the negative reaction to restatement announcements (Chakravarthy et al. 2014). Our prior evidence is consistent with this story as we find that the negative market returns are concentrated in peers of meritorious litigation (Table 4) and the change in voluntary disclosures are largely concentrated in the same peer firms (Table 6).

However, to more directly examine the linkage between negative market reaction and the subsequent changes to voluntary disclosure, we conduct a test similar to that of Crane and Koch (2018) and interact $CAR_{[-10,+60]}$ for peer firms around the litigation announcement with our *Treat* and *Post* variables in Equation (1). We estimate the following OLS regression:

$$\begin{aligned}
 VDisclosure_{i,t} = & \beta_1 Treat_{i,t} + \beta_2 Post_{i,t} + \beta_3 CAR_{i,t} + \beta_4 Treat_{i,t} \times Post_{i,t} + \beta_5 Treat_{i,t} \times CAR_{i,t} \\
 & + \beta_6 Post_{i,t} \times CAR_{i,t} + \beta_7 Treat_{i,t} \times Post_{i,t} \times CAR_{i,t} + \Sigma Controls_{i,t} + \alpha_k + \theta_t + \varepsilon_{i,t} \quad (2)
 \end{aligned}$$

where CAR is equal to the total cumulative abnormal return for peer firm i around the filing date as discussed in Table 4 ($CAR_{[-10,+60]}$). All variables are discussed previously and defined in Appendix A. The coefficient of interest in this specification is β_7 , which identifies the association between our treated peer firms' market reaction around the filing date and their voluntary disclosure response following the filing date.

Results are presented in Table 9. We find that the market reaction at the announcement date is negatively associated with treated firms' future voluntary disclosures for the remaining three of our four outcome variables ($QtrEPS$, $QtrSales$, and $AnnSales$, $p < 0.01$). This indicates that for treated peer firms, a more negative market reaction to the case filing is associated with greater increases in future voluntary disclosure. Thus, the disclosure response is strongest for the peers for whom the spillover effect is most costly.

Peer firm mandatory disclosure reaction

Our primary tests examine peer firms' changes in voluntary disclosure using management forecasts. We focus on voluntary disclosure as a setting with significant firm discretion based on an assessment of the costs and benefits of disclosure and given that voluntary disclosure is the focus of prior litigation research (e.g., Field et al. 2005; Francis, Philbrick, and Schipper 1994; Houston et al. 2019; Rogers and Van Buskirk 2009). However, to complement these tests, we also examine if peer firms change voluntary attributes of their mandatory disclosures (i.e., the qualitative characteristics of the 10-K). Any such changes may be substitutes or compliments of changes to voluntary disclosure. For example, peer firms will not increase voluntary disclosure after the focal firm SCA if they determine that the costs of initiating such disclosures exceeded the benefits, particularly because firms are penalized for ceasing voluntary guidance once started (Chen et al. 2011). However, litigation risk also affects qualitative characteristics of mandatory

disclosure (Li 2010), and peer firms may conclude it is relatively lower cost to adjust voluntary attributes of these mandatory disclosures to communicate information to the market. Relatedly, firms that change voluntary disclosures may deem it unnecessary to also change mandatory disclosures. We estimate the following OLS regression:

$$QUALCHAR_{i,t} = \beta_1 Treat_{i,t} + \beta_2 Post_{i,t} + \beta_3 Treat_{i,t} \times Post_{i,t} + \Sigma Controls_{i,t} + \alpha_k + \theta + \varepsilon_{i,t} \quad (3)$$

where *QUALCHAR* is equal to (1) the natural log of the number of words in the peer firm's 10-K (*LnWords*), where fewer words are associated with higher readability (Loughran and McDonald 2014), (2) a plain English measure of financial reporting readability (e.g., increased use of active voice and fewer hidden verbs, *BogIndex*), which is similarly scaled such that lower values are associated with higher readability (Bonsall et al. 2017), and (3) the percentage of litigious words in the 10-K (*Litigious*), where higher values indicate more frequent use of such words (Loughran and McDonald 2011).¹⁷ We condition these tests on focal case merits to focus on the focal firm SCAs with the highest litigation costs.¹⁸ All control variables are the same as discussed previously and defined in detail in Appendix A.

Results are presented in Table 10. We observe that peer firms with meritorious focal firm cases significantly change their 10-Ks ($p < 0.01$). Specifically, peer firms of meritorious focal litigation reduce the number of words in their 10-K by approximately 4 percent ($p < 0.01$), a change that indicates the financial statements are more readable (Loughran and McDonald 2014). We similarly find that peer firms increase their use of plain English attributes as the *BogIndex* decreases for these firms in the post-period ($-0.162, p < 0.10$). Interestingly, we also

¹⁷ The list of litigious words reflects a propensity for legal proceedings and outcomes, such as claimant, deposition, lawsuit, motions, and settlements (see Loughran and McDonald 2011). The full list of litigious words is available at <https://drive.google.com/file/d/15UPaF2xJLSVz8DYuphierz67trCxFLcl/view?usp=sharing>.

¹⁸ In untabulated analysis, we find a significant decrease in both *LnWords* and *Litigious* in the full sample ($p < 0.05$).

find that treated peer firms reduce the level of litigious words in their disclosures (-0.049, $p < 0.01$). This corresponds to a decrease of approximately 3 percent relative to the pre-litigation mean. This result may be explained by managers attempting to put their best foot forward; however, this strategy could be costly given that excessively optimistic disclosures are targeted by plaintiffs (Rogers, Van Buskirk, and Zechman 2011).

In contrast, we find no evidence that peer firms change qualitative attributes of mandatory disclosure after nonmeritorious litigation against a focal firm. Results for readability are statistically different between the settled and dismissed subsamples ($p < 0.01$), providing more evidence that treated peer firms primarily respond to meritorious focal firm litigation.

To explore whether these changes substitute or complement changes to voluntary disclosure, we partition the sample on the peer firm characteristics used in our prior analysis: value versus growth firms and high versus low litigation industries. We find no significant differences between these subsamples, indicating that adjustments to voluntary attributes of mandatory disclosures does not systematically vary with the same characteristics that drive the adjustments to voluntary disclosure examined in our primary tests (untabulated). Thus, some peer firms likely view these changes as substitutes while others view them as complements.

