EXECUTIVE GATEKEEPERS: THE PARADOX OF LAWYERS IN THE FIRM

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Abstract

We study the paradox of executive gatekeepers serving both an internal governance role and a strategic officer role inside the firm. We document that moving in-house legal counsel into the executive suite is associated with improvement in internal governance. Their fixed effect explains 4% of variation in governance and 2.8% in investment across firms. We then consider whether strategic initiatives divert executive gatekeepers away from governance, using equity incentives as a proxy for the importance of strategic tasks to firm value. Our identification strategy relies on the assertion that executive gatekeepers hired from law firms are less likely to react to equity incentives initially by shifting their effort from internal governance (i.e., the natural lawyering behavior) to strategic growth than those poached from other corporations. We find that a one standard deviation increase in their compensation delta unwinds at least 2/3rds of the prevention of securities fraud associated with hiring an executive lawyer. These executive gatekeepers instead spend time advising investment and business expansion. Our results suggest that executive gatekeepers may only serve as totem of governance.

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"*Lawyers are what today we call crucial gatekeepers, responsible for safeguarding shareholders' interests*"
– SEC Chairman Christopher Cox
– Address to the Corporate Counsel Institute, March, 8, 2007

"*I have been there at the beginning of an idea, I have helped implement the idea, and on those occasions where an idea has turned out poorly, I was there to help clean up the mess, too.*"
– Peter Bragdon, SVP, General Counsel, and Secretary of Columbia Sportswear Company[1]

I. Introduction

Over the last four decades, internal lawyers have assumed a more prominent role in U.S. corporations (Heineman (2012)). Many of the functions of external lawyers have been brought in-house to save costs. Beyond costs, conventional wisdom suggests that having day-to-day lawyering done in-house better aligns lawyer activity to firm goals, especially with the growing importance of intellectual property and the information economy (Sorkin (2012)). In addition, the top internal lawyer (often with the title of General Counsel or Chief Legal Officer) is increasingly found among the higher executive ranks. Lawyers now sit among the top five executives in over 44% of corporations, up from 33% in 1995. These transitions are not without economic causes and implications.

Three main functions characterize day-to-day corporate lawyering – (i) compliance, (ii) litigation and infraction avoidance (internal governance), and (iii) strategic value creation through legal expertise.[2] The accounting literature (e.g. Jagolinzer, Larcker, and Taylor (2011), Kwak, Ro, and Suk (2012), and Hopkins, Maydew, and Venkatachalam (2014)) studies the compliance function of internal lawyers, finding that they curb insider trading; yet the results are mixed on their impact on the quality of disclosure. We instead focus on the internal governance and strategic aspects of executive lawyers' jobs.

We first build on the existing literature, looking for evidence supporting internal governance arising from in-house lawyering. In her book entitled *Corporate Lawyers and Corporate Governance*, Loughrey (2011) describes internal governance emerging in lawyers' duties as they move from being external to internal,

> *…while both external and internal lawyers can act as gatekeepers in a broad sense, by disrupting or averting managerial misconduct, the ways in which they can do so will vary. Thus while monitoring for misconduct is often seen as a key aspect of gatekeeping, it is rarely required of external lawyers, nor are they usually in a position to perform such a role, since they lack the necessary degree of knowledge and continuous oversight of the client's business.*

Thus, one would expect internal governance to improve when lawyering functions move in-house.

[1] See Dubey and Kripalani (2013) – page 42.
[2] The top internal corporate lawyer is also tasked to supervise the event-based lawyer activities – mergers, law suits, contracting, etc., -- many of which are outsourced to external lawyers to avoid staffing for unique events. Our study focuses on the day-to-day duties, as opposed to event-based lawyering.

With the transition in-house, lawyers are often moving to executive positions, with the additional responsibility of being strategic officers. Executive lawyers play an ever-growing role in weighing risk and reward in new strategic initiatives; they are privy to ideas and innovations early in their life cycle and are relied upon to find solutions that advance the business. Russell Reynolds Associates analyzed their database of 3,000 assessments of corporate executive and found that "*contrary to conventional wisdom, the legal executives go well beyond spotting legal issues to helping the business actually take risks and find creative solutions.*"

The strategic mandate and the internal governance mandate compete for executive lawyers' attention and effort, which leads to our main empirical question: whether and with what consequence lawyers divert monitoring for strategic duties as they emerge into executive ranks? The *Report of the Task Force on the Lawyer's Role in Corporate Governance* (New York City Bar Association, November 2006) states that "*the role of the general counsel of a public company is central to an effective system of corporate governance.*" And yet we see internal governance potentially being sacrificed because the lawyer may be able to add more value via strategic initiatives. It is hard to reconcile a single person with the duties of an executive, agents of corporate owners, compensated to maximize value (Berle and Means, 1932), with those of a reputation intermediaries positioned by owners to prevent managerial wrongdoing (Coffee, 2006).[3] Lawyers are naturally reputation intermediaries, by training and by career path. We hypothesize that the tool of diversion from monitoring to strategic initiatives is compensation, equity incentives in particular.

Our first empirical exercise examines the proposition of Loughrey (2011) that having more internal lawyering improves internal governance. Other research has studied the importance of having powerful internal lawyers in compliance activities (function 1). Kwak, Ro, and Suk (2012) find that so-called *super lawyers* enhance the frequency and accuracy of management earnings forecast, whereas Hopkins, Maydew, and Venkatachalam (2014) find the opposite that executive general counsels are associated with more aggressive accounting practices. Further, Jagolinzer, Larcker, and Taylor (2011) show that the informed corporate insider trading can be mitigated by the requirement of general counsel's execution approval. Moreover, Krishnan, Wen, Zhao (2011) find that financial reporting quality is higher when the board has a legal gatekeeper. Our focus here is internal governance (function 2). Compared to

[3] A case in point is Jeff Kindler, who was among the first of the big-name lawyers to choose the corporation over the firm when he left Williams & Connolly for General Electric (Dubey and Kripalani, 2013). He worked at GE as Vice President of Litigation and Legal Policy, with a focus on litigation avoidance. Kindler's transition from the lawyering side to the business side took place upon his move to McDonald's as General Counsel. In that capacity, he not only brought his litigation expertise, but also his desire of "*add(ing) value … to move the business forward*". He convinced the CEO of McDonald's to preserve the Boston Market brand after acquisition and was appointed as head of this brand while retaining his role as General Counsel.

the compliance mandate, which the internal lawyers' reputation hinges on, the monitoring task has more tension. In surveys of Deloitte (2011) and KPMG (2012) on general counsel, roughly two-thirds of general counsels cite *maintaining regulatory compliance* as their greatest concern.[4] One would unlikely hold the prior that in-house lawyers would deteriorate compliance. In contrast, the hypothesis of internal monitoring need not be one-sided. It may be that bringing more lawyering in-house waters down monitoring, following Coffee who argues that internal gatekeepers are captured because they are compensated by the gatekeeper.

In contrast to the panel regression approach used by prior studies, we employ 1) matched difference-in-differences test and 2) fixed effect analysis to address the selection of hiring decision from different angles. Most firms have legal officers in the corporate hierarchy; yet variance exists in the stature of these legal officers in the corporation. We use a proxy measure of whether a general counsel appears on the list of executive officers on the 10-K filing or the proxy statement as the gauge of internal lawyering with important stature. Using these two lines of tests we consistently find that more internal lawyering is associated with stronger internal governance. We discuss that both methodologies suffer from endogenous selection of which firms hire general counsel as corporate officer, but the consequence to the selections seemingly work in opposite directions, which lends credence to our results.

Our main empirical exercise studies the proposition that when lawyers move into the executive suite, they take on additional strategic duties, potentially diverting time from monitoring. Under an optimal contracting frame, we impose that the sensitivity of the executive lawyer's compensation to the firm stock price (the "delta") is a measure of the degree to which the firm views the importance of strategic initiatives. One can plausibly argue that the introduction of upside exposure to firm value can tilt a lawyer's actions away from gatekeeping toward strategic initiatives, making lawyers more like the other business leaders such as CEOs and CFOs. As such, equity incentives may render the general counsel's gatekeeping title to be partially a totem of governance. We leave open the possibility that it is the lawyer herself making an opportunistic diversion decision in reaction to compensation incentives, to the extent that firms must herd into providing equity to lawyers to attract them to employment. In either case, our interest is in whether internal governance outcomes (failures of governance) are sensitive to equity incentives.

Of course, equity incentives given to a general counsel may also motivate value creation through internal governance, following Gompers, Ishii and Metrick (2003) generally and specifically Acharya, Myers, and Rajan, (2011). Karpoff, Lee, and Martin (2008a and 2008b) show that severe monetary and reputational penalties are imposed on firms targeted by SEC enforcement actions, and top managers

[4] See Deloitte Global Corporate Counsel Report 2011: How the game is changing; Beyond the Law: KPMG's global study of how General Counsel are turning risk to advantage (2012).

suffer substantial financial losses through their inability to secure future employment after turnover. Thus, equity incentives may further encourage effort to prevent governance lapses, particularly compliance lapses.

To analyze our question, we exploit a comparison of corporations that hire executive lawyers from law firms to ones that poach executive lawyers from other companies. Both the treated and the control are firms hiring executive lawyers; we therefore avoid the endogeneity of whether or not one is hired. The remaining selection issue is that firms endogenously choose which source to hire executive lawyers from. We address the selection by matching control firms to the treated with the closest litigation score of hiring from corporations within firms pre-bucketed on year, size and industry. Then our setup differences out the selection of hiring sources, leaving only a difference between the treated and the control, which is the way executive lawyers *react* to equity incentives for which we have to assert identification arguments.

Our identification argument is that executive lawyers hired from law firms are initially less likely to reduce their natural lawyering behavior (internal governance) as a reaction to equity incentives. The diversion from monitoring to strategic tasks would take place if 1) efforts in strategic tasks tend to generate more marginal increase of firm value, and that 2) reduced efforts in monitoring does not trigger great reputation loss. Lawyers that are freshly off the law firm are not yet skilled to add value through strategic tasks, at least not until the learning curve dials out. As pointed out by Dubey and Kripalani (2013), law firm lawyers are trained to avoid risk and, in general, to steer clients toward the lowest risk alternative, yet in-house lawyers must learn to be more comfortable with risk and manage it effectively within the context of the organization's overall tolerance for risk. Secondly, law firm lawyers have not yet had the chance to diversify their human and reputational capital outside the lawyering community, thus likely have a lower hurdle of reputational concern. This notion finds support in sociology literature that studies organization behavior when individuals define loyalties in dimensions of both a professional association (as in the legal bar) and an organization (the employer) (Goode, 1957; Hall, 1968). Building off these foundation papers, Wallace (1995) examines lawyers that work in law firms versus those working in corporations, and finds that lawyers working in corporations are significantly less committed to the legal profession than those working in law firms.

Our main results are as follows. We find that compensation does not distract executive gatekeepers from regulatory compliance. This result is intuitive; regulatory compliance concerns are the front where lawyers are most exposed in personal liability and reputation. However, equity incentives do affect internal governance. Our results suggest that giving executive gatekeepers more compensation sensitivity to stock prices increases the future likelihood of class action law suits and uncaught fraud. In particular, a one standard deviation increase ($52,851) in the sensitivity of general counsel's wealth to a

one percent change in stock price (the compensation "delta") associates with 22% higher likelihood (1.4 raw percentage points) of class action lawsuits, unwinding 67% of the governance improvements in terms of avoiding securities fraud associated with hiring an executive gatekeeper. In our more stringent specification, the unwind increases to 89.9% of the governance improvements. Said another way, if a gatekeeper were hired to avoid class actions suits, a larger compensation delta would decrease at least two thirds of the securities fraud prevention that gatekeeper brought. In terms of uncaught financial misrepresentation, we find that the gatekeeper unwinds 12% -19% of governance improvements. Further, there is some evidence that equity incentives are associated with more corporate investment in growth. However, it seems that the magnitude of the increase in investment is less that magnitude of unwinding of governance improvement.

This paper is related to several lines of research. First, our study contributes to the internal governance literature. Up till now the topic of internal governance specifically through in-house lawyers has received only sparse academic attention. Little scientific evidence exists on the effectiveness of general counsels, either in preventing governance breaches or in adding value, building off the general idea of internal governance of Acharya, Myers, and Rajan, (2011), Kim and Lu (2012), and Khanna, Kim and Lu (2015). A recent legal literature (Duggin, 2006; Rostain, 2008; DeMott, 2012) outlines the compliance and monitoring roles of general counsel. For example, Demott (2012) describes how general counsel monitor with case examples. We build on Demott's expertise and put out the question of whether her description of the actions that general counsel can take is empirically effective. We complement studies on the compliance role of in-house lawyers (Hopkins, Maydew, and Venkatachalam, 2014; Jagolinzer, Larcker and Taylor, 2011; Kwak, Ro, and Suk, 2012), adding evidence on the governance role and strategic development role with a focus on the trade-off between the two. Further, our study is related to Litov, Sepe, and Whitehead (2013), who study the governance effect of lawyers in the board of directors.

Second, our paper contributes to bringing together the literatures of governance and equity incentives. The nature of our test, is whether equity incentives divert governance or not while the perfectly reasonable alternative hypothesis is that equity incentives align executive gatekeepers with governance effort. Such a finding would contribute to the literature stemming from seminal papers in governance (e.g., Shleifer and Vishny (1998), Jensen (2000), Gompers, Ishii, and Metrick (2003)), asking not just whether well-governed firms command higher valuations, but how incentives and governance mechanisms interact.[5]

[5] A large literature finds that firm performance overall improves when executives are exposed to firm performance; e.g., Demsetz and Lehn (1985), McConnell and Servas (1990), Core and Guay (1999), Guay (1999), Himmelberg, Hubbard, and Palia (1999), Core and Larcker (2002), and Goyal and Wang (2014). In contrast, some hold the opposite view that equity-based compensation is a double-edged sword, inducing managers to exert productive effort but also to divert valuable firm resources to opportunistic activities. For example, equity incentives induce managers to manipulate earnings (Cheng and Warfield, 2005; Bergstresser and Philippon, 2006), misreport financial statements

Finally, our contribution adds executive lawyers to the literature on the importance of characteristics of individuals inside the executive suite and board (e.g., Bertrand and Schoar, 2003; Güner, Malmendier, and Tate. 2008; Malmendier and Tate, 2009; Custodio and Metzer, 2014).

