

Corporate External Legal Counsel and Company Disclosures

Zahn Bozanic
The Ohio State University
bozanic.1@fisher.osu.edu

Preeti Choudhary*
Georgetown University
Preeti.Choudhary@georgetown.edu

Kenneth J. Merkley
Cornell University
kmerkley@cornell.edu

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* Corresponding author.

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Abstract

We exploit the unique setting of SEC comment letters to identify the participation of external legal counsel involved in comment letter discussions. Using the comment letter setting, we examine how the retention of high quality external legal counsel (HQLC) affects disclosure by studying the impact HQLC has on the resolution of disclosure deficiencies identified in comment letters. We find that the involvement of HQLC in the comment letter process is associated with a greater number of rounds of comment letter correspondence, an increase in the likelihood of requesting confidential treatment to redact comment letter correspondence, and a decrease in the likelihood of amendments following the comment letter process. These results are consistent with HQLC using their expertise to protect and withhold information from investors (i.e., the resistance hypothesis), rather than to enhance disclosure compliance. Our evidence contrasts extant empirical evidence on the role of general counsel, which prior research largely finds is to facilitate better disclosure and enhance compliance.

1. Introduction

We examine how the participation of high quality external legal counsel (HQLC) affects disclosure by studying the impact HQLC has on the resolution of disclosure deficiencies identified in comment letters resulting from the Securities and Exchange Commission's (SEC) filing review process. While prior research studies the impact of various parties who influence financial reporting, such as the Board of Directors, CEOs, and auditors (e.g. Klein 2002; Xie et al. 2003; Faleye et al. (2011); Armstrong et al. 2012; Francis 2011), little is known about the role of external legal counsel. In light of accounting scandals, the Sarbanes-Oxley Act of 2002 (SOX), and other recent regulations, the presence and need for external legal expertise in the disclosure process is increasing. Along with increased presence, scrutiny of lawyer's actions has also increased, some of which extends to external legal counsel (Lowenfels et al. 2006).¹ We exploit the comment letter setting to gain a better understanding of the role external legal experts play in public company disclosures.

The enforcement of disclosure regulation plays a critical role in the effectiveness of company's public information provided to capital market participants (Christensen, Hail, and Leuz 2013). In the United States, the SEC enforces disclosure requirements by reviewing the periodic filings of publicly traded companies at least once every three years to ensure the quality and completeness of public disclosures. Within this filing review process, the SEC's Division of Corporation Finance (DCF) initiates dialogue with a company by issuing comment letters to seek clarification from the company regarding its regulatory filings and/or to request that companies make changes to their filings.

¹ One well noted case is SEC v. Spiegel. The general counsel retained an external law firm Kirkland & Ellis LLP as principal outside counsel to provide depth in corporate and securities matters. Kirkland & Ellis LLP received a clear warning regarding their complacency in permitting inaccurate disclosures despite their attempt to provide legally correct advice and their attempt to report the inaccuracy to the audit committee.

Beyond the critical role of filing reviews, it is a particularly useful setting to examine how external legal counsel influences disclosure for several reasons. First, the comment letter setting is unique in that it allows us to specifically identify the participation and affiliations of company's external legal counsel. While external law firms are likely involved in other financial disclosures, we are unaware of any requirement to disclose their specific involvement, making it difficult to study their influence and role. Second, comment letters are non-routine correspondence and frequently involve interaction with SEC lawyers in areas specific to securities law. The advice of external legal counsel is particularly useful in these situations because internal legal counsel typically focuses on contractual, reoccurring issues and seldom has the requisite expertise to address specific disclosure and securities related matters. As such, we expect external legal counsel to play a significant role in this setting. Third, the comment letter process allows us to observe specific outcomes that vary across company and time, such as the extent of correspondence with the SEC required to complete the process, whether the company can withhold the requested information, and whether the company is requested to amend a previous filing. We believe comment letter outcomes are generally more closely linked to the actions of external legal counsel relative to financial accounting measures (e.g., accruals) and therefore allow us to provide direct evidence about the role of external legal counsel.