Litigation outcomes for peer firms

The evidence presented previously indicates that peer firm investors and managers are concerned that peer firms may themselves be the target of a SCA following focal firm litigation. Absent any changes in their own behavior, we would expect peer firms to face higher litigation risk than the control firms, due to their higher ex-ante litigation risk and potential for industry-wide litigation (Gande and Lewis 2009; Kim and Skinner 2012). However, given that we find peer firms subsequently change their disclosures, which may reduce litigation risk (see Skinner

1994; Field et al. 2005), it is an empirical question whether these firms are *actually* sued at higher rates in the post period. Said more directly, are the changes to disclosure successful at deterring litigation? To test this question, we estimate the following OLS regression:

$$Litigation_{i,t} = \beta_1 Treat_{i,t} + \Sigma Controls_{i,t} + \alpha_k + \theta + \varepsilon_{i,t} \quad (4)$$

where *Litigation* equals one if the firm is sued and zero otherwise. All other variables are as previously defined.¹⁹ As with our main tests, we focus on the two years after focal firm litigation. We also split the dependent variable based on whether the future peer firm litigation is dismissed (*DismissedLitigation*) or settled (*Settled Litigation*).

Results are presented in Table 11. Despite the fact that treated peer firms have higher ex-ante litigation risk in Table 2, we find that treated peer firms have a lower incidence of future litigation compared to other firms ($p < 0.05$). However, we find no evidence that this decrease is driven by meritorious or nonmeritorious litigation. These findings are somewhat counterintuitive given documented industry waves of litigation but would be consistent with peer firms' responses to focal firm litigation minimizing the probability that they too incur litigation.

Robustness

Peer firm identification

As discussed in Section 3, we identify industry peer treatment (control) firms as those in the top (bottom) tercile of ex-ante litigation risk and the same Fama-French 49 industry. However, there are many broader and narrower industry definitions and other thresholds that we could use to split peer firms into those more (less) expected to respond to focal firm litigation. In

¹⁹ This is a simple difference test, unlike our prior tests. By construction, we exclude firms from our sample if they were sued in the pre-period, so we are unable to conduct a difference-in-differences design.

untabulated analysis, we also use Fama-French 30, SIC2, or SIC3 industry definitions and also identify high and low litigation risk firms using terciles, quintiles or deciles in all our analyses.

We find generally similar inferences in all of our analyses using each of these alternative classifications. Moreover, the magnitude of our findings generally increases as we focus on subsamples with higher litigation risk, suggesting that our choice to select treatment firms based on litigation risk appropriately identifies firms that respond more strongly to litigation events. Overall, this robustness test validates our design choices while confirming that our inferences are robust to different approaches used to construct our sample.

Market reaction due to litigation or underlying bad news?

While we observe a significant negative market reaction for peers of focal firms that face meritorious litigation, an alternative explanation is that the reaction is due to material news released at the end of the class period, rather than the litigation. While unlikely to explain the significant abnormal returns we observe over the sixty trading days following the filing date, it is possible that the anticipation we observe is at least in part due to such underlying news, particularly because some litigation is filed relatively quickly after the end of the class period. However, the fact that we omit focal firm litigation accompanied by restatements, SEC comment letters, or SEC investigations should mitigate these concerns as these are some of the events one would most expect to incite significant negative market reactions.

Nevertheless, in untabulated analysis, we re-perform this analysis after excluding all focal firm litigation that occurred within 15 trading days of the litigation filing date to allow time for the market to impound the effect of any such news prior to the anticipation measurement

window that we examine, similar to Griffin et al. (2004) and Donelson and Yust (2019).²⁰ As expected, we lose over 40 percent of our peer firm sample, and this decrease is disproportionately concentrated in meritorious cases as the sample of peers with settled (dismissed) litigation decreases by around half (a third). Potentially as a result of this decrease in sample size, the negative anticipation we observe for settled cases is no longer statistically significant. However, we continue to find a negative abnormal return for peers of such cases after the filing of similar magnitude to our primary tests (-3.99 percent, $p < 0.01$). Thus, while we cannot rule out that part of the anticipation effect that we observe is due to factors other than the litigation, the spillover effects after the filing appear to be due to the focal firm SCA filing itself.

VI. CONCLUSION

We extend our understanding of litigation as a corporate governance mechanism by documenting that the reach of private securities litigation extends to a sued firm's industry peer firms. Following an industry litigation event, investors appear to update their valuation of the industry. However, investors also distinguish between nonmeritorious and meritorious litigation, and peer loss of market value is concentrated in industries with meritorious litigation events.

In response to the litigation event and/or the loss of market value, managers of peer firms provide greater voluntary disclosure. The disclosure increases are stronger in subsamples where a litigation event should serve as a more tangible signal to peer firms. First, peer firms respond more strongly to focal cases that are more meritorious, where litigation costs are expected to be

²⁰ That said, while further removing the effect of any other bad news from our analysis, this design significantly reduces the sample size and will likely understate the effects of litigation since many of the most meritorious and significant SCAs are filed relatively quickly after the class period end. Consistent with this, nine of the ten SCAs with the largest settlements since the PSLRA would be excluded with this design (Stanford 2021). See the list at <https://securities.stanford.edu/top-ten.html>.

higher. Second, growth peer firms increase voluntary disclosure more than value peer firms, consistent with higher information uncertainty and greater potential losses among growth firms. Third, peers respond more strongly when they operate in an environment with relatively low litigation incidence, where an industry SCA is likely to be a larger shock to the firms' litigation environment. Overall, the increases in disclosure appear to be effective as peer firms experience a lower rate of litigation in the two years following the industry litigation event.

Our study provides important evidence that a single securities litigation filing can have far-reaching effects on a broad sample of industry peers. While prior research shows that litigation is costly to the sued firm, we document a loss of value across the sued firm's industry. Further, we provide evidence that litigation influences managerial behavior at peer firms by examining the strategies that managers pursue to recoup value and ward off the risk of being targeted in a litigation wave.