The rest of the paper is organized as follows. Section two provides background on general counsels as gatekeepers. Section three describes data construction and sources. Section four addresses the baseline difference-in-difference results and general counsel fixed effect in explaining governance and investment outcomes. Section five delineates our methodology to test the impact of equity incentives on executive lawyers' gatekeeping and strategic advising roles. Section six presents the main results of the equity incentive tests and section seven concludes.

II. The Roles of General Counsel

The General Counsel (GC), sometimes referred to as the Chief Legal Officer, is an important but under-studied component of the governance system within a corporation. Legal research suggests the following roles played by GCs.

- **Compliance**

GCs have an ongoing role to proactively assess and control legal risks and assist corporations on a daily basis to detect actions that could lead to corporate liability (Lipson et al. 2012). Among all potential risks, maintaining regulatory compliance is quoted as the greatest legal risk in the view of GCs (Deloitte, 2011; KPMG, 2012). Specifically, the following five areas are what GCs concern the most: SEC fraud investigation, insider trading, stock market disclosure, breaches of competition or antitrust laws, and breaches of directors' and officer's duties (Deloitte, 2011). Recent accounting papers (Jagolinzer, Larcker, and Taylor (2011), Kwok, Ro, and Suk (2012) and Hopkins, Meydew, and Venkatachalam (2012)) investigate GC's compliance role in corporate disclosure, financial reporting quality, and insider trading policies. In fact, the legal department works closely with the accounting crew not only to avoid regulatory breaches, but also to jointly design ways to get around the regulations. As commented by Brad Thies, General Counsel and Secretary of FEI Company, "*In-house counsel needs to be hand-and-glove with the accounting team. Better still is the lawyer who knows enough accounting to be able to suggest creative alternatives in structuring a deal. In that way, lawyers can drive value*." (Dubey and Kripalani, 2013)

- **Internal governance**

(Efendi, Srivastava, and Swanson, 2007), rig the performance measure chosen (Morse, Nanda, and Seru, 2011), conduct fraud (Denis, Hanouna, and Sarin, 2006; Erickson, Hanlon, and Maydew, 2006), and opportunistically time option grants (Aboody and Kasznik, 2000).

SEC puts governance duties and liabilities on institution of general counsel. Similarly, GCs view themselves as "a guardian of the corporation's integrity and reputation" (Heineman 2007). As such, GCs' role goes beyond regulatory compliance to preventing potential governance breaches.

SOX Section 307 further intensifies the responsibility of the GC as an internal governance mechanism. Pursuant to Section 307 of SOX, the SEC adopted minimum standards of professional conduct for attorneys, which require attorneys to report evidence of material violations of securities laws or any breaches of fiduciary duties "up-the-ladder" within the company. In-house lawyers are required to "report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company."[6] In addition, SOX provided the SEC with the necessary power to discipline attorneys who are deemed to lack character or integrity or have engaged in unethical or improper professional conduct. As a result, GCs face harsh sanctions upon conviction of misconduct. A case in point is former Apple general counsel Nancy Heinen, who paid $2.2 million with the SEC to settle backdating charges filed against her. In addition, she was barred from serving as an officer or director of any public company for five years and suspended from appearing or practicing as an attorney before the SEC for three years.

- **Strategic growth**

Compared to the first two roles this last one may seem controversial — GC is also one of the most important executive officers involved in strategic value-creation and business development. The role of the legal executive has changed dramatically in a world with increasing importance of intangible assets and growth options. Once exclusively responsible for managing outside counsel, providing legal support and preparing board materials, today's executive lawyers also must take an enterprise view of risk and advance corporate strategy (Russell Reynolds Associates, 2012). GCs are engaged in business ideas and innovations through the work done by the legal department's intellectual property teams (Dubey and Kripalani, 2013). Moreover, such involvement occurs at an earlier phase (Demott, 2005). As Peter Bragdon, General Counsel of Columbia Sportswear Company, commented: "*I have been there at the beginning of an idea, I have helped implement the idea, and on those occasions where an idea has turned out poorly, I was there to help clean up the mess, too.*" (Dubey and Kripalani, 2013)

Far from allowing legal to be the department of "no," GCs consider and devise unconventional solutions. They go well beyond spotting legal issues to helping the business actually take risks and find creative solutions. Consistent with the notion that strategic value creation is an important part of their work, GCs are found to often carry an official designation as a business or corporate development executive. Examples are James Dalton, who served as Senior Vice President, Corporate Development, for Tektronix,

[6] See http://www.sec.gov/rules/final/33-8185.htm.

as well as its General Counsel, and Terry Larkin, Executive Vice President of Business Development and General Counsel of Lear Corporation.

III. Data

Our analysis measures the importance of in-house lawyering on internal governance and also speaks to the effect of equity incentives on executive gatekeepers' tradeoff between internal governance and strategic initiatives. Thus, from the start, we limit our analysis to ExecuComp firms for which we have compensation data. ExecuComp covers all firms in the S&P large, mid and large cap indices. Our ExecuComp sample covers 1994-2012, including 32,617 annual firm level observations for more than 3,000 unique firms.

III.a. General Counsel, Executive General Counsel and Compensation Data

To identify the general counsel, sometimes called chief legal officer, we identify individuals holding the requisite titles by searching three key words: "Counsel," "Legal," and "Law" or abbreviations thereof. Our main identification of these titles comes from manual searches in 10-K filings (items 4b and 10) and proxy statements, where we first look for key words in the list of executive officers of the company and then read each signatory as the company legal representative to identify the title of the company lawyer that signs. Each company should have a lawyer that carries the responsibility of the legal signatory to the SEC. If such person is not listed as one of the executive officers and the name signing the legal certification does not have a general counsel or chief legal officer designation, it is likely that the lawyer is not an important corporate officer in the firm. We further look to Execucomp titles for the same legal recognition, just in case the legal counsel also holds another title which she uses to sign the SEC documents.[7] In our sample, 70% percent of firms on average have a general counsel, relatively stable over time.

When we move to the main tests of the paper, we impose an additional attribute to designate general counsel as being in the inner executive office as executive gatekeepers (ExecGKs).[8] We apply a monetary proxy for the importance of the general counsel in the firm; individuals must be among the top paid officers in a company in ExecuComp. We force stringency that this proxy is not transitory in requiring that the

[7] ExecuComp often records multiple titles. One issue with Execucomp is in its use of abbreviations of an executive title. For example, the title of a GC could be spelled as "gen cou," "gncns," "gen cns," etc. We add all versions of these words we can find. Further, the initial search of the three key words resulted in many executives who are not GC (e.g. "Special Counsel", "Former Counsel"). We verify whether the executive officer identified is in fact a general counsel of the firm through further reading their full executive titles.

[8] The other potential gatekeepers within a corporation are secretary, chief risk officer, and controller. We choose to focus on legal guardians because they are the gatekeeper designated by regulators, with the legal expertise to fulfill the gatekeeping role and with reputational capital exposed to misconduct. As a matter of fact, 60% of the general counsels in our sample also serve the role of corporate secretary, reporting to board.

officer remain in the top paid executives for three years. This is admittedly a monetary proxy for being in the inner executive team, but it seems a reasonable assumption for most cases.

Our empirical design relies on the employment history of these ExecGKs. We look up the full career path of work experience from law school graduation to prior to becoming ExecGK of a firm by collecting information on the names of prior employers, whether the prior employer is a law firm, the job title at the firm, and the duration of the employment. We hand-collect these ExecGK's bios from corporate filings and then from online sources such as LinkedIn and law firm websites.

We use compensation data for the ExecGK, CEO, and the highest paid executives, which are from ExecuComp. We value option grants using the Black-Scholes model[9] and define total pay as the sum of salary, bonus, other cash compensation, restricted stock grants and option grants. We follow Core and Guay (2002) to estimate the sensitivity of the value of the ExecGK's accumulated equity-based compensation (including both stocks and options) to a one-percent change in the stock price, which is referred to as "delta".[10] Because we focus our attention on the hiring year delta, we are intentionally isolating incentives created by the sign-on and first year equity grants (both restricted and not) as our measure of equity incentives.

Table 1 profiles ExecGKs' presence in the top management team and their characteristics on an annual basis. Statistics of this table are based on our full sample of 32,617 firm-year observations and tabulated by fiscal years. A few statistics are of particular interest. The first column, labelled ExecGK, reports the percentage of firms' having an ExecGK by year. There is a secular trend on having an ExecGK in a corporation. In the year 1995, 33% of the S&P 1,500 firms have an ExecGK; the percentage increases to 44% as of year 2012.

Conditional on having an ExecGK, the remaining statistics report that ExecGK compensation has increased as a fraction of CEO pay from 34% to 43%. Executive lawyers earn $1.442 million in constant 2012 dollars on average over the last two decades. For every 1% increase in shareholder value, executive gatekeepers make another $55,000 in equity income, a much smaller fraction (6%) of the CEOs' delta

[9] We follow Core and Guay (2002) with minor modifications to estimate the grant date value of options. First, if the grant date is missing, it is assumed to be June 30 of that year. Option maturity is assumed to be seven years if the maturity date is missing. Second, the expected stock return volatility is measured as the annualized standard deviation of daily stock returns over the fiscal year in which the grant was made. A firm must have 50 observations for its volatility to be estimated, or else we use the median of the volatility distribution of all firms in ExecuComp in a given year. Third, expected dividend yield is the ratio of cash dividends paid in the fiscal year of the grant and the fiscal year-end stock price. Finally, the Treasury bond yield corresponding to the option's expected time to maturity is used as the risk-free rate.

[10] In order to calculate delta, we require information on the number of shares and both the number and value of unexercised options held by the ExecGK. We find that ExecuComp often does not report the actual share ownership for non-CEO executives. In such cases, we assume the delta of stock holdings to be zero. Nevertheless, for robustness purpose, we perform additional multivariate tests by using the sub-sample after dropping delta that carries missing/zero values.

compared to the total compensation. About one third of the ExecGK deltas are zero, and the ExecGK delta is right skewed even without the zeros. Our results are robust if we toss out the zeros, but instead, we choose to deal with both the zeros and the skewed distribution by adding the sample mean of the ExecGK delta before taking the natural log transformation, namely *LogExecGKDelta =log(ExecGK delta+55)*, both expressed in thousands of dollars.

III.b. Compliance Failures

In the introduction, we listed the three main general counsels duties: (i) compliance on all regulation fronts, (ii) the monitoring of all types of misbehaviors, and (iii) strategic value creation to the corporation more generally (first two duties: Duggin (2006), Rostain (2008) and DeMott (2012); last duty: Sorkin (2012) and Heineman (2012)). Our governance failure and investment outcome measures map directly to (i), (ii), and (iii) of this list.

The *Deloitte Global Corporate Counsel Report 2011* cites fraud, insider trading, and stock market disclosure as among the top issues for regulators and thus to which general counsels pay close attention. Corporate attorney recruiters and corporate executive compensation firms often list compliance as tantamount in importance in recruitment and remuneration (KPMG report, 2012). We measure the failures of regulatory compliance in two dimensions –accounting fraud and insider trading. Because internal gatekeepers sign off filings with the SEC and insider trades often require approval of general counsels, general counsels' reputation capital is severely at stake when a failure occurs in these types of compliance.

We measure accounting fraud with Accounting and Auditing Enforcement Releases (*AAERs*) issued by the SEC. The releases pertain to financial reporting enforcement actions from civil lawsuits brought by the SEC in federal court, issued during or at the conclusion of an investigation against a company, an auditor, or an officer for alleged accounting and/or auditing misconduct. We code the variable AAER to capture when the alleged accounting misconduct takes place rather than when the enforcement action is launched, i.e., AAER is set to 1 if financial statements in that firm year were restated and later became a subject for SEC enforcement action. AAERs that are not related to misstatement (e.g., for reasons such as bribery and disclosure) are excluded from our sample. We obtain AAERs from the Center for Financial Reporting and Management Center at the Haas School of Business, UC Berkeley. We truncate the analysis to 2009 when we use AAERs because it takes a year and a half for frauds to emerge (Dyck, Morse, and Zingales, 2010) and another span of a year or two for the SEC to complete an investigation. Thus, the frauds committed during the 2010-2012 period will likely not yet be reported in the AAER list, which is updated to summer 2012.

As our first measure of misconduct in insider trading, we manually collected information from the

SEC litigation releases,[11] which are summaries issued by the SEC that describe civil lawsuits brought by the Commission in federal court. We read litigation releases to uncover investigations involving insider trading as the reason for the suits. If a corporate executive is alleged to have traded his/her own company's stock based on insider information or have tipped such information for others to trade, then we code that firm year to be an insider trading year (SEC insider trade =1). This measure is unique in the sense that it is based on uncovered insider trading cases alleged by the SEC rather than an inferred measure as used in prior studies of insider trading. This measure is likely to be precise, but also incomplete in that the SEC need not uncover all insider trading.[12] Thus, we offer a second measure that follows recent studies (e.g., Jagolinzer, Larcker and Taylor (2011), Ravina and Sapienza (2010)) that measure insider trading performance by calculating the market-adjusted return after the trade. The underlying assumption is that if the trade does not involve nonpublic information then the insider should on average earn zero abnormal return. Following Dechow, Lawrence and Ryans (2013) and Skaife, Veenman, and Wangerin (2013), we focus on the profitability of insider sales and compute for each firm-year the 12-month buy-and-hold returns following the sales weighted by the value of insider sales by all executives in the executive suite. We use the post-trade return to gauge whether sales were made to avoid a foreseen loss. Insider trading profits can be interpreted as the outcome of opportunistic trading because insider sale for other reasons like liquidity or hedging should not result in profits, on average. Insider trading data come from the Thomson Reuters Insider Transaction database, which are then merged to CRSP to calculate the post-trade market-adjusted returns.