We measure in the presence of external legal counsel by whether the company retains a highly rated external law firm to help the company navigate the SEC comment letter process. We identify whether an external law firm is highly rated by their inclusion in the *American Lawyer* top 200 listing of top law firms (Choudhary et al. 2014). *American Lawyer* ranks law firms by the amount of gross revenue they receive from legal work. Using this identification strategy,

companies in our sample retain highly rated external legal counsel about 28% of the time.² We assume that these highly rated law firms provide high quality service given the depth of their expertise, the quality of their clients, and the demand for their services in the legal services market.

Because companies choose to retain high quality external lawyers to resolve comment letter inquiries, it is important to consider the nature of this decision. We first examine the determinants of high quality external legal counsel to better understand the types of circumstances that warrant their retention. We find that public companies with less experience, more reliance on other external experts, greater financial statement scrutiny, greater financial reporting complexity, and higher proprietary costs are more likely to seek high quality external counsel. These results are consistent with the costs and benefits of retaining high quality legal counsel relating to the value of outside expertise to the company.

We next turn to the influence of high quality external legal counsel on the resolution of disclosure deficiencies. Upon receiving an initial comment letter, several rounds of correspondence between the company and the SEC often occur to resolve the disclosure deficiency. Several non-mutually exclusive outcomes of this correspondence are possible. First, the SEC may become satisfied with the company's response to its request for clarification. Second, the company may request confidential treatment of the comment letter to protect proprietary information in the process of resolving a deficiency. Third, the SEC may require disclosure revisions in order to enhance compliance. We examine how the retention of high quality external legal counsel influences companies' disclosure through their impact on comment letter outcomes.⁴

² We note that the fraction of firms that retain highly rated legal counsel is much less than the number of firms that retain a Big 4 Auditor (76%). This is due to two factors. First, there is no regulation that requires external counsel or any legal participation, and second the law firm market has greater fragmentation relative to the market for public accounting firms.

⁴ We use the phrase "comment letter process" to reflect both the SEC's initial filing review as well as the comment letters (both SEC and firm generated) that arise consequent to the SEC's initial review.

High quality external legal counsel could impact comment letter outcomes in several ways. External lawyers could demonstrate their expertise by resolving SEC inquiries more quickly, which we term *the resolution hypothesis*. In essence, this would suggest that external counsel's expertise is displayed through facilitating better compliance with SEC disclosure regulation that leads to timelier resolution. Timelier resolution is valuable because of the opportunity cost of dedicating managerial time to additional financial reporting issues instead of the companies' profit producing activities. Under *the resolution hypothesis*, we would expect high quality external counsel to have fewer rounds of exchanges with the SEC, fewer requests for confidential treatment, and greater propensities to amend to resolve the SEC inquiry. Alternatively, high quality external counsel could display their expertise by resisting the SEC's inquiry, rather than simply complying with the request, which we call *the resistance hypothesis*. This reasoning suggests that companies retain external counsel to defend their existing disclosure positions and potentially withhold the additional information the SEC believes requires disclosure. Under this scenario, we would expect high quality external counsel to be associated with more rounds of correspondence, greater propensities for confidential treatment request, and fewer amendments in response to SEC comments.

After controlling for company and comment letter characteristics, we find that the participation of high quality external legal counsel in the comment letter process is associated with 6.6% more rounds of comment letter correspondence and a 33% increased propensity to request confidential treatment of the otherwise publicly available correspondence, relative to unconditional means. A request to redact the comment letter prevents the redacted information from being publicly disclosed in current or future filings. Relative to the unconditional mean, we find that the participation of high quality lawyers in the comment letter process is associated with

an 8% lower propensity to amend periodic filings. Further, when amended, amended filings involving high quality external legal counsel tend to convey greater magnitudes of negative news (0.7%) as compared to those without high quality external counsel. The latter result is consistent with high quality legal counsel recommending amendments only in the more severe instances. Collectively, these results are consistent with the resistance hypothesis which suggests that companies retain high quality external legal counsel to defend their existing disclosure practices so that sensitive information is not revealed.