APPENDIX A – VARIABLE DEFINITIONS

Variable	Definition
<i>AnalystFollowing_{i,t}</i>	The number of analysts providing an earnings per share forecast for firm <i>i</i> at the beginning of year <i>t</i> .
<i>AnnEPS_{i,t}</i>	The natural logarithm of one plus the count of annual management earnings forecasts provided by firm <i>i</i> in year <i>t</i> following litigation against a focal firm.
<i>AnnSales_{i,t}</i>	The natural logarithm of one plus the count of annual management sales forecasts provided by firm <i>i</i> in year <i>t</i> following litigation against a focal firm.
<i>BogIndex_{i,t}</i>	A measure of readability from Bonsall et al. (2017), where lower values indicate higher readability. It is based on several attributes of plain English language, such as sentence length, passive voice, weak verbs, overused words, complex words, and jargon.
<i>BTM_{i,t}</i>	The book to market ratio of firm <i>i</i> in year <i>t</i> , calculated as the book value of common equity divided by the market value of equity at the beginning of year <i>t</i> .
<i>CAR_{i,t}</i>	The cumulative abnormal return for firm <i>i</i> at the filing date of a SCA against a focal firm, calculated using the Fama-French (1993) three factors plus the momentum factor (Carhart 1997).
<i>DismissedLitigation_{i,t}</i>	An indicator variable equal to one if firm <i>i</i> is sued in year <i>t</i> and the SCA is later dismissed, and zero otherwise.
<i>Litigation_{i,t}</i>	An indicator variable equal to one if firm <i>i</i> is sued in year <i>t</i> , and zero otherwise.
<i>LitigationRisk_{i,t}</i>	The ex-ante litigation risk of firm <i>i</i> in year <i>t</i> , as calculated in Table 7, Model (3) of Kim and Skinner (2012).
<i>Litigious_{i,t}</i>	The number of litigious words in firm <i>i</i> 's 10-K filing for year <i>t</i> , scaled by the total number of words in firm <i>i</i> 's 10-K filing for year <i>t</i> , multiplied by 100 for expositional convenience. Litigious words are described in detail in Loughran and McDonald (2011) and the full list can be downloaded from Bill McDonald's website.
<i>LnMVE_{i,t}</i>	The natural logarithm of one plus the market value of equity of firm <i>i</i> in year <i>t</i> , calculated as the number of shares outstanding multiplied by the stock price of firm <i>i</i> at the beginning of year <i>t</i> .
<i>LnWords_{i,t}</i>	The natural logarithm of the number of words in firm <i>i</i> 's 10-K filing for year <i>t</i> , excluding exhibits. Fewer words indicate higher readability (Loughran and McDonald 2014).
<i>Loss_{i,t}</i>	An indicator variable equal to one if firm <i>i</i> reports negative net income in year <i>t</i> , and zero otherwise.
<i>Post_{i,t}</i>	An indicator variable that is equal to one for the two years following focal firm litigation, and equal to zero for the two years preceding focal firm litigation.
<i>QtrEPS_{i,t}</i>	The natural logarithm of one plus the count of quarterly management earnings forecasts provided by firm <i>i</i> in year <i>t</i> following litigation against a focal firm.
<i>QtrSales_{i,t}</i>	The natural logarithm of one plus the count of quarterly management sales forecasts provided by firm <i>i</i> in year <i>t</i> following litigation against a focal firm.
<i>SettledLitigation_{i,t}</i>	An indicator variable equal to one if firm <i>i</i> is sued in year <i>t</i> and the SCA is later settled, and zero otherwise.
<i>Stop_j</i>	An indicator variable equal to one if the focal firm <i>j</i> reduces its guidance relative to the prior year, and zero otherwise.
<i>Treat_{i,t}</i>	An indicator that is equal to one if firm <i>i</i> is a treated firm in year <i>t</i> , and zero if firm <i>i</i> is a control firm in year <i>t</i> . Treated firms are defined as firms in the same industry as a sued focal firm and highest tercile of litigation risk. Control firms are defined as firms in the same industry as a sued focal firm and lowest tercile of litigation risk

APPENDIX B – DISTRIBUTION OF LITIGATION BY FAMA-FRENCH 49 INDUSTRY AND YEAR

Fama-French 49 Industry	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Agriculture			1																1
Food Products			1		1	1	1					1							5
Candy & Soda				1				1	1										3
Beer & Liquor																			0
Tobacco Products																			0
Recreation				1															1
Entertainment						1	1	1	1			1			1			1	7
Printing and Publishing																			0
Consumer Goods			1	1	1		1	1		1		1				1			8
Apparel						1		1			1			1	1	1			6
Healthcare	1	1		1	1	1	1	1	1	1	1	1	1	1					13
Medical Equipment	1	1	1	1			1		1	1	1	1	1	1	1	1			13
Pharmaceutical Products	1		1	1	1	1	1	1	1	1	1							1	11
Chemicals						1	1	1			1			1					5
Rubber and Plastic Products		1			1		1												3
Textiles		1				1						1							3
Construction Materials					1					1									2
Construction							1												1
Steel Works Etc.			1		1	1													3
Fabricated Products																			0
Machinery			1			1	1												3
Electrical Equipment	1	1	1	1	1	1				1									7
Automobiles and Trucks				1	1		1		1			1		1	1		1		8
Aircraft					1												1		2
Shipbuilding, Railroad Equipment																		1	1
Defense		1						1	1		1								4
Precious Metals			1		1		1		1						1				5
Non-Metallic and Industrial Metal Mining																		1	1

Fama-French 49 Industry	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
Coal							1												1
Petroleum and Natural Gas	1						1		1	1									4
Utilities			1	1	1	1		1	1			1	1						8
Communication	1	1	1	1		1	1	1									1		8
Personal Services		1	1	1		1	1	1		1	1			1		1	1	1	12
Business Services		1	1		1	1	1		1	1	1	1					1		10
Computers	1	1	1	1	1		1								1	1	1		9
Computer Software	1	1	1	1	1	1		1	1	1			1	1	1				12
Electronic Equipment	1	1	1	1	1	1	1		1		1			1		1			11
Measuring and Control Equipment	1				1	1								1			1		5
Business Supplies																			0
Shipping Containers			1																1
Transportation	1	1				1		1							1		1		6
Wholesale		1	1		1		1						1		1		1		7
Retail	1	1	1	1	1		1	1	1			1	1		1				11
Restaurants, Hotels, Motels	1		1	1			1	1											5
Banking	1	1	1	1	1	1		1	1			1	1		1	1	1	1	14
Insurance	1	1	1		1	1	1	1	1		1	1						1	11
Real Estate																			0
Trading	1	1	1	1	1	1		1		1	1	1				1			11
Other			1					1							1				3
Total	16	18	24	18	22	21	23	19	16	11	11	13	7	9	12	8	10	7	265

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TABLE 1
Litigation Sample Composition

Details	Observations
Advised Population of SCAs brought under Rule 10b-5 (1997–2014)	3,248
Less: Litigation related to IPOs	(518)
Less: Litigation without required firm data	(846)
Less: Litigation against firms in the lower terciles of litigation risk (population industry-year)	(741)
Less: Duplicate industry-year cases	(751)
Less: Litigation with insufficient peer firm data	(10)
Less: Litigation contaminated by restatements, SEC comment letters, SEC investigations	(117)
Final Sample	265

Table 1 presents information on the final litigation sample. To remain in the sample, we require that focal firms have CRSP and Compustat identifiers and variables to calculate *LitigationRisk*. The sample composition by industry is shown in Appendix B.