III.c. Monitoring Failures

The other three types of governance failure relate not directly to compliance, but to monitoring. These monitoring failures are securities fraud allegations, "uncaught" likelihood of accounting fraud, and option grants backdating.

Securities fraud occurs when management destroys shareholder value by misrepresentations, omissions of disclosure, or other violations of securities law. These frauds are more general than misconduct caught in AAERs. Dyck, Morse and Zingales (2010; 2014) show that nearly 40 percent of securities fraud are outside of accounting compliance activities and instead relate to misleading or omissions in communication or self-dealing. (See Karpoff, Koester, Lee, and Martin (2013) for a comparison of fraud

[11] The SEC litigation releases are publicly available on the SEC website: https://www.sec.gov/litigation/litreleases.shtml.

[12] The SEC litigation releases often do not list the exact dates when insider trading took place. This makes it hard to identify the fiscal year for the misconduct. We have to remove these cases from our sample study due to data unavailability.

data.) Thus, this measure of fraud contains a mixture of governance failures resulting from compliance and monitoring lapses. To construct a securities fraud variable, we collect the class action lawsuits filed during 1995-2012 from the Stanford Law School Securities Class Action Clearing House and merge them to Compustat.[13] There are altogether 1,187 lawsuits filed against public firms during this period, with 582 cases that were dismissed by the court and 78 that were not settled, which are removed from the sample. Our measure of governance failure is an indicator (*Class Action*) that takes the value of one if the firm fiscal year coincides within the class period (the period during which the alleged fraud was occurring), and zero otherwise.

The uncaught likelihood of accounting fraud is captured by *Fraud Score*, which is calculated using the misstatement prediction model and coefficient estimates of Dechow, Ge, Larson, and Sloan (2011). We relegate a full list of inputs and the formula to Appendix Table 1.

Finally, our *backdating* measure of governance is the list published by the *Wall Street Journal* of companies that have disclosed government probes on misdated options and related restatements as of September 2007.[14] For each listed company, we manually searched for the ultimate findings of the investigation. Backdating indicator (*Backdating*) is set to one for firm years when firms are convicted of backdating or misdating. Although after the backdating scandal, gatekeepers might face large ex ante reputation concern about backdating, this should not be the case before 2007, as this was not a compliance issue until the scandals were discovered.

III.d. Strategic Initiatives Measured by Investments

Our final analysis considers lawyers exerting effort to advise on strategic planning, especially when involving intellectual property exposures. We refer to such tasks as strategic initiatives. As in the case for frauds above, we cannot measure the effort input and thus measure the outcome as our variable of interest, in this case corporate investment. Bagley (2008) points out that firms characterize their executive general counsels more as entrepreneurs rather than policing lawyers. Horner (2007) discusses how corporate lawyers are involved in early stages when strategic initiatives are developed or transactions are contemplated, and that they are expected to be advising the CEO and the board in the same way that the CFO or COO would.[15] This view is echoed on the practitioners' side, that the legal executives that receive

[13] The Stanford Law School Securities Class Action Clearing house database has been employed by a number of prior studies (e.g., Lowry and Shu (2002), Field, Lowry, and Shu (2005), Dyck, Morse, and Zingales (2010), Hanley and Hoberg (2012), and Kim and Skinner (2012)). These securities frauds are alleged rather than proven, in that no case ever goes to trail, but rather settles out of court because D&O insurance do not cover the executives with court convictions.

[14] See http://online.wsj.com/public/resources/documents/info-optionsscore06-full.html

[15] We find that general counsels that make to the executive office on average garner an impressive 32% of CEO pay, comparable to the total pay of CFOs, which is 34% of the CEO's (Jiang et al (2010)).

the best assessment are 11% more willing to take risks than the average legal executive, and they are as likely to take risks as the typical business executive (Russell Reynolds Associates, 2012). With higher commitment to their role of business executives, GCs are more likely to switch from the lawyer mindset of risk avoidance to a more entrepreneurial attitude of business development. Instead of voting no to risk-taking initiatives, their value lies in navigating through risks in growth options, designing unconventional ways to achieve the goal of value creation, and as a result, help firm take risks and grow. We use analysis on investments as a flip-side measure of general counsel being diverted away from internal governance; in our framing, if an ExecGK spends less time on compliance or monitoring, we would expect to see an increase in the investment outcome associated with spending more time in strategic initiatives.

We use three measures that gauge the outcome of lawyer's strategic input in investment. (Note that we do not study acquisitions as a natural outcome to strategic effort because corporations almost always hire external transaction lawyers for one-time events such as M&A or spinoffs (Karsten et al, 2014).) The first measure is the ratio of capital expenditure to PP&E as in Eisdorfer (2008). It captures the investment intensity in tangible assets. Second, we use R&D expenses scaled by assets as a proxy for investment intensity in intangible assets.[16] Prior studies (e.g. Shaked and Sutton (1987) and Valta (2012)) suggest that firms use R&D to differentiate their products from those of competitors. This investment in intangibles makes it difficult for rivals to enter and to compete with these firms. The third captures expansion of business segments, as captured by the entropy measure (calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments).[17]

III.e. Other Company Outcomes and Measures

Our analysis also considers typical measures on corporate governance that characterize internal and external monitoring. We will use these measures to gauge whether the firm strengthens other governance mechanisms when bringing in a gatekeeper, to speak to the mechanisms of our results. To strengthen the board, the shareholders may bring in more independent board members. We gather these data from Riskmetrics. We also obtain the G-index of governance of Gompers, Ishii and Metrick (2003) from Riskmetrics to measure shareholder rights. A higher value of G-index indicates weaker shareholder monitoring.

[16] Koh and Reeb (2014) find that firms reporting no information about R&D actually file more patents than firms reporting zero R&D, suggesting that the non-reporting firms may have made non-trivial investment but opted to classify R&D expenditures into other expenses, putting into question the practice of treating missing R&D as zero. We, therefore, replace missing R&D with industry median based on 2-digit SICs.

[17] The measure was developed by Jacquemin and Berry (1979), and used in prior studies such as Bushman, Indjejikian, and Smith (1995), Khanna and Palepu (2000), Cassell, Huang, Sanchez and Stuart (2012).

IV. The Importance of Gatekeepers in Internal Governance

Our first empirical attempt is to look at the governance impact of bringing a lawyer into the executive suite, using two approaches. First, we employ a matched difference-in-differences test to compare firms that hire a lawyer into the executive suite to otherwise matched firms that choose not to hire. The underlying assumption is that if bringing lawyering in-house has no impact we would see governance outcomes evolve in the same way in the treated as in the control firms. Second, within firms that hire executive lawyers we adopt a fixed effect model to study how the variation of individual lawyers impacts governance.

It is an endogenous choice whether or not to hire a lawyer into the executive suite. To provide a sense of company attributes that correlate with the hiring decision, Table 2 provides summary statistics that compare hiring firms in the year of executive lawyer being hired to non-hiring firms (i.e., firms that do not have executive lawyers from two years prior to two years after). The statistics show that firms with smaller market capitalization, lower market-to-book ratio, higher volatility, and higher litigation risk tend to hire an executive lawyer. In terms of investment activity, firms that hire executive lawyers have lower investment in intangible assets but no difference in tangible assets. Governance in some dimensions, e.g., AAER fraud, profitability of insider trading, and class action law suits seem to be weaker in the group of executive lawyer hiring firms than no-hiring firms, but not so in SEC alleged insider trading, fraud score and backdating. The results on other governance metrics are also mixed in sign. In sum, the firms appear quite different, not in an easily characterizable way.

To address the selection of hiring, we use a matched difference-in-differences approach. We match the treatment and control in year of the hire, tertile of firm market capitalization, and one-digit industry, and then within these matched buckets, we draw three nearest neighbor matches on the litigation propensity following Choudhary, Schloetzer, and Sturgess (2012), who find that firms that are more complex, and with higher litigation risk are more likely to hire top tier corporate attorneys. To construct ex ante litigation propensity, we follow the procedure in Kim and Skinner (2012) to construct an *ex ante* litigation risk measure for all sample firm years. In particular, we implement a litigation determinant logit model using all securities class action lawsuits filed during 1995-2012 from the Stanford Law School Securities Class Action Clearing House. Kim and Skinner identify industry (such as membership in the biotechnology, computers, electronics, and retail industries), size, sales growth, stock returns, return volatility, skewness, and liquidity as among the most important factors in determining firm litigation risks. *Litigation propensity* is calculated based on the coefficient estimates of this logit regression.[18]

[18] The explanatory variables used in the logit model (lagged by one year), including FPS, natural logarithm of sales, sale growth, market-adjusted returns, volatility, skewness, and liquidity, are defined in Appendix Table 1. Our

We want to make a few points with this exercise. First, firms that hire executive gatekeepers are statistically different from matched, non-hiring firms in the pre-hiring period in eight of the eleven dimensions covered in panels A-D of Table 3. In particular, hiring firms are worse ex ante in governance.

Second, firms that hire an executive gatekeeper almost always experience a governance improvement. AAER fraud falls by 0.021 with an executive lawyer hiring. Relative to the pre-hiring two-year mean of 0.042, this decline represents a 50 percentage reduction. SEC alleged insider trading falls by 0.017, a 94 percentage reduction. Insider trading profits falls by 0.023, an 85 percentage reduction. Class action suits fall by 0.02, a 33 percentage reduction. Fraud scores decreases by 0.16, a 13 percentage reduction.

Third, the governance improvement is statistically larger than the zero-to-small improvements in governance found in the matched sample of firms not hiring an executive lawyer. Both findings two and three are consistent with the existing literature on general counsel's compliance role, which usually, but not always, finds governance improvements with the presence of *super lawyers* in the firm (Kwak, Ro, and Suk (2012), Hopkins, Meydew, and Venkatachalam (2012), Jagolinzer, Lacker, and Taylor (2011)). These papers take up the issues and struggle with identification, often with competing results reflecting the difficulty therein. Although we present these results in a difference-in-differences table, we refrain from using causal language because we cannot prove causality of the design especially given the differences in the firms ex ante.[19] However, this leads us to the fourth point.

Fourth, in Panels A and B, the difference-in-differences results (bolded in Table 3) for the majority of governance failure measures are significant in the direction of the executive lawyer being a mechanism in improving firm governance. It is possible that our measures were simply correlated with outcomes coming from other governance actions taken by the board at the same time as hiring an executive lawyer, but this appears not to be the case. In Panel C, we show no difference-in-difference result in other internal governance dimensions (board independence, g-index) that the board might have used concurrently to

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estimation results are similar to those presented by Kim and Skinner. The coefficients are 0.536 for FPS (an indicator variable for high intellectual property industries), 0.463 for natural logarithm of sales, 0.229 for sales growth, 0.002 for market-adjusted returns, 0.315 for volatility, -0.260 for skewness, 0.0002 for liquidity, and -8.418 for the intercept, respectively. There are a total 86,062 observations for the estimation.

[19] In our setup, the conditional mean independence assumption for a causal interpretation would be that in the absence of hiring an ExecGK, the firm's governance [investment] would have evolved as other firms in the same industry and in the same year with similar governance risk [investment intensity]. Violations to a causal interpretation of such a design might be (1) that firms hiring ExecGKs should correlate with those desiring to mitigate a future strain on governance [or those having a need for future investment], or (2) that the hiring of ExecGKs reflects boards or CEOs with an overall strategy to improve governance on many dimensions [or embark on strategic investments]. We therefore cautiously refrain from interpreting these around-hiring differences as governance and strategic investment causal effects from hiring ExecGK.

improve governance.[20] Thus, we think the evidence is at least suggestive that the lawyer is the mechanism for the Table 3 results, even if the intent of the changes may be due to the board.

Finally, we turn to Panel D, which shows that both hiring firms and matched firms experience reduction in capital expenditures; R&D expenditures are reduced in the matched firms but not in the hiring firms. Both hiring firms and matched firms experience an increase in expansion in business segments. The difference in changes between the two sets of firms is statistically significant only in tangible capital investment.

This first approach addresses the selection of whether or not a firm hires executive lawyer through matching; admittedly this approach cannot deal with the selection entirely. We then turn to the second approach using a relatively homogenous sample of firms (in the sense that they all have executive lawyers) to test the effect of the legal executives on corporate outcomes. We use a general counsel fixed effect model, following Bertrand and Schoar (2003) and Malmendier and Tate (2009), who study the amount of fixed effect associated with CEOs, to measure to what extent differences among individual CEOs matter. Their empirical insight is to use the movement of CEOs across firms to gauge how much variation in the performance of relevant firm metrics is due to individual managers versus firm fixed effects. Subsequent work by Güner, Malmendier and Tate (2008) and Custodio and Metzer (2014) implements similar methodologies for CFOs.[21]

We use this methodology to accomplish two goals. First, we build on the literature of Kwak, Ro, and Suk (2012), Hopkins, Maydew, and Venkatachalam (2014), Jagolinzer, Larcker, and Taylor (2011) and Krishnan, Wen, Zhao (2011), by offering a quantification of the governance importance of individual lawyers across firms. Second, we motivate our analysis of the paradox of executive lawyers by studying the top lawyer fixed effects in governance and investment dimensions. If general counsels matter for both governance and strategic initiatives, then we begin to see a stress for time and effort in their multitask roles. We interpret the total magnitude of partial r-square of the general counsel over and above CEO and firm fixed effects as a metric for saying how important the institution of general counsel is, generally and relatively in their governance mandates versus strategic initiative tasks.[22]

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[20] Board independence does show a difference-in-difference result, but it is driven entirely by the non-hiring firms getting worse in governance.

[21] Recent accounting research documents significant top mangers' individual effects on firms' voluntary disclosures, tax avoidance, and a wide range of financial reporting choices (Bamber, Jiang and Wang (2010); Dyreng, Hanlon and Maydew (2010); Ge, Matsumoto and Zhang (2011)). Yang (2012) finds that the market recognizes managers' individual style and reacts to their earnings forecasts accordingly. Most of the existing studies focus on CEOs and CFOs, and Bamber, Jiang and Wang (2010) is the only study we know of that examines general counsel's fixed effect on management earnings forecast. Different from their paper, we offer a big-picture view on both compliance roles and monitoring roles of executive gatekeepers.