The results outlined above are robust to various methods used to address self-selection concerns driven by a company's ability to choose whether to retain and external legal expert. Controlling for company and comment letter characteristics that relate to selecting high quality external counsel is only effective at addressing observable characteristics that are linearly related to outcomes. We find that our results are robust to i) using a Heckman procedure to address unobservable characteristics of choosing to involve high quality lawyers in the comment letter process, ii) matching treatment and control samples on characteristics of the SEC inquiry letter that capture the complexity of the issues raised, and, iii) changes analyses on companies that receive more than one comment letter in our sample period. The first method ensures our results are robust to observable characteristics that lead to the selection of high quality counsel (Rosenbaum and Rubin 1983). The second method ensures our results are robust to unobservable characteristics associated with the selection of high quality counsel (Heckman 1979). The third method ensures our results are robust to observable, time-varying company characteristics as well as unobservable, time-invariant company characteristics that are potentially correlated omitted variables (Woolridge 2002).

Our study contributes to two streams of literature. First, we contribute to a small but growing literature on the role of experts, in particular legal experts in publicly traded companies. Some of this literature specifically focuses on how external experts influence financial reporting characteristics and outcomes.⁵ While there are a few recent studies that focus on legal expertise, much of this literature measures the presence of legal expertise based on the prominence of a company's internal general counsel (as one of the top 5 highly paid managers in the company). These studies find that internal general counsel influences the market's assessment of security class action filings (Bird et al. 2014), companies' propensity to manage earnings (Hopkins, Maydew and Venkatachalm 2014), and the likelihood that (accuracy of) companies' issue voluntary management forecasts (Kwak, Ro, and Suk 2012).

Our study differs in that we consider the role of legal expertise outside of the company in a setting where legal expert participation is directly observable. The presumed advantage of engaging external legal counsel in the financial reporting process is to exploit their expertise in securities law. We build on this literature by investigating how external legal experts affect financial disclosure through their influence on the resolution of disclosure deficiencies identified by the SEC. Second, we contribute to the growing literature on SEC comment letters. Some of this literature focuses on understanding how the SEC monitors disclosure (e.g., Boone et al. 2013; Cassell et al. 2013; Gao et al. 2010) while other literature focuses on the benefits comment letters provide to the users of companies' financial disclosures (e.g., Bozanic et al. 2014; Brown et al. 2014; Johnston and Petacchi 2012). We build on this literature by enhancing our understanding of

⁵ For example, prior research investigates how financial expertise among the independent audit committee members (e.g., Farber 2005; Dhaliwal, Naiker, and Navissi 2010; Bryan, Liu, Tiras, and Zhuang 2013), how external auditor expertise (e.g., Reichelt and Wang 2009; Gul, Fung, and Jaggi 2009; Minutti-Meza 2014) or how outsourced internal audit expertise (e.g., Abbott, Parker, Peters, and Rama 2007) affects financial reporting quality.

a key “behind the scenes” player retained by the company to shape the comment letter process and its outcomes.

The paper proceeds as follows. In Section 2, we review the related literature on both legal counsel and comment letters, respectively. Section 3 develops our hypotheses and Section 4 outlines the data and methodology used in the study. Section 5 presents our main empirical results while Section 6 presents additional analyses. Section 7 concludes.

2. Literature Review

2.1. Lawyer involvement in financial disclosures

Prior literature examines how various individuals impact financial disclosure including boards, public accounting firms, and managers. An emerging literature investigates the role lawyers play in the company and how they affect financial disclosures. Much of this research defines the intensity of legal expertise by the number of legal experts on the board (e.g. Krishnan, Wen, and Zhao 2011) or their presence among top management (Kwak, Ro, and Suk 2012; Bird, Borochin and Knopf 2014). These papers generally find evidence that the presence of legal expertise is associated with better financial reporting quality such that the role of legal expertise among insiders (board and management) is used to enhance financial reporting, consistent with a gatekeeper role. In contrast, Hopkins, Maydew, and Venkatachalam (2014) find that greater legal expertise among top management is associated with worse accounting quality and more earnings management. They interpret this evidence that insider lawyers are captured by management and act as a facilitator rather than a gatekeeper. While most of this research focuses on the presence of the *general* counsel among management, Choudhary, Schloetzer, and Sturgess (2014) extend this literature to focus on how both general and external legal counsel influence the lexical properties of financial disclosures. Research on legal expertise is limited possibly because it is

often difficult, if not impossible, to directly observe any legal presence/participation in any particular disclosure let alone the presence/participation of *external* counsel. We complement this body of work by examining how *external* lawyers impact financial disclosure in the comment letter setting where we can uniquely identify the participation of high quality external council.