TABLE 2
Descriptive Statistics

<i>Panel A: Treatment Peer Firms</i>							
	Pre-Focal Litigation			Post-Focal Litigation			Change
	N	Mean	Std. Dev.	N	Mean	Std. Dev.	
<i>QtrEPS</i> _{i,t}	21,640	0.29	0.59	21,640	0.33	0.64	0.05***
<i>AnnEPS</i> _{i,t}	21,640	0.37	0.68	21,640	0.43	0.73	0.07***
<i>QtrSales</i> _{i,t}	21,640	0.17	0.51	21,640	0.22	0.57	0.05***
<i>AnnSales</i> _{i,t}	21,640	0.19	0.53	21,640	0.25	0.59	0.06***
<i>LnWords</i> _{i,t}	14,205	10.67	0.64	15,444	10.76	0.60	0.09***
<i>BogIndex</i> _{i,t}	17,737	82.87	7.64	17,960	83.83	7.27	0.96***
<i>Litigious</i> _{i,t}	14,205	1.72	0.89	15,444	1.65	0.84	-0.07***
<i>LitigationRisk</i> _{i,t}	21,640	0.08	0.07	21,640	0.09	0.07	0.01***
<i>Loss</i> _{i,t}	21,640	0.17	0.38	21,640	0.19	0.40	0.02***
<i>LnMVE</i> _{i,t-1}	21,640	6.93	2.06	21,640	7.23	2.01	0.30***
<i>BTM</i> _{i,t-1}	21,640	3.23	12.05	21,640	3.19	11.86	-0.04
<i>AnalystFollowing</i> _{i,t}	21,640	8.83	8.05	21,640	9.42	8.11	0.59***
<i>Litigation</i> _{i,t}	21,640	0.00	0.00	21,640	0.04	0.19	0.04***
<i>Stop_j</i>	21,640	0.87	0.33	21,640	0.88	0.32	0.01***

<i>Panel B: Control Peer Firms</i>							
	Pre-Focal Litigation			Post-Focal Litigation			Change
	N	Mean	Std. Dev.	N	Mean	Std. Dev.	
<i>QtrEPS</i> _{i,t}	21,588	0.09	0.34	21,588	0.10	0.37	0.01***
<i>AnnEPS</i> _{i,t}	21,588	0.09	0.34	21,588	0.12	0.39	0.03***
<i>QtrSales</i> _{i,t}	21,588	0.07	0.31	21,588	0.09	0.36	0.02***
<i>AnnSales</i> _{i,t}	21,588	0.07	0.31	21,588	0.11	0.37	0.03***
<i>LnWords</i> _{i,t}	15,898	10.18	0.60	17,143	10.26	0.56	0.08***
<i>BogIndex</i> _{i,t}	19,505	80.92	7.57	19,820	81.77	7.25	0.84***
<i>Litigious</i> _{i,t}	15,898	1.48	0.90	17,143	1.43	0.86	-0.06***
<i>LitigationRisk</i> _{i,t}	21,588	0.02	0.02	21,588	0.02	0.02	0.00***
<i>Loss</i> _{i,t}	21,588	0.31	0.46	21,588	0.34	0.47	0.03***
<i>LnMVE</i> _{i,t-1}	21,588	4.17	1.30	21,588	4.16	1.35	-0.01
<i>BTM</i> _{i,t-1}	21,588	0.86	1.86	21,588	0.99	2.79	0.13***
<i>AnalystFollowing</i> _{i,t}	21,588	1.52	2.39	21,588	1.44	2.37	-0.08***
<i>Litigation</i> _{i,t}	21,588	0.00	0.00	21,588	0.01	0.09	0.01***
<i>Stop_j</i>	21,588	0.87	0.34	21,588	0.88	0.33	0.01**

Table 2 presents descriptive statistics for the firms in our sample, separately for the two-year period preceding litigation against an industry focal firm (Pre-Focal Litigation) and the two-year period following litigation against an industry focal firm (Post-Focal Litigation). Treated peer firms are those in the highest tercile of litigation risk within the Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within the Fama-French 49 industry. Panel A presents descriptive statistics for the treatment firms in our sample, and Panel B presents descriptive statistics for the control firms in our sample. We use *t*-tests to test whether the difference between the Pre-Focal Litigation and Post-Focal Litigation means (presented in the final column) is statistically significant. *** and ** denote statistical significance at the 1 percent and 5 percent levels, respectively. Variables are defined in Appendix A.

TABLE 3
Pairwise Correlations

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) $Post_t$	1						
(2) $QtrEPS_{i,t}$	0.037***	1					
(3) $AnnEPS_{i,t}$	0.048***	0.508***	1				
(4) $QtrSales_{i,t}$	0.048***	0.585***	0.267***	1			
(5) $AnnSales_{i,t}$	0.052***	0.365***	0.577***	0.513***	1		
(5) $LnWords_{i,t}$	0.070***	0.024***	0.153***	0.055***	0.103***	1	
(6) $BogIndex_{i,t}$	0.064***	0.075***	0.130***	0.176***	0.206***	0.338***	1
(7) $Litigious_{i,t}$	-0.040***	-0.008	0.052***	-0.085***	-0.052***	0.515***	0.012**
(8) $LitigationRisk_{i,t}$	0.062***	0.043***	0.027***	-0.022***	-0.058***	0.234***	0.073***
(9) $Loss_{i,t}$	0.024***	-0.045***	-0.142***	0.027***	-0.038***	0.047***	0.196***
(10) $LnMVE_{i,t-1}$	0.074***	0.210***	0.315***	0.118***	0.168***	0.314***	0.099***
(11) $BTM_{i,t-1}$	-0.002	-0.110***	-0.129***	-0.075***	-0.089***	0.048***	-0.003
(12) $AnalystFollowing_{i,t}$	0.037***	0.253***	0.259***	0.180***	0.157***	0.179***	0.026***
(13) $OwnLitigation_{i,t}$	0.142***	0.039***	0.042***	0.028***	0.035***	0.063***	0.052***
(14) $Stop_j$	0.018***	-0.152***	-0.105***	-0.155***	-0.104***	0.030***	-0.028***

Table 3 presents Pearson correlations for the treatment peer firms in our sample. *** denotes statistical significance at the 1 percent level. Variables are defined in Appendix A.