[22] In the rest of the paper, we focus on executive general counsels, i.e, those in the inner executive suite as proxied by stable compensation. In this section, we used the larger set of general counsel because we were not constrained to

Table 4 produces this result, mimicking layout of Bertrand and Schoar (2003). The estimation regresses governance on firm and year fixed effects, and then iteratively adds in CEO fixed effects and general counsel fixed effects.[23] The table reads down by rows. The first row reports just the firm and year fixed effects result for AAERs. The adjusted r-squared is 0.299; firm and year fixed effects account for about 30 percent of the variation in realized AAERs. The CEO addition (the second row) increases the r-squared to 0.499. The general counsel adds another 7 percent, increasing the adjusted r-squared to 0.570. This represents a 14% change increase in adjusted r-squared. The f-test for the joint significance of the general counsel fixed effects has a p-value of <0.0001.

Doing the same exercise for the other governance failure dependent variables finds that the general counsel fixed effect explains 1.9 percent of the variation in SEC alleged insider trading (representing 12% increase in adjusted r-squared), 1.2 percent of the variation in insider trades profits (17% increase in adjusted r-squared), 6 percent of the variation in securities class action suits (18% increase in adjusted r-squared), 4 percent of the variation in accounting fraud score (10% increase in adjusted r-squared), and 3 percent of the variation in backdating (4% increase in adjusted r-squared). The F-tests for each estimation can be interpreted as that the general counsel fixed effects being jointly significant in explaining variation.

The last two rows report the general counsel fixed effect on investment decisions. The addition of general counsel fixed effect explains an additional 4.9 percent of the variation in capital expenditure (12% increase in adjusted r-squared), and 0.6 percent of the variation in in R&D investment (2% increase in adjusted r-squared).

In sum, over and above firm and CEO fixed effects, general counsel fixed effects on average explain 4 percentage points of the variance in governance measures and 2.8 percentage points of the variance in investment. CEO fixed effects on average explain 11.0 percent in governance and 3.9 percent in investment. To the extent that the literature on CEO fixed effects deems the CEOs important in governance and investments, general counsel are as well, confirming the notion from prior literature that they preside over gatekeeping and strategic advising roles.

V. Methodology of the Test on Equity Incentives

Our second and main empirical question is that when lawyers move into the executive suite, they take on additional strategic duties, potentially diverting time from monitoring. We use equity incentives as

have compensation data and because using a more complete dataset allows for a cleaner identification of true moves of lawyers across firms. However, we only have compensation data for the sample of firms in ExecuComp. It is worth noting that these magnitudes may be conservative as compared to the executive general counsel (as opposed to all general counsel) especially for investments in that lower-rank general counsels probably have less impact on strategic decision-making.

[23] Our results stay qualitatively the same if we retain only the 328 unique general counsels that work at two or more firms (i.e. movers) for our fixed effect regressions.

a measure of the importance of strategic initiatives to the firm, consistent with optimal contracting view that firms use compensation to align managers' actions with value creation. With the introduction of upside exposure to firm value a lawyer's actions can be tilted away from gatekeeping toward strategic initiatives. As such, equity incentives may render the general counsel's gatekeeping title to be partially a totem of governance. The problem resonates of Coffee's (2002; 2006) criticisms of gatekeeper conflicts-of-interests.[24] However, we do not take the strong stance that lawyers with equity incentives are captured; our focus is rather the tradeoff between the internal governance and strategic advising roles, which need not be with malintent.

The intuition of our empirical methodology is as follows. Imagine two firms wanting to hire a prominent lawyer to be the executive lawyer. One firm hires a lawyer from a law firm; the other, from another corporation. The reason for hiring an executive lawyer is certainly endogenous, but because we are comparing only within the set of firms that hire, the endogeneity task we face is to address the selection of hiring from a law firm versus from a corporation. If we can handle this selection, we build off a single identifying assertion. The assertion is that executive lawyers hired from law firms are initially less likely to reduce their effort in internal governance (i.e., the natural lawyering behavior) as a reaction to equity incentives. Executive lawyers can create value through two channels: strategic tasks or internal governance (or both); therefore, diversion would take place if the marginal value they create from strategic initiatives is higher than that from internal governance. Executives that are fresh from the law firm has built their habit and skill set solely as a lawyer, thus are likely more efficient in preventing potential breaches than advising on risk-taking initiatives. This does not mean that they share no strategic work but they face a learning curve to effectively add value through that channel. Secondly, internal governance is partially driven by reputational exposure. The law firm lawyer has built her reputational capital and human capital mainly in the lawyering community, and thus likely has more at stake in the event of monitoring failures. Bounded by this stronger reputational constraint, law firm lawyers are less likely to divert. This view is consistent with the sociology literature on professionalism. The foundations are found in Goode (1957), who defines a professional community (e.g., doctors, lawyers, professors, etc.) as occupations where all members are bounded by a sense of identity and share values in common. Hall (1968) discusses how professionals in an organization may identify less with the organization compared to other employees, because of conflicts between administrative imperatives and professional norms. For our setting, Wallace (1995) provides evidence consistent with our assumption. He finds that lawyers working in corporations are significantly

[24] Rostain (2008) suggests that financial dependence raises concerns about the alacrity with which gatekeepers will pursue potential wrongdoings if revealing such problems would materially damage the firm's profits. Our view is that the diversion need not be with mal-intent.

less committed to the legal profession than those working in law firms. If we are wrong in this assumption, our tests will be conservative.

To offer evidence supporting our identification assertion, we return to the fixed effect model of the form of Bertrand and Schoar (2004). Our idea is to take a subset of the data – firm-year observations that have hired a general counsel externally – and then identify general counsel fixed effects by whether these hires are "young" or "old". We define young general counsels as those that are hired from law firms and have a tenure of three years or less. Old general counsels refer to the law firm hires that have more than three years of tenure or those that are poached from other corporations. Therefore, the terms "young" and "old" do not refer to their age but their job experience as general counsel. We thus identify these fixed effects off the hiring of general counsel by the hiring sources and off the tenure or movement of general counsel among firms. If lawyers hired from law firms are unlikely to divert their attention from gatekeeping job to strategic growth initially, we expect that young general counsels explain the variation of investment to a less extent than old general counsels. Appendix Table 2 presents results exactly to this effect. Young general counsels fixed effects do not seem to explain the variation in investments while old general counsels explain 2-4% of variation in investment across firms. There is evidence that both young and old general counsels explain the variation in compliance and monitoring across firms.

Our empirical setup begins with a simple difference-in-differences equation for an outcome variable *y* measuring compliance failures, monitoring failures, or investment. The sample is firms that hire an ExecGK externally from either another company (*Treat =1*) or a law firm (*Treat =0*). None of the firms included have an ExecGK in the pre-period (i.e., two years before the hire), and all hires must remain as ExecGKs for three years. We match the treatment and control in year of the hire, tertile of firm market capitalization, and one-digit industry, and then within these matched buckets, we draw three nearest neighbor matches on the litigation propensity following Choudhary, Schloetzer, and Sturgess (2012), who find that firms that are more complex, and with higher litigation risk are more likely to hire top tier corporate attorneys.

To construct ex ante litigation propensity, we follow the procedure in Kim and Skinner (2012) to construct an *ex ante* litigation risk measure for all sample firm years. In particular, we implement a litigation determinant logit model using all securities class action lawsuits filed during 1995-2012 from the Stanford Law School Securities Class Action Clearing House. Kim and Skinner identify industry (such as membership in the biotechnology, computers, electronics, and retail industries), size, sales growth, stock returns, return volatility, skewness, and liquidity as among the most important factors in

determining firm litigation risks. *Litigation propensity* is calculated based on the coefficient estimates of this logit regression.[25]

With the match done, a simple difference-in-differences estimating equation would be:

$$y_{it} = \alpha_1 Post_{it} + \alpha_2 Treat_i + \alpha_3 Post_{it} Treat_i + \mu_{year} + \mu_{industry} + \mu_{hireyear} + \varepsilon_{it}. \quad (1)$$

Indices *i* and *t* denote firm and year respectively. *hireyear* indexes the year of the hiring. Notation μ denotes fixed effects, including year, hire year, and industry (at the two-digit SIC code level). We only keep the two years prior to the hiring and the two years subsequent in the panel, tossing out the year of hiring to allow for the transition in outcomes. In all estimations, we will cluster standard errors at the firm level. *Post* is an indicator for time *t* being after the hiring.

Equation (1) does not include any role for equity incentives. Instead it is a matched difference-in-differences comparing corporate versus law firm hires to check whether fraud/investment levels (α_2) and changes (α_3) are sensitive to the selection of hiring an ExecGK from a law firm or a corporation. To implement tests on equity incentives, we introduce the delta of the gatekeeper *i*, $X^{GK}_{i,hireyear}$, interacted with the treatment framework:

$$\begin{aligned} y_{it} &= \alpha_1 Post_{it} + \alpha_2 Treat_i + \alpha_3 Post_{it} Treat_i + \mu_{year} + \mu_{industry} + \mu_{hireyear} \\ &+ \alpha_4 X^{GK}_{i,hireyear} + \alpha_5 Treat_i X^{GK}_{i,hireyear} + \alpha_6 Post_{it} X^{GK}_{i,hireyear} + \alpha_7 Post_{it} Treat_i X^{GK}_{i,hireyear} + \varepsilon_{it} \end{aligned} \quad (2)$$

$X^{GK}_{i,hireyear}$ is static, defined only at the hiring year to avoid confounding effect of performance. Although this variable is in the future for the *Post = 0* observations, its interaction with *Treat* allows us to difference out a selection effect that the treated and control groups may exhibit differing sensitivities of the outcome measures to the level of incentive pay.[26]

What we are left with is a plausible conditional mean independence assumption for interpreting our main variable of interest, α_7: Had the firm hired an ExecGK from law firm rather than a corporation, the firm's governance/investment sensitivity to equity incentives would have evolved as a similar firm that chooses to hire a lawyer from a law firm once we:

(i) match on litigation risk within the year, industry and size of firm,

(ii) control for both the selection of hiring from a corporation (*Treat, Post, and Post*Treat*),

(iii) control for the level of incentive pay for the selection of a corporate hire

[25] The explanatory variables used in the logit model (lagged by one year), including FPS, natural logarithm of sales, sale growth, market-adjusted returns, volatility, skewness, and liquidity, are defined in Appendix Table 1. Our estimation results are similar to those presented by Kim and Skinner. The coefficients are 0.536 for FPS (an indicator variable for high intellectual property industries), 0.463 for natural logarithm of sales, 0.229 for sales growth, 0.002 for market-adjusted returns, 0.315 for volatility, -0.260 for skewness, 0.0002 for liquidity, and -8.418 for the intercept, respectively. There are a total 86,062 observations for the estimation.

[26] Our results hold when removing this level effect.

$$\left(X_{i,hireyear}^{GK}, TreatX_{i,hireyear}^{GK}\right).$$

It is worth noting that this approach further deals with the endogeneity of equity incentives. The level of equity incentives granted to the gatekeepers is endogenous. Contract theory predicts that firms with different contracting environment vary in optimal incentive levels. Studies on executive compensation (e.g. Core, Holthausen and Larcker (1999), Armstrong, Jagolinzer, and Larcker (2010)) suggest that both innate firm economic characteristics such as size, complexity, growth, and firm corporate governance characteristics affect managerial compensation. Suppose there are common unobserved factors that drive both the level of incentive pay and the outcome measures (e.g. corporate governance, ability of the gatekeepers, etc.), such factors should have the same impact in law firm hires and corporate hires. With the setup of the corporate hire as the treatment group and the law firm hire as the control, we difference out such endogeneity effect, and the two groups are different only in the way they *react* to equity incentives *ex post*, which goes back to the core of our identification.

With so many differencing and interactions, it is perhaps more straightforward to state the opposite, which is, what it would take for our identification to fail. A possible endogeneity concern that remains is that the firm's selection of hiring a gatekeeper from another company versus hiring from a law firm may reflect some omitted variable correlated with the effectiveness of equity incentives. That is, some unobservable factors may drive both the selection of hiring sources and the sensitivity of corporate outcomes to equity incentives. For example, firms in trouble may choose to hire gatekeepers from law firms, and for these firms the marginal value of governance improvement may be higher than the marginal value of growth.

To address this concern, we implement a triple difference form as follows:

$$\begin{aligned} y_{it} &= \alpha_1 Post_{it} + \alpha_2 Treat_i + \alpha_3 Post_{it} Treat_i + \mu_{year} + \mu_{industry} + \mu_{hireyear} \\ &+ \alpha_4 X_{i,hireyear}^{GK} + \alpha_5 Treat_i X_{i,hireyear}^{GK} + \alpha_6 Post_{it} X_{i,hireyear}^{GK} + \alpha_7 Post_{it} Treat_i X_{i,hireyear}^{GK} \\ &+ \alpha_8 Post_{it} X_{i,hireyear}^{CEO} + \alpha_9 Post_{it} Treat_i X_{i,hireyear}^{CEO} + \varepsilon_{it} . \end{aligned} \tag{3}$$

We introduce $X_{i,hireyear}^{CEO}$ into the equation, which is the level of equity incentives of the CEO in the hiring year of the ExecGK. In essence, we are forcing the comparison to difference around the endogenous use of equity incentives for firms. Thus, the "triple" effect is that we isolate the sensitivity of governance/investment to ExecGK equity incentives by comparing (i) over time, (ii) against outcomes when similar equity incentives are granted to ExecGKs hired from law firms, and (iii) compared to the sensitivity of governance/investment to within-firm equity incentives granted to CEOs. (We omit the CEO forward looking variables.)