Given our focus on external legal counsel, it is useful to distinguish between the role of general and external counsel. Demott (2005) describes four typical roles of a general counsel: legal adviser to corporation and constituents, over and member of senior management, administrator of internal legal department, and agent of corporation in dealing with external parties including external legal counsel. Consistent with the first two roles, the general counsel often participates on the disclosure committee for the Board of Directors (Kwak et al. 2013) and deals with threats to company value arising from internal wrong doing (Krishnan, Wen, and Zhao 2011; Armstrong, Jagolinzer, and Larcker 2010).

In contrast, external legal counsel, similar to other outsourced experts, is typically retained for a particular expertise. Latham and Watkins, a top *American Lawyer* rated law firm, describes their public company representation as ranging from serving as “primary outside legal counsel advising on day-to-day operations.... to serv[ing] as adjunct to in-house legal departments, counseling clients in high specialized areas of the law.”⁶ Under the latter scenario, the general counsel reviews which issues require additional expertise, and contract out when necessary. Lee, Pinker and Shumsky (2012) show that, under certain conditions, having an in-house gatekeeper review and determine when external expertise is most useful, maximizes efficiency.⁷ For example, external legal experts are often retained when an issue does not recur with sufficient frequency to

⁶ <http://www.lw.com/practices/PublicCompanyRepresentation>

⁷ In our setting, the gatekeeper role is fulfilled by the general counsel (i.e., client) and the external service provider is the law firm.

develop the expertise in-house (GPSolo Magazine July/Aug 2004). Since many companies do not regularly receive SEC disclosure inquiries, external experts likely provide useful insights beyond general counsel's existing knowledge of SEC disclosure rules and regulations.

In the comment letter setting, we can uniquely identify the participation of external legal counsel, which allows us to examine whether external legal counsel uses their expertise to enhance disclosure compliance or protect and withhold information from investors. Specifically, our study contributes to this stream of literature by examining the on-going role of legal counsel in facilitating compliance. As such, our evidence suggests that high quality external legal counsel are retained for the purpose of defending companies' existing disclosure positions by withholding information, rather than to facilitate better disclosure and enhance compliance, which contrasts with the extant empirical evidence on the presence of internal legal expertise among company insiders.

2.2. Comment Letters

The initial wave of comment letter research examines the determinants or consequences of specific types of comment letter issues, such as those related to compensation (Robinson et al 2011), IPO registration statements (Ertimur and Nondorf), or 8-K disclosures stemming from auditor changes (Ettridge et al. 2011). Cassell et al. (2013) and Boone et al. (2013) build on this research by investigating the determinants of comment letters more generally. Some research in the area also examines the impact of comment letters on capital market outcomes, such as trading volume/analyst forecast accuracy (Johnston and Petacchi 2013) and insider sales (Dechow et al. 2014). Most recently, the literature has begun to examine the impact of the comment letter process on company disclosures (e.g., Bozanic et al. 2014 and Brown et al. 2014). We build on this literature by examining an important player in this process that has not been considered in prior

studies. That is, we provide evidence regarding how external legal counsel influences the comment letter process; namely, whether and how external legal counsel facilitates the resolution of disclosure deficiencies identified by the SEC. To the best of our knowledge, prior research on comment letters has left unaddressed the role external legal counsel plays in resolving disclosure deficiencies, despite the relative prominence of the legal profession in the activities of both the SEC and public companies.

3. Hypothesis Development

There are at least two potential ways external legal experts could influence the disclosure process. First, it is possible that external legal experts play a monitoring role by using their expertise to efficiently resolve disclosure issues. Their expert knowledge of securities laws and general knowledge of disclosure from serving multiple clients could lead them to more quickly identify the relevant laws and appropriate resolutions. If so, their expertise should enhance compliance through quicker solutions and better compliance with regulatory inquiries. This would be consistent with external legal experts serving a corporate governance or gatekeeper role where they represent shareholder interest through enhancing disclosure effectiveness and completeness, improving compliance with disclosure regulations.⁸ We term this the *resolution hypothesis*. *Ceteris paribus*, this will lead to fewer exchanges between the regulator and the company to resolve disclosure issues. Additionally, such resolutions should result in more forthcoming disclosures that satisfy the regulator.