TABLE 4
Market Returns around Peer Litigation Date

<i>Panel A: Abnormal Peer Returns</i>								
	All Focal Litigation							
	[-10,-2]	[-1,+1]	[+2,+10]	[+11,+60]				
$CAR_{i,t}$	-0.33%***	-0.04%	-0.57%***	-1.58%***				
T-statistic	3.54	0.81	5.95	6.50				
N	10,784	10,784	10,784	10,784				

<i>Panel B: Abnormal Peer Returns Conditioned on Case Outcomes</i>								
	Settled Focal Litigation				Dismissed Focal Litigation			
	[-10,-2]	[-1,+1]	[+2,+10]	[+11,+60]	[-10,-2]	[-1,+1]	[+2,+10]	[+11,+60]
$CAR_{i,t}$	-0.60%***	0.02%	-1.06%***	-3.15%***	-0.10%	-0.10%	-0.15%	-0.23%
T-statistic	4.04	0.19	7.27	8.86	0.85	1.40	1.17	0.70
N	4,990	4,990	4,990	4,990	5,794	5,794	5,794	5,794
<u>Test</u>								
Returns (<i>Settled</i>) -	-0.50%***	0.12%	-0.91%***	-2.92%***				
Returns (<i>Dismissed</i>) = 0	2.65	1.03	4.76	5.98				

<i>Panel C: Abnormal Peer Returns Conditioned on Case Outcomes - Removing Sued Peer Firms</i>								
	Settled Focal Litigation				Dismissed Focal Litigation			
	[-10,-2]	[-1,+1]	[+2,+10]	[+11,+60]	[-10,-2]	[-1,+1]	[+2,+10]	[+11,+60]
$CAR_{i,t}$	-0.60%***	0.03%	-1.05%***	-3.14%***	-0.13%	-0.09%	-0.12%	-0.14%
T-statistic	3.96	0.35	7.09	8.67	1.12	1.34	0.96	0.42
N	4,769	4,769	4,769	4,769	5,572	5,572	5,572	5,572
<u>Test</u>								
Returns (<i>Settled</i>) -	-0.47%***	0.12%	-0.93%***	-3.00%***				
Returns (<i>Dismissed</i>) = 0	2.44	1.12	4.72	6.02				

Table 4 presents cumulative abnormal returns for the treatment peer firms in our sample surrounding litigation against an industry focal firm. Panel A presents returns for the full set of treatment firms in our sample. Panel B presents returns conditioned on the case outcome. Panel C presents returns dropping 443 peer firms that are sued in the year following focal firm litigation. We use *t*-tests to test whether the cumulative abnormal return is significantly different from zero. *** and ** denote statistical significance at the 1 percent and 5 percent levels, respectively. Variables are defined in Appendix A.

TABLE 5
Litigation and Voluntary Disclosure Spillover

	(1)	(2)	(3)	(4)
	<i>QtrEPS</i> _{i,t}	<i>AnnEPS</i> _{i,t}	<i>QtrSales</i> _{i,t}	<i>AnnSales</i> _{i,t}
<i>Treat</i> _{i,t}	0.053*** (0.012)	0.082*** (0.013)	0.051*** (0.010)	0.057*** (0.010)
<i>Post</i> _{i,t}	-0.020*** (0.003)	-0.011*** (0.003)	-0.016*** (0.003)	-0.008*** (0.003)
<i>Treat</i> _{i,t} × <i>Post</i> _{i,t}	0.025*** (0.005)	0.023*** (0.005)	0.030*** (0.004)	0.023*** (0.004)
<i>LitigationRisk</i> _{i,t}	-0.539*** (0.101)	-0.748*** (0.115)	-0.785*** (0.074)	-0.893*** (0.075)
<i>Stop</i> _j	-0.047*** (0.006)	-0.009 (0.006)	-0.072*** (0.006)	-0.025*** (0.006)
<i>Loss</i> _{i,t}	-0.079*** (0.008)	-0.154*** (0.009)	-0.028*** (0.008)	-0.076*** (0.008)
<i>LnMVE</i> _{i,t-1}	0.028*** (0.003)	0.058*** (0.004)	0.007** (0.003)	0.024*** (0.003)
<i>BTM</i> _{i,t-1}	-0.002*** (0.000)	-0.002*** (0.000)	-0.000 (0.000)	-0.001* (0.000)
<i>AnalystFollowing</i> _{i,t}	0.015*** (0.001)	0.011*** (0.001)	0.012*** (0.001)	0.008*** (0.001)
Industry & Year FE	Yes	Yes	Yes	Yes
N	86,420	86,420	86,420	86,420
Adj. R ²	0.218	0.276	0.232	0.239

Table 5 presents results for ordinary least squares regressions of *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales* on an indicator variable for the post-litigation period, an indicator variable for treatment, their interaction, and control variables. The sample period includes two years preceding and two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.