To deal with the concerns of serial correlation and over-rejection of the null, we adopt the collapsed estimation procedure recommended by Bertrand, Duflo, and Mullainathan (2004). Following their approach, we collapse our time series observation around ExecGK hiring into a pre and post period and calculate the change in fraud/investment measures of the treatment group and the control group respectively. The form of this estimation equation is given below, where Δ implies the average in the post period minus the average in the pre period:

$$\Delta y_i = \lambda_1 Treat_i + \lambda_2 X^{GK}_{i,hireyear} + \lambda_3 Treat_i X^{GK}_{i,hireyear} + \lambda_4 X^{CEO}_{i,hireyear} + \lambda_5 Treat_i X^{CEO}_{i,hireyear} + \mu_{industry} + \mu_{hireyear} + \varepsilon_i \quad (3)$$

The collapsed version is our preferred specification, but we present both forms for robustness.

VI. Executive Lawyers' Response to Equity Incentives

VI.a. Selection tests on the choice of corporate hires

The pre-hiring results in Table 3 and almost all of Table 2 statistics reinforce our need for an experimental design that embraces the hiring endogeneity rather than trying to argue that we can make the hiring decision orthogonal. In Table 5, we move in that direction in selection tests, comparing statistics in the year of ExecGK hiring for the corporate hire firms and the law firm hire firms, after matching the two groups of hiring firms in size, year, industry and the litigation propensity of Kim and Skinner (2012).[27] The results of Table 5 are noticeably different from those in Table 2. ExecGKs hired from law firms and their hiring firms have statistically similar characteristics in means and medians to ExecGKs hired from other companies and their firms across all dimensions of the executives and firms characteristics except for one. The only difference we observe is that the law firm hires garner higher equity incentives (*ExecGKDelta*) than their matched corporate hires. The incentive pay scheme may be designed to counteract a conservative bias, which is at the core of our identification. Since we are interested in the sensitivity of ExecGKs' gatekeeping behavior to a unit change in delta, we naturally control for the level of these deltas and can focus our empirical attention to the marginal effect of the delta. Overall, the statistics in Table 5 greatly reduce concern that two groups are different in dimensions that are indicative of the effectiveness of incentive pay.

VI.b. Governance Results: Compliance & Monitoring

Tables 6 and 7 report the results as to whether equity incentives impact executive lawyers' effort exerted in compliance. Before looking explicitly at the equity incentive interactions, we first use column 1

[27] We present results based on the litigation match, because it follows directly from Kim and Skinner (2012) in being a predictor of hiring super lawyers, but no other significant difference emerge when we match on the other dependent variables in pre-period scorings.

(for the AAER dependent variable), column 4 (for SEC alleged insider trading) and column 7 (for insider profits) of Table 6 to test for selection on the difference between law firm hires (*Treat=0*) and corporate hires (*Treat=1*) not on *ex ante* firm characteristics (as in Table 5), but on expected *ex post* governance. The selection story of concern is that a firm knowingly facing a future governance stress or a need for future improvement in governance would systematically choose either law firm lawyer or a corporate lawyer to mitigate the governance strains forthcoming. In columns 1, 4 and 7 of Table 6, we find that neither the coefficients on *Treat* nor the coefficients on *Treat*Post* are significant for compliance outcomes. As in all of our specifications, we first match treatment and control samples on the fraud risk within the industry-year-size. Both the governance quality of the firm and the change in governance quality of the firm are unrelated to selection of hiring source. Likewise, in the collapsed implementation of Table 7, the coefficient on *Treat* in columns 1, 4 and 7 again reaffirm that the average effect of treatment into the corporate hire group is unrelated to changes in compliance governance.

The main variable of interest in Table 6 is *Post*Treat*Log(ExecGKDelta)*.[28] This coefficient speaks to whether equity incentives cause a diversion of or an enhancement to gatekeeping effort in compliance. Columns 2 and 3 consider AAER fraud outcomes, columns 5 and 6 report SEC alleged insider trading and columns 8 and 9, insider trading profits. Columns 3, 6 and 9 add in the additional dimension of controlling for the equity incentive level of the CEO, differentially for the treated and the control. We include a series of fixed effects for industry, year and hiring year, and cluster errors at the firm-hire level. Overall, we have 283 firm-hires which result in about four times that number of observations.

We find little evidence that equity incentives divert or enhance regulatory compliance efforts, as manifested in AAER fraud and insider trading measures. The coefficient of interest is positive and marginally significant in columns 2 and 8, but the addition of the differencing around the CEO equity incentives erodes this coefficient. More importantly for our skepticism of interpreting any impact are the collapsed results in Table 7, where we find coefficients more precisely estimated to be zero and in some cases, with the opposite sign from Table 6. The lack of an effect of incentive pay on compliance outcomes is perhaps to be expected because of steep reputation costs to infractions.

Tables 8 and 9 repeat the exercise of Tables 6 and 7, but this time for the monitoring aspect of gatekeeping. We measure gatekeeping monitoring effectiveness in three dimensions – class action frauds, the scoring of uncaught fraud, and option backdating. The sample is thinner for option backdating because backdating stops in 2007. Again, we first start by looking at selection gauged ex post. Herein again, we find no evidence than on average the hiring of a lawyer from a corporation is any different from the hiring from a law firm. None of the coefficients on *Treat* or *Post*Treat* in columns 1 (class actions), 4 (fraud

[28] Recall in reading the magnitudes that we have shifted delta to its mean value of $55,000: *LogExecGKDelta =log(ExecGK delta+55)*. We will translate significant results into magnitudes shortly.

score) and 7 (backdating) are significant in Table 8. Likewise, the *Treat* coefficients in Table 9 columns 1, 4 and 7 are also not significant.

Turning to the results, the coefficients on *Post*Treat*LogExecGKDelta* in columns 2, 3, 5, 6, 8 and 9 are all positive and significant. Under our causal design interpretation, equity incentives divert monitoring, resulting in an increase in the likelihood of a firm committing a fraud that will be later the subject of a class action suit, an increase in the fraud score, and an increase in the likelihood of later being caught for backdating. Before looking to the magnitude, we check robustness in our collapsed specification, with one observation per firm. We find that our results remain similar to Table 9 in all but the backdating cases, which we cease interpreting.

In terms of the magnitude, we focus on a one standard deviation higher value of the *ExecGKDelta* in the cross section, or $52,851 (0.053 in the scaling of the table). A $52,851 larger ExecGK delta translates into an increase in the independent variable (*Post*Treat*LogExecGKDelta)* equivalent of 0.112, because of the log transform and bulk of zeros from the interaction terms *Post* and *Treat*.[29] In Table 8, a one standard deviation larger *ExecGKDelta* increases probability of class actions law suits and fraud scores each by 0.014 and 0.012 respectively, using the conservative estimates in columns 2 and 5. This marginal effect represents a percentage increase in class actions by 22% (shown at the bottom of Table 8). The fraud score percentage change is a more modest percentage change of 1%, but this is a score and not a likelihood. Our preferred way to interpret these results is as monitoring diversion as a percentage of the governance improvements associated with hiring an ExecGK from Table 4. In particular, a one standard deviation increase from the mean *LogExecGKDelta* diverts 67% of the governance improvements in litigation law suits we found in Table 3. The more rigorous triple difference result in column 3 suggests that a standard deviation larger equity incentive divert nearly all of the monitoring improvements (89.9%). For the uncaught measure of fraud score, diversion unwinds 11.7% - 19.1% of the governance improvements.

Before leaving this section, we want to emphasize a point or two about the magnitude of our main results. A one standard deviation increase in the cross section of equity incentives is a much larger spectrum to consider than a time series deviation. Thus, we speak of diversion, even under our largest magnitude results, very few firms experience a complete diversion from the governance monitoring task for which the ExecGK was at least partially hired. Nevertheless, the magnitude suggests a gatekeeping-diverting result from compensation structures.

VI.c. Investments Results

[29] Alternatively, a one standard deviation increase in this independent variable is more than two-times larger, but we did not think this was a fair magnitude statistic to present.

In this section, we explore evidence that ExecGKs' efforts may have been diverted away from gatekeeping to another dimension of their multiple tasks; that is, equity incentives may encourage general counsels to spend more effort facilitating investment through strategic planning or legal risk mitigation. We set up the tests in the identical design as in Tables 6 – 9, by comparing the effect of equity incentives on investment for firms hiring a corporate ExecGKs against the control of ExecGKs hired from a law firm. We want to qualify these results in that the mechanism is less direct than the governance tests. Governance results are a direct outcome of an ExecGK's effort, whereas strategic investment is an outcome of the set of executives at large. Nevertheless, our empirical design allows us to narrowly look to the role of different ExecGKs by differencing out the hiring endogeneity. Moreover, the academic literature has numerous examples of managerial incentives being identified with greater effort. Brown, Harlow, and Starks (1996) and Chevalier and Ellison (1997) examine how managers change the riskiness of their activities in response to incentives and find that risk-taking is induced when managers' payoff is convex. Coles, Daniel, and Naveen (2006) document a strong positive relation between CEO equity incentives and riskiness of investment and leverage policies. Low (2009) show that in response to an exogenous shock that leads to risk-reduction, firms counter such adverse effects by providing managers with higher equity incentives. Following this evidence, we expect that equity incentives imposed on executive general counsels would turn their attention to mitigating legal risk and providence strategic initiative input on investment and innovation.

Tables 10 and 11 report our results as to whether equity incentives induce investment goals for a gatekeeper. As before, we start by looking at the difference-in-differences to see if selection in law firm versus corporate hires seems at play. In columns 1 and 4 of Table 10 and Table 11, we find no significant on *Treat* or *Treat*Post* variables.

Again, our main independent variable is *Post*Treat*LogExecGKDelta* in Table 10 or *Treat*LogExecGKDelta* in Table 11, i.e., the treated wealth sensitivity of the ExecGK to firm equity performance. Across our two investment measures in Table 10, we find support for investment increasing incentives in all three measures including the capital expenditure measure of investment intensity (columns 2 and 3), the R&D measure of investment intensities (columns 5 and 6), and segment expansion (columns 8 and 9). The collapsed estimation in Table 11 suggests that equity incentives have effects on R&D investment only, and even this is a bit weaker. We interpret the R&D results as robust because in the subsequent analysis breaking down equity incentives into options and stock grants, we consistently find that stock options are robust in their effect on R&D expenditures. Using the same economic magnitude gauge as before, a one standard deviation increase in the sensitivity of ExecGK's equity wealth to a one percent change in stock price increases R&D investment by 5.7% (column 5 of Table 10).

VII. Conclusion

Internal governance is an idea that has grown in popularity among executives, as they have increasingly become exposed to regulation and punishment for misconduct. In this paper we investigate an important and special facet of internal governance, i.e., lawyer gatekeepers in the executive suite, and examine the paradox introduced by the fact that these gatekeepers preside over the role of monitoring corporate misconduct as well as participating strategic value-creation.

We start off to document the impact of in-house legal counsel on internal governance. With a matched difference-in-difference test, we find governance improvement after a firm hires an executive lawyer to its c-suite. Prior literature guides our intuition that individual executives matter; using movement of executives for identification, the fixed effect of CEOs explain a host of variation in firm outcomes. In addition, financial expertise matters inside the firm (Custodio and Metzger (2014)). We introduce legal expertise into the box, documenting that general counsels command meaningfully large governance and investment fixed effects. Hopefully this simple result itself will stimulate further work into lawyers in the firm. The work on the effect of external lawyers on M&A negotiations and outcomes by Krishnan and Masulis (2013) and Karsten, Malmendier and Sautner (2014) is a nice complement and also serves this motivating purpose.

For our purposes, however, governance and strategic advisory roles of lawyers in executive offices together imply a paradox. We find that equity incentives granted to the executive lawyers introduce a tradeoff between the two commands that vie for gatekeepers' attention. In particular, equity incentives divert much of the improvement in governance associated with having an internal gatekeeper. Such diversion, however, only happens in monitoring dimensions of executive lawyers' jobs and is not observed in compliance measures. On the flip side, equity incentives shift executive lawyers' effort toward strategic investment tasks, suggesting that they are diverted away from traditional monitoring jobs to strategic tasks when incentivized to create value for the firm. Coffee (2002) might fairly interpret our results that compensation distorts gatekeeping. We do not, however, offer the welfare implication, as any value estimations would be fraught with speculation in interpretation.

Our study is one of the first to empirically examine the effect of equity incentives on internal governance by executive gatekeepers. The individual, concerned with reputation capital loss, faces the choice between monitoring and advising strategic initiatives. The non-linearity of option payoffs induces time allocation towards more risk taking. We conclude with the thought that as long as intellectual property continues to be a major part of production, legal expertise will continue to be needed in decision making, and the lines between legal value-creators and legal guardians will remain blurry. Intellectual property is not going away.