Alternatively, lawyers could use their expertise to resist the SEC disclosure deficiencies and fight or avoid any proposed modifications to identified issues. Their expert knowledge of

⁸ Coffee (2003) defines the gatekeeping role as the lawyer serving as reputational intermediary with some responsibility to monitor the accuracy of corporate disclosures.

securities laws would then be used to navigate relevant laws and resist SEC inquiries to avoid compliance. This is more similar to the role tax experts might serve a company by minimizing the cost of regulation. Under this view, the external legal expertise is used to shield the company (its client) against an oppressive state (Coffee 2003, p. 1294). *Ceteris paribus*, this will lead external legal experts to take longer to resolve SEC inquiries because their goal is to resist the proposed solution by regulators. Similarly, disclosure deficiencies would be less likely to be satisfied through enhanced disclosure completeness and more likely to lead the company to withhold information deemed sensitive or proprietary in nature. We call this alternative the *resistance hypothesis*. These competing hypotheses lead to the following testable implications regarding the resolution of disclosure deficiencies:

H1: The extent of correspondence needed to resolve a disclosure deficiency will differ by the quality of external legal counsel (HQLC).

H2: The propensity to withhold information from the public will differ by the quality of external legal counsel (HQLC).

H3: The propensity to correct deficiencies in existing filings subsequent to a comment letter will differ by the quality of external legal counsel (HQLC).

4. Data and Methodology

4.1. Data

The unit of observation in our sample is a completed SEC comment letter conversation. A conversation typically begins with an initial inquiry letter from the SEC to a company, continues with correspondence between the company and the SEC, and ends with a “No Further Comment” letter from the SEC. As comment letters are publicly available beginning in 2004, our sample includes completed SEC comment letter conversations between 2005 and 2012 from the Audit Analytics SEC Comment Letters database. We require that companies involved in these letters

have coverage on both CRSP and COMPUSTAT and sufficient data to construct the variables used in our analyses. In addition, we focus on comment letter conversations regarding 10-K filing reviews because 10-K filings tend to receive the most attention relative to other SEC filings (Drake et al. 2013). Consistent with this notion, Bozanic et al (2014) find 10-Ks are the most frequently referenced periodic filing in comment letters. Furthermore, focusing the sample on comment letters that reference 10-K filings reduces some variation in comment letter characteristics, improving comparability across the treatment and control samples. This results in a sample of 10,094 observations.⁹

We extract and match the entity names of the companies included in the comment letter conversation from the correspondence field in Audit Analytics to company names in Audit Analytics, CRSP, COMPUSTAT, and those that represent the SEC. We review and classify all remaining parties by hand, specifically identifying the names of external law firms involved in the conversations. We classify an external law firm as high quality legal counsel (HQLC) if the law firm is ranked by *American Lawyer* as a “Top 200 Law Firm” in the year prior to the comment letter.¹⁰ We identify law firm name matches through exact name matches listed by *American Lawyer*. Law firms without an exact match on *American Lawyer* are then reviewed by hand to ensure correct identification and matching. As stated previously, we implicitly assume that law firms ranked as top tier per *American Lawyer* are high quality given the revealed demand for their services in the legal services market.

The variable, Rounds, is the number of correspondence letters exchanged between the SEC and the company, including the initial comment letter sent by the SEC and the final “No Further

⁹ Most 10-K inquiries also reference other SEC filings such as 10-Qs, 8-Ks etc. Expanding our sample by including comment letters that reference 10-Q filings increases the sample size by 491 observations and yields similar inferences.

¹⁰ *American Lawyer* ranks law firms based upon the amount of annual legal fees generated.

Comment” letter from the SEC. CTR, is an indicator variable set equal to one if the company made a confidential treatment request (CTR) to withhold the comment letter discussions from public disclosure. Amend, is an indicator variable set equal to one if the company made any 10-K or 10-Q amendment between the first comment letter and three months after the last comment letter, and zero otherwise.