TABLE 6
Litigation and Voluntary Disclosure Spillover Conditioned on Case Merits

	Settled Focal Litigation				Dismissed Focal Litigation			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	<i>QtrEPS</i> _{i,t}	<i>AnnEPS</i> _{i,t}	<i>QtrSales</i> _{i,t}	<i>AnnSales</i> _{i,t}	<i>QtrEPS</i> _{i,t}	<i>AnnEPS</i> _{i,t}	<i>QtrSales</i> _{i,t}	<i>AnnSales</i> _{i,t}
<i>Treat</i> _{i,t}	0.036*** (0.012)	0.047*** (0.013)	0.038*** (0.010)	0.045*** (0.010)	0.067*** (0.015)	0.113*** (0.016)	0.058*** (0.013)	0.065*** (0.013)
<i>Post</i> _{i,t}	-0.019*** (0.004)	-0.006 (0.005)	-0.025*** (0.004)	-0.008** (0.004)	-0.019*** (0.004)	-0.013*** (0.005)	-0.012*** (0.004)	-0.007* (0.004)
<i>Treat</i>_{i,t} × <i>Post</i>_{i,t}	0.035*** (0.007)	0.036*** (0.007)	0.027*** (0.005)	0.020*** (0.006)	0.014** (0.006)	0.011 (0.007)	0.030*** (0.005)	0.024*** (0.006)
<i>LitigationRisk</i> _{i,t}	-0.319*** (0.106)	-0.514*** (0.119)	-0.538*** (0.069)	-0.641*** (0.074)	-0.718*** (0.120)	-0.943*** (0.135)	-0.979*** (0.097)	-1.087*** (0.098)
<i>Stop</i> _j	-0.048*** (0.009)	-0.028*** (0.009)	-0.066*** (0.008)	-0.029*** (0.008)	-0.035*** (0.009)	-0.005 (0.008)	-0.054*** (0.008)	-0.018** (0.008)
<i>Loss</i> _{i,t}	-0.074*** (0.009)	-0.141*** (0.010)	-0.022*** (0.008)	-0.063*** (0.008)	-0.083*** (0.010)	-0.164*** (0.010)	-0.037*** (0.010)	-0.085*** (0.010)
<i>LnMVE</i> _{i,t-1}	0.028*** (0.004)	0.053*** (0.004)	0.004 (0.003)	0.022*** (0.003)	0.030*** (0.004)	0.061*** (0.005)	0.013*** (0.004)	0.028*** (0.004)
<i>BTM</i> _{i,t-1}	-0.002*** (0.000)	-0.002*** (0.000)	-0.001* (0.000)	-0.001** (0.000)	-0.001*** (0.000)	-0.002*** (0.000)	-0.000 (0.000)	-0.000 (0.000)
<i>AnalystFollowing</i> _{i,t}	0.013*** (0.001)	0.008*** (0.001)	0.010*** (0.001)	0.005*** (0.001)	0.016*** (0.002)	0.014*** (0.002)	0.014*** (0.001)	0.009*** (0.001)
<i>Industry & Year FE</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	40,107	40,107	40,107	40,107	46,312	46,312	46,312	46,312
Adj. R ²	0.222	0.270	0.229	0.255	0.221	0.289	0.254	0.243
<u>Test:</u>								
<i>Treat</i> × <i>Post</i> (Settled) -	0.021**	0.025***	-0.003	-0.004				
<i>Treat</i> × <i>Post</i> (Dismissed) = 0	5.17	7.35	0.20	0.25				

Table 6 presents results for ordinary least squares regressions of *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales* on an indicator variable for the post-litigation period, an indicator variable for treatment, their interaction, and control variables. The sample period includes two years preceding and two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Results are conditioned on case outcomes. Columns (1) - (4) present results for peers of firms with settling cases, and Columns (5) - (8) present results for peers of firms with dismissing cases. To evaluate the statistical significance of differences between coefficients, we estimate simultaneous equations and perform *F*-tests of coefficient equality. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.

TABLE 7
Litigation and Voluntary Disclosure Spillover Conditioned on Growth versus Value Firms

	Growth Firms				Value Firms			
	(1) <i>QtrEPS</i> _{i,t}	(2) <i>AnnEPS</i> _{i,t}	(3) <i>QtrSales</i> _{i,t}	(4) <i>AnnSales</i> _{i,t}	(5) <i>QtrEPS</i> _{i,t}	(6) <i>AnnEPS</i> _{i,t}	(7) <i>QtrSales</i> _{i,t}	(8) <i>AnnSales</i> _{i,t}
<i>Treat</i> _{i,t}	0.071*** (0.016)	0.109*** (0.018)	0.067*** (0.013)	0.083*** (0.013)	0.041*** (0.013)	0.062*** (0.014)	0.035*** (0.012)	0.030*** (0.011)
<i>Post</i> _{i,t}	-0.031*** (0.005)	-0.023*** (0.006)	-0.020*** (0.005)	-0.010* (0.005)	-0.009** (0.004)	0.002 (0.004)	-0.009** (0.003)	-0.001 (0.003)
<i>Treat</i> _{i,t} × <i>Post</i> _{i,t}	0.036*** (0.007)	0.041*** (0.008)	0.039*** (0.007)	0.034*** (0.007)	0.014** (0.007)	0.004 (0.007)	0.017*** (0.006)	0.008 (0.006)
<i>LitigationRisk</i> _{i,t}	-0.288* (0.165)	-0.433** (0.186)	-0.757*** (0.118)	-0.885*** (0.119)	-0.736*** (0.100)	-0.818*** (0.113)	-0.821*** (0.080)	-0.764*** (0.077)
<i>Stop_j</i>	-0.052*** (0.010)	-0.017* (0.010)	-0.091*** (0.010)	-0.038*** (0.009)	-0.047*** (0.008)	-0.007 (0.008)	-0.054*** (0.008)	-0.013* (0.007)
<i>Loss</i> _{i,t}	-0.122*** (0.014)	-0.210*** (0.015)	-0.042*** (0.013)	-0.097*** (0.013)	-0.049*** (0.009)	-0.115*** (0.009)	-0.020** (0.008)	-0.062*** (0.008)
<i>LnMVE</i> _{i,t-1}	0.023*** (0.006)	0.061*** (0.007)	0.003 (0.005)	0.024*** (0.005)	0.029*** (0.004)	0.049*** (0.005)	0.014*** (0.003)	0.022*** (0.003)
<i>BTM</i> _{i,t-1}	0.012 (0.008)	0.034*** (0.013)	0.015** (0.007)	0.016** (0.008)	-0.000* (0.000)	-0.001*** (0.000)	0.000 (0.000)	0.000 (0.000)
<i>AnalystFollowing</i> _{i,t}	0.012*** (0.002)	0.006*** (0.002)	0.012*** (0.001)	0.005*** (0.001)	0.019*** (0.002)	0.015*** (0.002)	0.016*** (0.002)	0.013*** (0.002)
<i>Industry & Year FE</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	43,378	43,378	43,378	43,378	43,042	43,042	43,042	43,042
Adj. R ²	0.231	0.293	0.255	0.270	0.195	0.238	0.214	0.213
<u>Test:</u>								
<i>Treat</i> × <i>Post</i> (Growth)-	0.022**	0.037***	0.022**	0.025***				
<i>Treat</i> × <i>Post</i> (Value)=0	4.33	10.69	5.28	6.76				

Table 7 presents results for ordinary least squares regressions of *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales* on an indicator variable for the post-litigation period, an indicator variable for treatment, their interaction, and control variables. The sample period includes two years preceding and two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Results are conditioned on value and growth firms. Columns (1) - (4) presents results for "growth" peers, and Columns (5) - (8) presents results for "value" peers based on a median industry split on book-to-market ratio. To evaluate the statistical significance of differences between coefficients, we estimate simultaneous equations and perform *F*-tests of coefficient equality. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.