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Table 1: Summary Statistics of Executive Gatekeeper (ExecGK) Characteristics by Fiscal Year

This table presents Executive Gatekeeper (ExecGK) characteristics (mean) by fiscal year. Our sample comprises firm years in ExecuComp from 1994 to 2012. Statistics reported in (1) and (2) are for the whole sample while statistics reported in (3)-(8) are for firm years with the presence of ExecGK. *ExecGK* is an indicator variable equal to one if a general counsel appears in ExecuComp as one of the top paid executives. *ExecGK pay* is the executive gatekeeper's total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars. *CEO pay* is the CEO's total compensation. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. Detailed variable definitions are provided in Appendix Table 1.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Year	N	ExecGK	Age	ExecGK pay	CEO pay	ExecGK pay / CEO pay	ExecGK delta	CEO delta
1994	245	0.278	47.6	910	3,753	0.377	0.016	0.449
1995	1,727	0.328	49.3	1,032	4,550	0.344	0.025	0.516
1996	1,926	0.320	49.5	1,351	6,716	0.364	0.034	0.653
1997	1,993	0.330	49.5	1,477	8,289	0.353	0.044	0.898
1998	2,030	0.353	49.7	1,600	12,523	0.335	0.047	0.933
1999	1,928	0.377	49.9	1,964	10,007	0.381	0.068	1.351
2000	1,831	0.398	50.1	2,088	11,067	0.346	0.064	1.247
2001	1,786	0.411	50.4	1,747	9,155	0.353	0.048	0.995
2002	1,821	0.426	50.6	1,436	6,740	0.369	0.041	0.821
2003	1,866	0.429	50.8	1,547	7,021	0.335	0.057	0.947
2004	1,810	0.408	51.1	1,567	7,403	0.345	0.068	0.789
2005	1,697	0.357	51.8	1,841	7,651	0.358	0.085	0.921
2006	1,858	0.377	51.3	1,196	4,793	0.416	0.097	1.279
2007	1,857	0.395	51.2	1,175	4,102	0.442	0.066	1.017
2008	1,790	0.410	51.2	973	3,359	0.414	0.039	0.509
2009	1,727	0.412	51.5	1,350	4,940	0.398	0.046	0.507
2010	1,666	0.466	52.0	1,133	4,034	0.394	0.049	0.603
2011	1,593	0.466	52.4	982	3,568	0.402	0.047	0.705
2012	1,466	0.440	53.3	1,537	3,355	0.431	0.059	0.852
All	32,617	0.392	50.9	1,442	6,566	0.378	0.055	0.863

Table 2: Summary Statistics with ExecGK Hiring Firms vs. No-ExecGK Firms

Executive Gatekeeper (ExecGK) refers to a general counsel that appears in ExecuComp as one of the top paid executives and stays in position for three consecutive years. This table presents the mean and standard deviation of ExecGK and CEO compensation, firm characteristics, compliance, monitoring, investments and other governance measures taken in the year when the ExecGK is hired. Firms with no ExecGK include firm years where there is no ExecGK in a five-year window (i.e., from two years prior to two years after). *ExecGK pay* is the executive gatekeeper's total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars. *CEO pay* is the CEO's total compensation. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. *Assets* , *Sales* , and Market Capitalization (*Marketcap*) are from the balance sheet in millions of constant 2012 dollars. *Market to Book* is the ratio of market value of asset (market value of equity, plus book value of debt and book value of preferred equity, minus deferred taxes) to book value of assets. *Sales Growth* is sales in the current year scaled by the average sales of last three years, minus one. *Market-adjusted returns* are annual cumulative stock returns minus cumulative market (CRSP value weighted) returns over the fiscal year. *Volatility* is the annualized standard deviation of daily stock returns over the fiscal year. *Probability (shareholder suit)* is the predicted probability of being litigated based on the coefficient estimates from the logit regression of determinants of litigation risk, following Kim and Skinner (2012). *Firm age* is the number of years since a firm first appears on CRSP. *AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC. *SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise. *Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns. *Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. *Fraud Score* is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year. *R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. *Board independence* is the percentage of independent directors on board. *Governance index* is the Gompers, Ishii and Metrick (2003) governance index. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1.

	ExecGK		No ExecGK		Difference
# of Obs.	576		9,124		
	Mean	Std	Mean	Std	p-value
Compensation					
ExecGK Pay ($ thousand)	1,034	2,028	.	.	
CEO Pay ($ thousand)	6,031	10,783	7,013	28,499	0.412
ExecGK pay / CEO pay	0.318	0.437	.	.	
ExecGK delta ($ million)	0.016	0.053	.	.	
CEO delta ($ million)	0.996	4.114	3.533	60.667	0.325
Firm characteristics					
Assets ($ million)	16,722	78,694	19,609	110,396	0.536
Sales ($ million)	5,993	16,314	6,493	20,695	0.570
Marketcap	7,410	21,052	9,763	31,283	0.075
Market to Book	1.596	1.554	1.765	2.097	0.059
Sales Growth	0.254	0.642	0.223	0.487	0.139
Market-adjusted returns	0.065	0.640	0.112	0.769	0.149
Volatility	0.504	0.275	0.470	0.245	0.001
Probability (shareholder suit)	0.020	0.026	0.018	0.020	0.028
Firm age	21.8	17.4	21.7	16.6	0.826
Compliance					
AAER Fraud	0.034	0.182	0.021	0.145	0.052
SEC Insider Trade	0.005	0.072	0.005	0.069	0.897
Insider Sale Profit	0.035	0.255	0.005	0.282	0.024
Monitoring					
Class Action	0.047	0.212	0.028	0.165	0.010
Fraud Score	1.185	0.903	1.169	1.075	0.718
Backdating	0.020	0.141	0.023	0.150	0.698
Investment					
CapEx	0.314	0.389	0.299	0.363	0.353
R&D	0.047	0.114	0.063	0.186	0.042
Entropy	1.199	0.767	1.122	0.746	0.018
Other internal governance measures					
Board indpendence	0.689	0.165	0.664	0.169	0.003
Governance Index	9.262	2.524	8.801	2.642	0.001

Table 3: Compliance, Monitoring and Investment around ExecGK Hiring

This table presents the mean of compliance and minitoring failures, other internal governance measures, and investment for both two years prior and two years subsequent to the year of ExecGK hiring. The change from pre- to post-hiring is tablulated, and then compared against the change in a matched sample of firms with no ExecGK in a five-year window (i.e., from two years prior to two years after). The last column shows the p-values of t-tests in the difference between the mean of two years prior to hring and the mean of three years after hiring. There are 513 ExecGK firms and 1,438 matched No ExecGK firms based on ex ante litigation risks. *AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC. *SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise. *Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns. *Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. *Fraud Score* is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year. *R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. *Board independence* is the percentage of independent directors on board. *Governance index* is the Gompers, Ishii and Metrick (2003) governance index. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1.

	Before	After	Diff	P-value
ExecGK by hiring sources (year 0 is the hiring year)	Mean (Year -2 to -1)	Mean (Year +1 to +2)	(after - before)	difference test
Panel A: Compliance				
AAER Fraud				
ExecGK	0.042	0.021	-0.021	*0.035*
No ExecGK - Matched	0.020	0.027	0.006	*0.305*
Diff-in-Diff			**-0.028**	
P-value of diff (ExecGK vs. No ExecGK)	*0.017*	*0.429*	***0.002***	
SEC Insider Trading				
ExecGK	0.018	0.001	-0.017	*0.002*
No ExecGK - Matched	0.007	0.003	-0.004	*0.035*
Diff-in-Diff			**-0.013**	
P-value of diff (ExecGK vs. No ExecGK)	*0.055*	*0.168*	***0.031***	
Insider Trading Profit				
ExecGK	0.027	0.003	-0.023	*0.066*
No ExecGK - Matched	0.014	0.002	-0.011	*0.156*
Diff-in-Diff			**-0.012**	
P-value of diff (ExecGK vs. No ExecGK)	*0.285*	*0.895*	***0.426***	
Panel B: Monitoring				
Class Action				
ExecGK	0.061	0.041	-0.020	*0.095*
No ExecGK - Matched	0.025	0.025	0.000	*0.997*
Diff-in-Diff			**-0.020**	
P-value of diff (ExecGK vs. No ExecGK)	*0.000*	*0.058*	***0.072***	
Fraud Score				
ExecGK	1.248	1.088	-0.160	*0.001*
No ExecGK - Matched	1.172	1.117	-0.055	*0.042*
Diff-in-Diff			**-0.105**	
P-value of diff (ExecGK vs. No ExecGK)	*0.082*	*0.365*	***0.014***	
Backdating				
ExecGK	0.016	0.015	-0.001	*0.878*
No ExecGK - Matched	0.018	0.020	0.002	*0.734*
Diff-in-Diff			**-0.003**	
P-value of diff (ExecGK vs. No ExecGK)	*0.855*	*0.553*	***0.482***	

Panel C: Other internal governance measures				
Board Independence				
ExecGK	67.304	72.039	4.736	*0.000*
No ExecGK - Matched	64.785	69.061	4.276	*0.000*
Diff-in-Diff			**0.460**	
P-value of diff (ExecGK vs. No ExecGK)	*0.007*	*0.000*	***0.100***	
Governance Index				
ExecGK	9.208	9.400	0.193	*0.310*
No ExecGK - Matched	8.557	8.853	0.296	*0.020*
Diff-in-Diff			**-0.104**	
P-value of diff (ExecGK vs. No ExecGK)	*0.000*	*0.000*	***0.763***	
Panel D: Investment				
CapEx				
ExecGK	0.359	0.259	-0.100	*0.000*
No ExecGK - Matched	0.308	0.253	-0.055	*0.000*
Diff-in-Diff			**-0.045**	
P-value of diff (ExecGK vs. No ExecGK)	*0.010*	*0.588*	***0.027***	
R&D				
ExecGK	0.049	0.045	-0.004	*0.609*
No ExecGK - Matched	0.064	0.053	-0.011	*0.080*
Diff-in-Diff			**0.008**	
P-value of diff (ExecGK vs. No ExecGK)	*0.037*	*0.146*	***0.342***	
Entropy				
ExecGK	1.059	1.156	0.097	*0.033*
No ExecGK - Matched	1.089	1.146	0.057	*0.054*
Diff-in-Diff			**0.039**	
P-value of diff (ExecGK vs. No ExecGK)	*0.443*	*0.765*	***0.276***	

Table 4: General Counsel Fixed Effects on Compliance, Monitoring and Investments

This table presents the general counsel fixed effects on compliance and monitoring failures and investments. Included firm years are those in which a general counsel can be indentified from 10-K filings. For each dependent variable, the fixed effects included are: year and firm fixed effects in row 1; year, firm, and CEO fixed effects in row 2; year, firm, CEO, and general counsel fixed effects in row 3. Reported in the second and third columns are F-tests for the joint significance of the CEO fixed effects and general counsel fixed effects, respectively. For each F-test, we report the value of the F-statistic, the p-value, and the number of constraints). Column 4 reports the number of observations and column 5 reports the adjusted R-squared for each regression. *AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC. *SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise. *Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns. *Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. Fraud Score is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year. *R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1.

	F-tests on fixed effects for			
	CEOs	General Counsels	N	Adjusted R-squared
AAER Fraud			21,342	0.299
	4.19 (<.0001, 2,353)		21,342	0.499
	3.93 (<.0001, 2,353)	3.01 (<.0001, 1,354)	21,342	0.570
SEC Insider Trade			22,523	0.101
	1.57 (<.0001, 2,462)		22,523	0.159
	1.27 (<.0001, 2,462)	1.27 (<.0001, 1,465)	22,523	0.178
Insider Sale Profit			19,690	0.045
	1.22 (<.0001, 2,190)		19,690	0.070
	1.20 (<.0001, 2,190)	1.15 (.0003, 1,292)	19,690	0.082
Class Action			22,523	0.192
	2.88 (<.0001, 2,489)		22,523	0.345
	2.88 (<.0001, 2,489)	2.31 (<.0001, 1,438)	22,523	0.408
Fraud Score			22,396	0.320
	1.87 (<.0001, 2,497)		22,396	0.386
	2.03 (<.0001, 2,497)	1.81 (<.0001, 1,431)	22,396	0.424
Backdating			15,889	0.634
	4.09 (<.0001, 1,786)		15,889	0.740
	4.60 (<.0001, 1,786)	2.55 (<.0001, 979)	15,889	0.770
CapEx				
			21,674	0.349
	1.98 (<.0001, 2,409)		21,674	0.420
	1.69 (<.0001, 2,409)	2.10 (<.0001, 1,369)	21,674	0.469
R&D				
			22,300	0.283
	1.09 (0.0031, 2,467)		22,300	0.290
	0.94 (0.9795, 2,467)	1.08 (0.0222, 1,425)	22,300	0.296
Entropy				
			22,523	0.719
	4.46 (<.0001, 2,489)		22,523	0.804
	3.59 (<.0001, 2,489)	2.89 (<.0001, 1,438)	22,523	0.830

Table 5: Summary Statistics with ExecGKs Hired from Corporations vs. ExecGKs Hired from Law Firms

This table presents the mean and median of ExecGK and CEO compensation, firm characteristics, compliance, monitoring, investments and other governance measures taken in the year when the ExecGK is hired, by the two different career sources from which ExecGKs are hired, i.e., externally hired from law firms and externally hired from other corporations. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. *ExecGK pay* is the executive gatekeeper's total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars. *CEO pay* is the CEO's total compensation. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. *ExecGK age* is the age of the ExecGK. *Assets*, *Sales*, and Market Capitalization (*Marketcap*) are from the balance sheet in millions of constant 2012 dollars. *Market to Book* is the ratio of market value of asset (market value of equity, plus book value of debt and book value of preferred equity, minus deferred taxes) to book value of assets. *Sales Growth* is sales in the current year scaled by the average sales of last three years, minus one. *Market-adjusted returns* are annual cumulative stock returns minus cumulative market (CRSP value weighted) returns over the fiscal year. *Volatility* is the annualized standard deviation of daily stock returns over the fiscal year. *Probability (shareholder suit)* is the predicted probability of being litigated based on the coefficient estimates from the logit regression of determinants of litigation risk, following Kim and Skinner (2012). *Firm age* is the number of years since a firm first appears on CRSP. *AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC. *SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise. *Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns. *Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. *Fraud Score* is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year. *R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. *Board independence* is the percentage of independent directors on board. *Governance index* is the Gompers, Ishii and Metrick (2003) governance index. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1.