Table 1 presents descriptive statistics and Table 2 a correlation matrix for the variables used in the study. We document that 28% of the companies in our sample retain high quality external legal counsel (HQLC). Companies on average experience roughly five rounds of exchanges with the SEC (Rounds), request confident treatment 17% of the time (CTR), and amend periodic filings approximately 20% of the time subsequent to receiving a comment letter (Amend). Univariate correlations in Table 2 reveal that HQLC is positively associated with Rounds, CTR, and Amend ($p < 0.05$).

5. Results

5.1. Determinants of Retaining High Quality External Legal Counsel (HQLC)

In this section, we analyze what company characteristics and/or circumstances lead managers to engage external legal experts. Specifically, we investigate whether managers are more likely to seek external legal counsel when they have less SEC disclosure experience, other experts (i.e., high quality auditors), greater outside scrutiny of their financial statements, more complex financial disclosure, higher proprietary costs, and more complex SEC inquiries. We then use the model in Equation 1 to address endogeneity concerns driven by unobservable characteristics in our subsequent analysis of how external legal experts affects comment letter outcomes. Our determinants model is as follows:

$$\begin{aligned}
\text{HQLC} = & \alpha + \beta_1 \text{Mrkt_Cap} + \beta_2 \text{Company_Age} + \beta_3 \text{Domestic} + \beta_4 \text{Big4} + \beta_5 \text{Tier2} + \\
& \beta_6 \text{Recent_Litigation} + \beta_7 \text{Restate} + \beta_8 \text{N_Analysts} + \beta_9 \text{IO} + \beta_{10} \text{10-K WC} + \beta_{11} \text{R\&D} + \\
& \beta_{12} \text{10-K Competition} + \beta_{13} \text{adjROA} + \beta_{14} \text{BHAR} + \beta_{15} \text{STD_RET} + \beta_{16} \text{Delaware} + \quad (1) \\
& \beta_{17} \text{Request_Amend} + \beta_{18} \text{Reference_Amend} + \beta_{19} \text{CL_WC} + \beta_{20} \text{N_Filings} + \\
& \beta_i \text{CL_Issues} + \varepsilon
\end{aligned}$$

Table 3 presents our estimate of Equation (1) using standard probit regression; z-statistics in parentheses are based on standard errors that are robust to heteroskedasticity and clustered by company. First, we proxy for SEC filing experience and company's ability to meet/comply with regulatory requirements with the log of market capitalization (Mrkt_Cap), the log of one plus the number of years the company has been publicly traded on CRSP (Company_Age), and an indicator if the company has domestic headquarters (Domestic). We anticipate companies with less SEC disclosure experience would be more likely to hire or need external legal expertise to help them resolve the SEC inquiry. As higher values of Mrkt_Cap, Company_Age, and Domestic represent more experience with SEC filings, we find negative and significant coefficients on each ($p < 0.01$), consistent with our expectations. Second, we proxy for the engagement of other experts using an indicator if the company engages a large, high quality auditor denoted by an auditor in the Big Four (Big4) or an auditor among the second tier (Tier2). We expect and find that companies more likely to engage audit experts are also more likely to engage external legal experts ($p < 0.01$).¹¹ Third, we use an indicator equal to one if the company had a securities class action lawsuit in the last three years (Recent_Litigation), an indicator equal to one if the company had a restatement in the last three years (Restate), the log of one plus number of analysts covering the company (N_Analysts), and the percentage of company's shares held by institutions (IO) as proxies for

¹¹ In untabulated analyses we find that the presence of general counsel among the top five highest paid managers (GC) is not correlated with HQLC ($p > 0.10$). In Section 6.4 we discuss results that include whether having a prominent general counsel as a legal expert is important, and find that the resolution of financial disclosure deficiencies identified by the SEC are not affected by the legal expertise among top management (i.e., the GC indicator variable is statistically insignificant when added to Equations 2, 3, or 4 ($p > 0.10$)).

attention paid to financial disclosure (i.e., scrutiny). We find some evidence consistent with greater scrutiny increasing the likelihood of retaining external legal expertise with positive and significant coefficients on *Restate* and *N_Analysts* ($p < 0.01$). However, we note positive, but insignificant coefficients on *Recent_Litigation* and *IO* ($p > 0.10$). Fourth, we proxy for financial reporting complexity using log of one plus the number of words in the most recent 10-K filing (10-K WC) and find more complexity increases the propensity to retain HQLC ($p < 0.01$). Fifth, we proxy for proprietary cost using the ratio of research and development expense to average total assets (*R&D*) and the ratio of competition related words to total words in the 10-K following Li et al (2013) (10-K Competition). We expect and find that greater financial reporting complexity and higher proprietary costs are positively associated with the retention of external legal expertise ($p < 0.01$).