TABLE 8
Litigation and Voluntary Disclosure Spillover Conditioned on Industry Litigation Frequency

	Low Litigation Industries				High Litigation Industries			
	(1) <i>QtrEPS</i> _{i,t}	(2) <i>AnnEPS</i> _{i,t}	(3) <i>QtrSales</i> _{i,t}	(4) <i>AnnSales</i> _{i,t}	(5) <i>QtrEPS</i> _{i,t}	(6) <i>AnnEPS</i> _{i,t}	(7) <i>QtrSales</i> _{i,t}	(8) <i>AnnSales</i> _{i,t}
<i>Treat</i> _{i,t}	0.016 (0.021)	0.064*** (0.022)	0.007 (0.013)	0.023 (0.015)	0.071*** (0.014)	0.090*** (0.015)	0.074*** (0.013)	0.071*** (0.012)
<i>Post</i> _{i,t}	-0.033*** (0.006)	-0.021*** (0.006)	-0.017*** (0.004)	-0.021*** (0.005)	-0.012*** (0.003)	-0.006* (0.004)	-0.011*** (0.003)	-0.000 (0.004)
<i>Treat</i> _{i,t} × <i>Post</i> _{i,t}	0.048*** (0.009)	0.050*** (0.010)	0.026*** (0.006)	0.031*** (0.007)	0.013*** (0.005)	0.010* (0.006)	0.029*** (0.005)	0.018*** (0.005)
<i>LitigationRisk</i> _{i,t}	-0.383* (0.207)	-0.422** (0.202)	-0.466*** (0.107)	-0.639*** (0.135)	-0.599*** (0.113)	-0.868*** (0.137)	-0.976*** (0.096)	-1.017*** (0.093)
<i>Stop_j</i>	-0.036*** (0.010)	0.008 (0.011)	-0.021*** (0.008)	0.005 (0.009)	-0.045*** (0.008)	-0.015* (0.008)	-0.096*** (0.009)	-0.041*** (0.008)
<i>Loss</i> _{i,t}	-0.080*** (0.011)	-0.124*** (0.012)	0.005 (0.008)	-0.023*** (0.008)	-0.077*** (0.011)	-0.167*** (0.011)	-0.041*** (0.011)	-0.099*** (0.010)
<i>LnMVE</i> _{i,t-1}	0.043*** (0.006)	0.073*** (0.007)	0.010*** (0.004)	0.019*** (0.004)	0.022*** (0.004)	0.049*** (0.005)	0.007* (0.004)	0.027*** (0.004)
<i>BTM</i> _{i,t-1}	-0.002*** (0.000)	-0.003*** (0.001)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001* (0.000)	-0.001 (0.000)	0.000 (0.001)	0.000 (0.000)
<i>AnalystFollowing</i> _{i,t}	0.013*** (0.002)	0.009*** (0.002)	0.006*** (0.001)	0.006*** (0.001)	0.015*** (0.002)	0.012*** (0.002)	0.016*** (0.001)	0.009*** (0.001)
<i>Industry & Year FE</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	27,416	27,416	27,416	27,416	59,004	59,004	59,004	59,004
Adj. R ²	0.222	0.292	0.136	0.215	0.216	0.263	0.264	0.253
<u>Test:</u>								
<i>Treat</i> × <i>Post</i> (Low) -	0.035***	0.04***	-0.003	0.013				
<i>Treat</i> × <i>Post</i> (High)=0	11.49	11.40	0.20	1.92				

Table 8 presents results for ordinary least squares regressions of *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales* on an indicator variable for the post-litigation period, an indicator variable for treatment, their interaction, and control variables. The sample period includes two years preceding and two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Results are conditioned on low litigation and high litigation industries, following Kim and Skinner (2012). Columns (1) - (4) presents results for low litigation industries, and Columns (5) - (8) presents results for high litigation industries. To evaluate the statistical significance of differences between coefficients, we estimate simultaneous equations and perform *F*-tests of coefficient equality. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.

TABLE 9
Litigation and Voluntary Disclosure Spillover Conditioned on Filing Date Cumulative Abnormal Returns

	(1)	(2)	(3)	(4)
	<i>QtrEPS</i> _{i,t}	<i>AnnEPS</i> _{i,t}	<i>QtrSales</i> _{i,t}	<i>AnnSales</i> _{i,t}
<i>CAR</i> _{i,t}	-0.012 (0.007)	-0.006 (0.008)	-0.006 (0.007)	-0.011 (0.007)
<i>Treat</i> _{i,t}	0.052*** (0.012)	0.082*** (0.013)	0.057*** (0.010)	0.052*** (0.010)
<i>Post</i> _{i,t}	-0.020*** (0.003)	-0.011*** (0.003)	-0.008*** (0.003)	-0.016*** (0.003)
<i>Treat</i>_{i,t} × <i>Post</i>_{i,t}	0.024*** (0.005)	0.025*** (0.005)	0.023*** (0.004)	0.029*** (0.004)
<i>Treat</i> _{i,t} × <i>CAR</i> _{i,t}	0.002 (0.013)	-0.020 (0.014)	0.012 (0.012)	0.037*** (0.012)
<i>Post</i> _{i,t} × <i>CAR</i> _{i,t}	0.010 (0.007)	0.027*** (0.007)	0.021*** (0.007)	0.019*** (0.006)
<i>Treat</i>_{i,t} × <i>Post</i>_{i,t} × <i>CAR</i>_{i,t}	-0.044*** (0.015)	0.019 (0.014)	-0.036*** (0.012)	-0.067*** (0.012)
<i>LitigationRisk</i> _{i,t}	-0.543*** (0.101)	-0.747*** (0.116)	-0.898*** (0.075)	-0.792*** (0.074)
<i>Stop</i> _j	-0.046*** (0.006)	-0.010 (0.006)	-0.025*** (0.006)	-0.072*** (0.006)
<i>Loss</i> _{i,t}	-0.079*** (0.008)	-0.154*** (0.009)	-0.076*** (0.008)	-0.028*** (0.008)
<i>LnMVE</i> _{i,t-1}	0.029*** (0.004)	0.058*** (0.004)	0.025*** (0.003)	0.007** (0.003)
<i>BTM</i> _{i,t-1}	-0.001*** (0.000)	-0.002*** (0.000)	-0.001* (0.000)	-0.000 (0.000)
<i>AnalystFollowing</i> _{i,t}	0.015*** (0.001)	0.011*** (0.001)	0.008*** (0.001)	0.012*** (0.001)
<i>Industry & Year FE</i>	Yes	Yes	Yes	Yes
N	86,224	86,224	86,224	86,224
Adj. R ²	0.218	0.276	0.240	0.232