	Mean			Median		
	Corp	Law	Diff (p-value)	Corp	Law	Diff (p-value)
Observations (unmatched)	363	213		363	213	
Observations (matched)	157	126		157	126	
Compensation						
ExecGK Pay ($ thousand)	841	1,098	0.277	503	549	0.441
CEO Pay ($ thousand)	6,118	5,692	0.780	2,598	3,139	0.184
ExecGK pay / CEO pay	0.262	0.332	0.183	0.171	0.208	0.115
ExecGK delta ($ million)	0.008	0.020	0.033	0.000	0.002	0.084
CEO delta ($ million)	1.121	0.838	0.667	0.166	0.204	0.219
ExecGK age	48.7	49.5	0.456	49	49	0.904
Firm characteristics						
Assets ($ million)	19,154	16,635	0.778	1,507	2,302	0.212
Sales ($ million)	5,491	7,299	0.432	1,431	1,799	0.441
Marketcap	8,239	8,064	0.954	1,452	1,812	0.312
Market to Book	1.482	1.517	0.855	1.243	1.027	0.092
Sales Growth	0.289	0.293	0.964	0.121	0.160	0.414
Market-adjusted returns	0.142	0.048	0.288	0.029	-0.003	0.632
Volatility	0.462	0.466	0.904	0.433	0.408	0.338
Probability (shareholder suit)	0.019	0.018	0.732	0.012	0.013	0.770
Firm age	23.7	23.9	0.935	16.4	18.3	0.287
Compliance						
AAER Fraud	0.060	0.034	0.417	0.000	0.000	0.556
SEC Insider Trade	0.000	0.008	0.318	0.000	0.000	0.263
Insider Sale Profit	0.036	0.051	0.675	0.000	0.000	0.806
Monitoring						
Class Action	0.063	0.061	0.804	0.000	0.000	0.330
Fraud Score	1.256	1.161	0.631	0.947	1.022	0.212
Backdating	0.000	0.019	0.157	0.000	0.000	0.121
Investment						
CapEx	0.295	0.306	0.859	0.200	0.226	0.250
R&D	0.044	0.040	0.712	0.022	0.014	0.336
Entropy	1.259	1.235	0.823	1.247	1.134	0.671
Other internal governance measures						
Board indpendence	0.686	0.668	0.427	0.714	0.692	0.185
Governance Index	9.258	9.187	0.855	10.000	9.000	0.136

Table 6: ExecGK Incentive Pay and Compliance Failures

This table presents difference-in-differences tests on ExecGK incentive pay and compliance failures. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. *Post* is set to zero for the two years prior to the hiring of ExecGK, and one for the two years subsequent. The year of hiring is tossed out. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. *AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC. *SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise. *Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	AAER Fraud	AAER Fraud	AAER Fraud	SEC Insider Trade	SEC Insider Trade	SEC Insider Trade	Insider Sale Profit	Insider Sale Profit	Insider Sale Profit
Post	0.024	0.386	0.387	-0.028	-0.027	-0.026	0.024	0.226	0.23
	[0.071]	[0.270]	[0.271]	[0.019]	[0.032]	[0.032]	[0.078]	[0.183]	[0.183]
Treat (Hire=Corporate)	-0.035	-0.156	-0.151	0.006	0.093	0.091	-0.043	0.022	0.04
	[0.026]	[0.248]	[0.249]	[0.019]	[0.082]	[0.082]	[0.039]	[0.262]	[0.264]
Post*Treat	0.005	-0.435	-0.435	-0.008	-0.016	-0.016	-0.016	-0.352*	-0.360*
	[0.033]	[0.270]	[0.270]	[0.018]	[0.039]	[0.039]	[0.045]	[0.211]	[0.211]
Log(ExecGKDelta)		0.007	0.009		-0.01	-0.011		-0.068	-0.064
		[0.036]	[0.036]		[0.017]	[0.017]		[0.046]	[0.046]
Post*Log(ExecGKDelta)		-0.089	-0.087		0.000	-0.001		-0.044	-0.048
		[0.060]	[0.060]		[0.009]	[0.009]		[0.042]	[0.048]
Treat*Log(ExecGKDelta)		0.03	0.029		-0.022	-0.021		-0.019	-0.023
		[0.062]	[0.062]		[0.019]	[0.019]		[0.061]	[0.061]
Post*Treat*Log(ExecGKDelta)		**0.108***	**0.102**		**0.002**	**0.005**		**0.082***	**0.073**
		[0.064]	**[0.066]**		**[0.006]**	**[0.007]**		**[0.048]**	**[0.056]**
Post*Log(CEODelta)			-0.001			0.001			0.003
			[0.007]			[0.002]			[0.017]
Post*Treat*Log(CEODelta)			0.005			-0.002			0.008
			[0.010]			[0.002]			[0.021]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Calendar Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two-Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	951	951	951	1,128	1,128	1,128	734	734	734
R-squared	0.168	0.189	0.189	0.085	0.088	0.088	0.146	0.157	0.158

Table 7: ExecGK Incentive Pay and Compliance Failures - Collapsed Estimation

This table presents the collapsed difference-in-differences tests on ExecGK incentive pay and compliance failures. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. The dependent variable is the change of compliance failure measure from pre- to post-hiring period. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999).*CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars*AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC*SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise*Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	AAER Fraud	AAER Fraud	AAER Fraud	SEC Insider Trading	SEC Insider Trading	SEC Insider Trading	Insider Sale Profit	Insider Sale Profit	Insider Sale Profit
Treat (Hire=Corporate)	-0.006	0.526	0.482	-0.009	-0.168	-0.177	-0.042	-0.178	-0.433
	[0.039]	[0.500]	[0.545]	[0.036]	[0.241]	[0.265]	[0.054]	[0.295]	[0.678]
Log(ExecGKDelta)		0.036	-0.002		0.016	0.024		0.105	0.065
		[0.042]	[0.065]		[0.040]	[0.061]		[0.079]	[0.124]
Treat*Log(ExecGKDelta)		**-0.13**	**-0.082**		**0.04**	**0.047**		**0.085**	**0.141**
		[0.121]	**[0.160]**		**[0.055]**	**[0.081]**		**[0.145]**	**[0.210]**
Log(CEODelta)			0.016			-0.009			0.018
			[0.022]			[0.012]			[0.040]
Treat*Log(CEODelta)			-0.028			-0.004			-0.031
			[0.038]			[0.024]			[0.054]
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two-Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	237	237	237	281	281	281	185	185	185
R-squared	0.212	0.216	0.221	0.211	0.213	0.221	0.389	0.404	0.407

Table 8: ExecGK Incentive Pay and Monitoring Failures

This table presents difference-in-differences tests on ExecGK incentive pay and monitoring failures. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. *Post* is set to zero for the two years prior to the hiring of ExecGK, and one for the two years subsequent. The year of hiring is tossed out. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. *Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. *Fraud Score* is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. Governance reduction for a standard deviation change in ExecGK delta in the hiring year is presented at the bottom of the table. It is then compared to the pre-hiring mean of the governance failure measure (Table 4, Column B) to calculate reduction percentage. Reduction as a percentage of governance improvement is the ratio of governance reduction to governance improvement (Table 4, Diff-in-Diff). Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1) Class Action	(2) Class Action	(3) Class Action	(4) Fraud Score	(5) Fraud Score	(6) Fraud Score	(7) Backdating	(8) Backdating	(9) Backdating
Post	0.076	0.495**	0.522**	-0.022	0.209	0.226	0.047	0.284***	0.284***
	[0.065]	[0.216]	[0.210]	[0.090]	[0.236]	[0.232]	[0.035]	[0.104]	[0.104]
Treat (Hire=Corporate)	0.000	0.315	0.311	-0.109	0.001	-0.031	-0.019	0.105	0.107
	[0.033]	[0.237]	[0.241]	[0.075]	[0.661]	[0.668]	[0.012]	[0.144]	[0.144]
Post*Treat	-0.055	-0.552**	-0.580***	0.012	-0.432*	-0.450*	-0.01	-0.275***	-0.275***
	[0.050]	[0.220]	[0.213]	[0.082]	[0.256]	[0.252]	[0.015]	[0.103]	[0.103]
Log(ExecGKDelta)		-0.034	-0.036		0.124	0.114		0.035	0.035
		[0.042]	[0.044]		[0.102]	[0.107]		[0.029]	[0.029]
Post*Log(ExecGKDelta)		-0.102**	-0.178***		-0.042	-0.110*		-0.063**	-0.060**
		[0.049]	[0.054]		[0.054]	[0.062]		[0.027]	[0.026]
Treat*Log(ExecGKDelta)		-0.078	-0.077		-0.023	-0.016		-0.03	-0.03
		[0.056]	[0.057]		[0.154]	[0.156]		[0.034]	[0.034]
Post*Treat*Log(ExecGKDelta)		**0.121****	**0.162*****		**0.110***	**0.180****		**0.066*****	**0.063****
		[0.049]	**[0.060]**		**[0.057]**	**[0.074]**		**[0.025]**	**[0.024]**
Post*Log(CEODelta)			0.053***			0.048*			-0.002
			[0.017]			[0.025]			[0.005]
Post*Treat*Log(CEODelta)			-0.027			-0.05			0.002
			[0.026]			[0.042]			[0.004]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Calendar Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two-Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,128	1,128	1,128	1,120	1,120	1,120	753	753	753
R-squared	0.118	0.139	0.167	0.312	0.315	0.317	0.223	0.251	0.251
In Sample Pre-Hire Mean		*0.061*	*0.061*		*1.248*	*1.248*		*0.016*	*0.016*
Value of governance reduction		*0.014*	*0.018*		*0.012*	*0.020*		*0.007*	*0.007*
Reduction % given one s.d. change of Log(ExecGKDelta)		*22.1%*	*29.6%*		*1.0%*	*1.6%*		*45.1%*	*43.1%*
Reduction as % of governance improvement		*67.1%*	*89.9%*		*11.7%*	*19.1%*		*n/a*	*n/a*

Table 9: ExecGK Incentive Pay and Monitoring Failures - Collapsed Estimation

This table presents the collapsed difference-in-differences tests on ExecGK incentive pay and monitoring failures. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. The dependent variable is the change of monitoring failure measure from pre- to post-hiring period. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. *Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. *Fraud Score* is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1) Class Action	(2) Class Action	(3) Class Action	(4) Fraud Score	(5) Fraud Score	(6) Fraud Score	(7) Backdating	(8) Backdating	(9) Backdating
Treat (Hire=Corporate)	-0.086	-0.489**	-1.186**	0.034	-0.712**	-1.863**	0.000	-0.169	-0.386
	[0.061]	[0.248]	[0.527]	[0.066]	[0.354]	[0.749]	[0.003]	[0.135]	[0.304]
Log(ExecGKDelta)		-0.124	-0.296***		-0.209*	-0.337**		-0.091	-0.081
		[0.081]	[0.106]		[0.115]	[0.132]		[0.076]	[0.069]
Treat*Log(ExecGKDelta)		**0.219***	**0.428*****		**0.408****	**0.630*****		**0.092**	**0.087**
		[0.117]	**[0.152]**		**[0.180]**	**[0.195]**		**[0.075]**	**[0.071]**
Log(CEODelta)			0.082**			0.041			-0.009
			[0.033]			[0.029]			[0.006]
Treat*Log(CEODelta)			-0.125***			-0.131***			0.005
			[0.042]			[0.048]			[0.005]
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two-Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	281	281	281	279	279	279	188	188	188
R-squared	0.249	0.256	0.309	0.52	0.528	0.548	0.532	0.595	0.607

Table 10 ExecGK Incentive Pay and Corporate Investment

This table presents difference-in-differences tests on ExecGK incentive pay and corporate investment. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. *Post* is set to zero for the two years prior to the hiring of ExecGK, and one for the two years subsequent. The year of hiring is tossed out. *ExecGK delta* is the executive gatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars. *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year. *R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. Investment increase for a standard deviation change in ExecGK delta in the hiring year is presented at the bottom of the table. It is then compared to the pre-hiring mean of the investment measure (Table 4, Column B) to calculate increase percentage. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	CapEx	CapEx	CapEx	R&D	R&D	R&D	Entropy	Entropy	Entropy
Post	-0.071	0.178	0.169	0.070**	0.136***	0.140***	-0.017	0.366	0.346
	[0.092]	[0.191]	[0.190]	[0.030]	[0.044]	[0.044]	[0.109]	[0.226]	[0.229]
Treat (Hire=Corporate)	0.028	0.171	0.157	0.01	0.11	0.108	-0.009	-0.516	-0.552
	[0.038]	[0.434]	[0.432]	[0.010]	[0.115]	[0.117]	[0.082]	[1.305]	[1.311]
Post*Treat	-0.026	-0.451**	-0.444**	-0.017	-0.118***	-0.122***	-0.02	-0.705**	-0.685*
	[0.043]	[0.216]	[0.214]	[0.022]	[0.036]	[0.036]	[0.064]	[0.351]	[0.355]
Log(ExecGKDelta)		0.087	0.078		0.022	0.021		-0.064	-0.077
		[0.064]	[0.064]		[0.015]	[0.015]		[0.163]	[0.166]
Post*Log(ExecGKDelta)		-0.033	-0.029		-0.024	-0.023		0.123	0.132
		[0.105]	[0.105]		[0.028]	[0.029]		[0.319]	[0.320]
Treat*Log(ExecGKDelta)		-0.051	-0.043		-0.014**	-0.027**		-0.074	-0.049
		[0.045]	[0.046]		[0.007]	[0.012]		[0.048]	[0.081]
Post*Treat*Log(ExecGKDelta)		**0.105****	**0.127****		**0.025*****	**0.033****		**0.169****	**0.204***
		[0.051]	**[0.054]**		**[0.007]**	**[0.016]**		**[0.083]**	**[0.121]**
Post*Log(CEODelta)			-0.004			0.009			-0.016
			[0.011]			[0.009]			[0.047]
Post*Treat*Log(CEODelta)			-0.019			-0.005			-0.03
			[0.015]			[0.011]			[0.061]
Clustered s.e. at firm-hire year level	Y	Y	Y	Y	Y	Y	Y	Y	Y
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Calendar Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two-Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	1,084	1,084	1,084	1,127	1,127	1,127	1,128	1,128	1,128
R-squared	0.211	0.218	0.22	0.219	0.221	0.222	0.451	0.454	0.456
In Sample Pre-Hire Mean		*0.359*	*0.359*		*0.049*	*0.049*		*1.059*	*1.059*
Value of investment increase		*0.012*	*0.014*		*0.003*	*0.004*		*0.019*	*0.023*
% increase given one s.d. change of Log(ExecGKDelta)		*3.3%*	*4.0%*		*5.7%*	*7.6%*		*1.8%*	*2.2%*

Table 11 ExecGK Incentive Pay and Corporate Investment - Collapsed Estimation

This table presents the collapsed difference-in-differences tests on ExecGK incentive pay and corporate investment. The treatment group is corporations hiring ExecGKs from other corporations, and the control group is firms that are matched within the year-industry-size and litigation risk and hire ExecGKs from law firms. The dependent variable is the change of investment measure from pre- to post-hiring period. *ExecGK delta* is the executivegatekeeper's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars, following Core and Guay (1999). *CEO delta* is the CEO's total wealth to performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year. *R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1. Standard errors are clustered at the firm level. Superscripts ***, **, * indicate statistical significance level at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	CapEx	CapEx	CapEx	R&D	R&D	R&D	Entropy	Entropy	Entropy
Treat (Hire=Corporate)	-0.003	0.175	0.208	-0.01	-0.157**	-0.157*	-0.032	0.162	0.171
	[0.048]	[0.868]	[0.913]	[0.008]	[0.074]	[0.080]	[0.074]	[0.695]	[0.717]
Log(ExecGKDelta)		-0.033	0.001		-0.023**	-0.018		0.127	0.136
		[0.099]	[0.106]		[0.011]	[0.012]		[0.089]	[0.112]
Treat*Log(ExecGKDelta)		**-0.044**	**-0.073**		**0.035****	**0.035**		**-0.044**	**-0.054**
		[0.214]	**[0.258]**		**[0.017]**	**[0.024]**		**[0.160]**	**[0.198]**
Log(CEODelta)			-0.018			-0.004			-0.005
			[0.021]			[0.003]			[0.037]
Treat*Log(CEODelta)			0.016			0.001			0.006
			[0.039]			[0.006]			[0.055]
Hire Year F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
SIC Two-Digit F.E.	Y	Y	Y	Y	Y	Y	Y	Y	Y
Observations	271	271	271	280	280	280	281	281	281
R-squared	0.313	0.314	0.317	0.282	0.292	0.299	0.548	0.55	0.55

Appendix Table 1: Variable Definition, Data Sources and Descriptive Statistics

This table presents the definition and sources of the variables used in the study and shows the summary statistics of the variables.