Further, we include company specific controls for performance and operating risk using the return on assets based on operating income before depreciation, R&D, and advertising expense (*adjROA*), buy and hold raw returns for the 12 month prior to the comment letter (*BHAR*), and the standard deviation of raw returns for the 12 months prior to the comment letter (*Std_Ret*). We also include an indicator if the company is incorporated in Delaware (*Delaware*) since external legal experts are more likely to specialize in Delaware corporate law due to economies of scale and the existence of well-developed legal precedents (Bebchuk 2003). We find that companies registered in Delaware are more likely to seek external legal experts ($p < 0.01$).

Finally, we use characteristics of the initial SEC comment letter to proxy for the complexity of the SEC inquiry, with the expectation that more complex inquiries will increase the likelihood the company will seek external legal expertise to resolve the issue. *Request_Amend* (*Reference_Amend*) is an indicator equal to one if the SEC requested the company amend a filing (comment letter makes a reference to amend) and *CL_WC* (*N_Filings*) is the log of one plus the

number of words (filings referenced) in the initial SEC comment letter. We find that greater complexity in the nature of the inquiry (proxied by Request_Amend, Reference_Amend, CL_WC, and N_Filings) is associated with greater propensities to hire external legal experts. We find evidence that the more complex the SEC inquiry letters are, the more likely a company is to retain HQLC ($p < 0.10$).

We also control for whether the nature of the SEC inquiry are associated with the propensity to retain external legal counsel through comment letter issue types (CL_Issues). These include: the log of one plus the number of accounting standard issues (N_AccStd), the log of one plus the number of operational, controls, and risk assessment issues (N_OPCR), the log of one plus the number of securities regulations issues (N_SECRReg), the log of one plus the number of non-standard and other disclosure issues (N_NstdOth), and the log of one plus the number of new and secondary registrations issues (N_NewReg). We find that N_NewReg is positive ($p > 0.01$), consistent with a company's increased propensity to retain external legal expertise for registration issues. We also find N_AccStd and N_SECRReg are negative ($p < 0.05$), consistent with a decreasing propensity to retain external legal experts for comments about accounting standard issues and securities regulation issues. Overall, our model explaining the retention of external legal experts has reasonable explanatory power with a pseudo R-square of 9% and an ability to explain 0.71 of the area under the ROC curve.

5.2. Comment Letter Resolution

Hypothesis 1 - Extent of Correspondence

Having established an understanding of how company characteristics and circumstances lead managers to engage external legal expertise, we now turn to how external legal expertise shapes

comment letter resolutions. We test our first hypothesis regarding the number of rounds required to resolve a disclosure deficiency using the following model:

$$\begin{aligned} \text{Rounds} = & \alpha + \beta_0\text{HQLC} + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \\ & \beta_5\text{Tier2} + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \quad (2) \\ & \beta_{11}\text{R\&D} + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \\ & \beta_{16}\text{Delaware} + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \\ & \beta_{20}\text{N_Filing} + \beta_i\text{CL_Issues} + \varepsilon \end{aligned}$$

Table 4 presents the result of estimating Equation (2); t-statistics in parentheses are based on standard errors that are robust to heteroskedasticity and clustered by company. The dependent variable, Rounds, is the number of correspondence letters exchanged between the SEC and the company to include: the initial comment letter sent by the SEC, subsequent company and SEC responses, and the final “No Further Comment” letter from the SEC. The primary independent variable of interest is HQLC, or high quality external legal counsel, defined previously. Column 1 presents standard OLS regression analysis on the full comment letter sample. To mitigate possible selection on unobservable characteristics, Column 2 presents a two-stage Heckman-style analysis where the determinants model found in Equation (1) is the first stage model. The results from including the Heckman correction for self-selection suggest that self-selection from unobservable characteristics does not appear to pose a problem for estimation or inference, that is, the Inverse Mills ratio is statistically insignificant ($p > 0.10$). To mitigate possible selection based on the complexity of the issues raised in the comment letter, Column 3 presents a propensity score matched analysis where comment letters that involved HQLC are matched to those that did not involve HQLC, based on comment letter characteristics (i.e., Request_Amend, Reference_Amend,

CL_WC, N_Filing, and comment letter issues).¹² An untabulated analysis of covariate balance reveals that the panels are well-balanced.¹³ We further address self-selection from both observable time-varying company/letter characteristics and unobservable, time-invariant characteristics in our changes analyses discussed in Section 6.4.