Table 9 presents results for ordinary least squares regressions of *QtrEPS*, *AnnEPS*, *QtrSales*, and *AnnSales* on an indicator variable for the post-litigation period, an indicator variable for treatment, the peer firm's cumulative abnormal returns at the focal firm litigation filing date, their interactions, and control variables. The sample period includes two years preceding and two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.

TABLE 10

Litigation and Mandatory Financial Reporting Characteristics Spillover Conditioned on Case Merits

	Settled Focal Litigation			Dismissed Focal Litigation		
	(1) <i>LnWords</i> _{i,t}	(2) <i>BogIndex</i> _{i,t}	(3) <i>Litigious</i> _{i,t}	(4) <i>LnWords</i> _{i,t}	(5) <i>BogIndex</i> _{i,t}	(6) <i>Litigious</i> _{i,t}
<i>Treat</i> _{i,t}	0.218*** (0.019)	1.168*** (0.229)	0.073*** (0.027)	0.199*** (0.017)	1.082*** (0.227)	0.099*** (0.023)
<i>Post</i> _{i,t}	0.015** (0.007)	0.083 (0.066)	0.037*** (0.013)	-0.003 (0.006)	-0.087 (0.059)	0.016 (0.010)
<i>Treat</i> _{i,t} × <i>Post</i> _{i,t}	-0.040*** (0.011)	-0.162* (0.086)	-0.049*** (0.018)	-0.004 (0.008)	0.069 (0.072)	-0.014 (0.014)
<i>LitigationRisk</i> _{i,t}	0.769*** (0.152)	5.475*** (1.611)	0.078 (0.203)	0.812*** (0.137)	4.030** (1.622)	0.058 (0.180)
<i>Stop</i> _j	-0.007 (0.011)	0.125 (0.104)	0.018 (0.018)	-0.006 (0.008)	0.011 (0.093)	-0.003 (0.013)
<i>Loss</i> _{i,t}	0.220*** (0.012)	2.532*** (0.159)	0.102*** (0.020)	0.212*** (0.012)	2.569*** (0.169)	0.084*** (0.018)
<i>LnMVE</i> _{i,t-1}	0.099*** (0.007)	0.768*** (0.076)	0.060*** (0.009)	0.095*** (0.006)	0.604*** (0.080)	0.054*** (0.008)
<i>BTM</i> _{i,t-1}	0.036*** (0.009)	0.144 (0.099)	0.022** (0.009)	0.042*** (0.009)	0.168 (0.106)	0.025** (0.011)
<i>AnalystFollowing</i> _{i,t}	-0.003 (0.002)	-0.121*** (0.021)	0.001 (0.002)	-0.003* (0.002)	-0.091*** (0.021)	0.001 (0.002)
<i>Industry & Year FE</i>	Yes	Yes	Yes	Yes	Yes	Yes
N	27,813	34,726	27,813	34,849	40,264	34,849
Adj. R ²	0.385	0.348	0.142	0.387	0.353	0.133
<u>Test:</u>						
<i>Treat</i> × <i>Post</i> (Settled) -	-0.036***	-0.231**	-0.035			
<i>Treat</i> × <i>Post</i> (Dismissed) = 0	6.67	4.57	2.08			

Table 10 presents results for ordinary least squares regressions of mandatory financial reporting characteristics on an indicator variable for the post-litigation period, an indicator variable for treatment, their interaction, and control variables. The sample period includes two years preceding and two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French 49 industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Columns (1) - (3) present results for peers of firms with settling cases. Columns (4) - (6) present results for peers of firms with dismissing cases. Within each subsample, the dependent variables are *LnWords*, *BogIndex*, and *Litigious*, respectively. To evaluate the statistical significance of differences between coefficients, we estimate simultaneous equations and perform *F*-tests of coefficient equality. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.

TABLE 11
Litigation and Future Litigation Spillover

	(1)	(2)	(3)
	<i>Litigation_{i,t}</i>	<i>SettledLitigation_{i,t}</i>	<i>DismissedLitigation_{i,t}</i>
<i>Treat_{i,t}</i>	-0.005** (0.003)	-0.003 (0.002)	-0.002 (0.002)
<i>LitigationRisk_{i,t}</i>	0.187*** (0.030)	0.090*** (0.022)	0.080*** (0.020)
<i>Stop_j</i>	-0.001 (0.003)	-0.000 (0.002)	-0.001 (0.002)
<i>Loss_{i,t}</i>	0.019*** (0.002)	0.009*** (0.002)	0.008*** (0.002)
<i>LnMVE_{i,t-1}</i>	0.005*** (0.001)	0.003*** (0.001)	0.002*** (0.000)
<i>BTM_{i,t-1}</i>	-0.000** (0.000)	-0.000** (0.000)	-0.000 (0.000)
<i>AnalystFollowing_{i,t}</i>	0.001*** (0.000)	0.001*** (0.000)	0.001*** (0.000)
<i>Industry & Year FE</i>	Yes	Yes	Yes
N	43,223	42,804	42,719
Adj. R ²	0.036	0.018	0.015

Table 11 presents results for an ordinary least squares regression of *Litigation*, *SettledLitigation*, and *DismissedLitigation* on an indicator variable for treatment and control variables. The sample period includes two years following focal litigation. Treated peer firms are those in the highest tercile of litigation risk within Fama-French industry, and control peer firms are those in the lowest tercile of litigation risk within Fama-French 49 industry. Standard errors are shown in parentheses and clustered by firm. ***, **, and * denote statistical significance at the 1 percent, 5 percent, and 10 percent levels, respectively. Variables are defined in Appendix A.