Variable name	Variable definition	Sources	N	Mean	Median	Std
ExecGK Background						
ExecGK	Indicator variable that takes on the value of one if a general counsel appears in ExecuComp as one of the top paid executives.	Execucomp	32,617	0.392	0	0.488
Age	The age of the ExecGK	Execucomp, Def 14As and 10-Ks	12,629	50.874	51	7.289
(The statistics below are based on unique ExecGK-Firm observations where the immediate job experience prior to ExecGK is available)						
Internal	ExecGK was internally promoted	Execucomp, Def 14As and 10-Ks	2,602	0.274	0	0.446
Law Firm Hire	Indicator variable that takes on the value of one if an ExecGC was hired directly from a law firm.	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,602	0.271	0	0.445
Corporation Hire	Indicator variable that takes on the value of one if an ExecGC was hired directly from another corporation	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,602	0.444	0	0.497
Government Officials	Indicator variable that takes on the value of one if an ExecGK held important government positions (e.g. Attorney General, White House Counsel, Judge, Federal Attorney, Department of Justice etc.) before becoming a GC.	Def 14As, 10-Ks, Matindale-Hubbard, LinkedIn, online searches	2,602	0.007	0	0.081
Compensation						
ExecGK pay	ExecGK total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars.	Execucomp	12,777	1,442	797	3,671
ExecGK payrank	The total pay rank of ExecGK among top paid executives.	Execucomp	12,777	4.503	4.000	1.479
CEO pay	CEO total compensation (salary, bonus, other cash compensation, option grants, and restricted stocks) in constant 2012 dollars.	Execucomp	12,268	6,566	2,993	26,338
ExecGK pay / CEO pay	Total compensation of the ExecGC to the total compensation of the CEO.	Execucomp	12,238	0.378	0.301	0.378
ExecGK delta	Total wealth for performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars based on Core and Guay (1999).	Execucomp	12,429	0.055	0.020	0.200
CEO delta	CEO's total wealth for performance sensitivities based on stock holdings and unexercised options in constant 2012 (million) dollars based on Core and Guay (1999).	Execucomp	11,853	0.863	0.201	4.490
ExecGK stock delta	Total wealth for performance sensitivities based on stock holdings in constant 2012 (million) dollars based on Core and Guay (1999).	Execucomp	12,777	0.019	0.004	0.169
CEO stock elta	CEO's total wealth for performance sensitivities based on stock holdings in constant 2012 (million) dollars based on Core and Guay (1999).	Execucomp	12,268	0.591	0.061	4.200
ExecGK option delta	Total wealth for performance sensitivities based on unexercised options in constant 2012 (million) dollars based on Core and Guay (1999).	Execucomp	12,429	0.036	0.011	0.081
CEO option delta	CEO's total wealth for performance sensitivities based on unexercised options in constant 2012 (million) dollars based on Core and Guay (1999).	Execucomp	11,787	0.268	0.094	0.669
Compliance						
AAER Fraud	Indicator that takes on the value of one if the financial statements of a given fiscal year are restated and investigated by the SEC. Accounting and Auditing Enforcement Releases are issued by the SEC during or at the conclusion of an investigation against a company, an auditor, or an officer for alleged accounting and/or auditing misconduct. This variable is set equal to missing for fiscal years after 2009.	Center for Financial Reporting and Management Center at the Haas School of Business	27,689	0.020	0.000	0.140
SEC Insider Trade	Indicator that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise.	SEC Litigation Releases on Enforcement Actions on Insider Trading	32,617	0.004	0.000	0.067
Insider Sale Profit	The weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns.	Thomson Reuters Insider Transation	28,204	-0.001	0.000	0.359
Monitoring						
Class Action	Indicator that takes on the value of one for fiscal years coinciding the class period identified by the securities class action lawsuits. Dismissed cases are dropped for defining this variable.	Stanford Law School Securities Class Action Clearing House	32,617	0.029	0.000	0.168

Variable name	Variable definition	Sources	N	Mean	Median	Std
Fraud Score	The firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. We calculate predicted probability using the coefficient estimates from Dechow et al. (2011). Predicted Value= -7.893+0.79*rsst_acc 2.518*ch_rec+ 1.191*ch_inv + 1.979*soft_assets+0.171*ch_cs+(-0.932)*ch_roa+1.029* issue. RSST accruals come from Richardson, Sloan, Soliman, and Tuna 2005. This measure extends the definition of WC accruals to include changes in long-term operating assets and long-term operating liabilities.WC=(Current Assets- Cash and Short-term Investments)-(Current Liab - Debt in Current Liab); NCO=(Total Assets - Current Assets - Investments and Advances) - (Total Liab - Current Liab - LT Debt); FIN=(ST Investments + LT Investment) - (LT Debt + Debt in Current Liab + Preferred Stock); Chg in Receivables is defined as chg in AR/Average Total Assets; Chg in Inventory is chg in Inventory/Average Total Assets; % Soft Assets = [Total Assets - PPE - Cash and Cash Equivalent]/Total Assets; Chg in cash sales is Pct chg in cash sales, cash sales=[Sales - Chg in AR]; Chg in ROA is Earnings_t/Average total asset_t - Earnings_t-1/Average total asset_t-1; Issue is an indicator variable equal to 1 if the firm issued securities.	Center for Financial Reporting and Management Center at the Haas School of Business, Compustat	32,234	1.161	0.976	1.024
Backdating	Indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating.	WSJ	24,144	0.014	0.000	0.117
Determinants of Litigation Risks – Kim and Skinner (2012) Model						
FPS	Indicator variable equal to one if the firm is in the biotech (SIC codes 2833-2836 and 8731-8734), computer (3570-3577 and 7370-7374), electronics (3600-3674), or retail (5200-5961) industry, and zero otherwise	Compustat	32,617	0.280	0.000	0.449
Sales	Sales in millions of constant 2012 dollars.	Compustat	32,604	5,992	1,416	18,254
Sales growth	Sales in the current year scaled by the average sales of last three years, minus one.	Compustat	31,664	0.216	0.112	0.547
Market-adjusted returns	Annual cumulative stock returns minus cumulative market (CRSP value weighted) returns over the fiscal year.	CRSP	31,956	0.079	-0.006	0.680
Volatility	Annualized standard deviation of daily stock returns over the fiscal year.	CRSP	31,839	0.450	0.390	0.243
Skewness	Skewness of daily stock returns over the fiscal year.	CRSP	31,955	0.213	0.210	0.935
Liquidity	Average daily stock turnover over the fiscal year.	CRSP	31,957	0.890	0.658	0.770
Probability (shareholder suit)	Predicted probability of being litigated based on the coefficient estimates from the logit regression on the determinants of litigation risk (following Kim and Skinner (2012)).	Compustat and CRSP	30,663	0.017	0.011	0.197
Investment and Other Firm Characteristics						
Capex	The ratio of capital expediture to PP&E measured at the beginning of the fiscal year	Compustat	31,309	0.306	0.202	0.419
R&D	R&D expenses scaled by assets at the beginning of the fiscal year	Compustat	32,306	0.055	0.014	0.155
Entropy	Measure of business segment expansion - the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segment s.	Compustat segments	32,617	0.990	1.099	0.775
Assets ($ million)	Book value of assets in millions of constant 2012 dollars.	Compustat	32,617	15,864	1,936	91,036
Marketcap	Market capitalization in millions of constant 2012 dollars.	Compustat	32,371	8,113	1,672	26,666
Market to Book	The ratio of market value of asset (market value of equity, plus book value of debt and book value of preferred equity, minus deferred taxes) to book value of assets.	Compustat	32,123	1.631	1.140	2.089
Firm age	Number of years since a firm first appears on CRSP (use the median of the sample if missing).	CRSP	31,971	22.644	17.000	18.600
Other Internal Governance Measures						
Board independence	Percentage of independent directors on board	Riskmetrics	25,024	69.292	71.429	16.914
Governance Index	Gompers, Ishii and Metrick (2003) governance index	Riskmetrics	17,663	9.226	9.000	2.648

Appendix Table 2: Young and Old General Counsel Fixed Effects on Compliance, Monitoring and Investments

This table presents the general counsel fixed effects by sources of hiring and tenure at a firm on compliance and monitoring failures and investments. Included firm years are those in which a general counsel can be indentified from 10-K filings. For each dependent variable, the fixed effects included are: year, firm, and CEO fixed effects in row 1; year, firm, CEO, general counsel (young) and general counsel (old) fixed effects in row 2. Young general counsel is someone hired from a law firm and is still within three years of the tenure. Old general counsel is someone poached from another corporation or someone hired from a law firm but has more than three years of tenure as the general cournsel. Reported in the second and third columns are F-tests for the joint significance of the CEO fixed effects and general counsel fixed effects, respectively. For each F-test, we report the value of the F-statistic, the p-value, and the number of constraints). Column 4 reports the number of observations and column 5 reports the adjusted R-squared for each regression.*AAER Fraud* is an indicator variable that is one if the financial statements of a given fiscal year are restated and later investigated by the SEC.*SEC Inside Trade* is an indicator variable that is one if in a given year a corporate executive traded his/her own company's stock based on insider information or tipped such information for others to trade and later was investigated by the SEC, and zero otherwise.*Insider Sale Profit* is the weighted average stock sale profits realized by all executives in the c-suit in a fiscal year, where the stock sale profit is calcualted as negative one times the 12-month buy-and-hold stock returns*Class Action* is an indicator that takes on the value of one for fiscal years coinciding with the class period identified by the securities class action lawsuits. Fraud Score is the firm's probability of fraud based on the fraud model of Dechow et al. (2011) divided by the unconditional probability of fraud. *Backdating* is an indicator that takes on the value of one for firm years for which firms are convicted of backdating or misdating. *CapEx* is the ratio of capital expediture to PP&E measured at the beginning of the fiscal year.*R&D* is the R&D expenses scaled by assets at the beginning of the fiscal year. *Entropy* is calculated as the sum of Ps*Ln(1/Ps) where Ps is the proportion of the firm's total sales in industry segments. Our sample comprises firm years in ExecuComp from 1994 to 2012. Detailed variable definitions are provided in Appendix Table 1.

	F-tests on fixed effects for				
	CEOs	General Counsels (Young)	General Counsels (Old)	N	Adjusted R-squared
Panel A: Investments					
CapEx	3.00 (<.0001, 936)			7,567	0.458
	2.59 (<.0001, 936)	0.50 (1.000, 276)	1.67 (<.0001, 837)	7,567	0.496
R&D	1.33 (<.0001, 950)			7,710	0.358
	1.17 (<.0001, 950)	0.71 (0.9999, 287)	1.30 (<.0001, 860)	7,710	0.379
Entropy	4.64 (<.0001, 966)			7,836	0.808
	2.92 (<.0001, 966)	1.88 (<.0001, 293)	2.12 (<.0001, 860)	7,836	0.843
Panel B: Compliance and Governance					
AAER Fraud	2.77 (<.0001, 755)			5,886	0.450
	2.52 (<.0001, 755)	2.40 (<.0001, 226)	1.74 (<.0001, 693)	5,886	0.538
SEC Insider Trade	1.37 (<.0001, 966)			7,836	0.179
	1.34 (<.0001, 966)	2.98 (<.0001, 293)	0.95 (0.827, 875)	7,836	0.243
Insider Sale Profit	1.17 (0.0018, 779)			6,244	0.075
	1.17 (0.0022, 779)	1.10 (0.1421, 245)	1.15 (0.0073, 734)	6,244	0.098
Class Action	2.79 (<.0001, 966)			7,836	0.341
	2.54 (<.0001, 966)	2.18 (<.0001, 293)	1.73 (<.0001, 875)	7,836	0.421
Fraud Score	2.20 (<.0001, 962)			7,775	0.422
	1.86 (<.0001, 962)	1.77 (<.0001, 292)	2.27 (<.0001, 872)	7,775	0.524
Backdating	3.41 (<.0001, 555)			4,241	0.734
	2.09 (<.0001, 555)	1.19 (0.0527, 175)	0.88 (0.9719, 530)	4,241	0.722