Across all columns we find evidence consistent with the resistance hypothesis. We find a positive and statistically significant coefficient on HQLC, which suggests that high quality external legal counsel do not simply comply with SEC requests in order to resolve them in a timelier fashion. In terms of economic magnitude, the coefficient of .32 on HQLC in Column 1 suggests that companies have 0.32 more rounds on average when HQLC is involved, which reflects a 6.6% increase relative to the mean number of rounds in the sample (4.85).

Hypothesis 2 - Propensity to Withhold Information from the Public

Next, we test our second hypothesis regarding the likelihood of complying with an SEC disclosure request using the following model:

$$\begin{aligned} \text{CTR} = & \alpha + \beta_0\text{HQLC} + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \beta_5\text{Tier2} \\ & + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \beta_{11}\text{R\&D} \quad (3) \\ & + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \beta_{16}\text{Delaware} \\ & + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \beta_{20}\text{N_Filing} + \\ & \beta_i\text{CL_Issues} + \varepsilon \end{aligned}$$

Table 5 presents the result of estimating Equation (3); t-statistics in parentheses are based on standard errors that are robust to heteroskedasticity and clustered by company. The dependent variable, CTR, is an indicator variable set equal to one if the company made a confidential

¹² Note, this reduces the sample size as it is a one to one match such that firms with HQLC are matched to only one firm without HQLC. We also require that control observations have predicted values within 3% of that for treatment observations.

¹³ Specifically, we find insignificant differences ($p > 0.10$) using pairwise T-tests of comment letter SEC inquiry characteristics across treatment and control samples.

treatment request (CTR) in response to an SEC comment letter and zero otherwise. As before, the primary independent variable of interest is HQLC, or high quality external legal counsel. Similarly, Column 1 presents standard probit regression analysis, Column 2 presents the second stage of a two-stage Heckman analysis, and Column 3 presents a propensity score matched sample analysis, with matching based on comment letter characteristics.

Consistent with the resistance hypothesis, across all columns we find a positive and statistically significant coefficient on HQLC ($p < 0.01$). This suggests that high quality external legal counsel more frequently challenges the SEC inquiry by having the SEC redact potentially sensitive, proprietary information from the comment letter correspondence, which therefore serves as the basis for such information's exclusion from public disclosure revisions and/or future disclosure. In terms of economic magnitude, the coefficient of 0.23 on HQLC in Column 1 suggests that companies are 5.6% more likely to make a confidential treatment request when high quality external legal counsel is retained, which reflects a 33% increase relative to the unconditional likelihood of confidential treatment requests in the sample (17%).¹⁴

Further, companies are likely to request confidential treatment to redact their disclosure in the presence of greater concerns regarding proprietary costs (e.g., Verrecchia and Weber, 2006). Since companies with greater amounts of R&D are likely to have greater proprietary costs concerns, we examine where there is cross-sectional variation in CTR requests. We expect that legal expertise will play a more important role in confidential treatment requests in companies with greater proprietary costs (i.e., more R&D investment). To test this conjecture, we augment Equation (3) with an interaction term between HQLC and companies with heavy R&D exposures (High R&D), defined as companies with R&D/Assets in the top sample quartile. Table 6 presents

¹⁴ We calculate the 5.6% based on the average affect across all observations in a marginal effect analysis. The effects are similar when calculating the marginal effect at the mean of the independent variables.

the results of this test. Consistent with Table 5 and our second hypothesis, we find a positive and statistically significant coefficient on both HQLC and the interaction term (HQLC x High R&D; $p < 0.01$). This suggests that companies with higher proprietary cost concerns are incrementally more likely to request confidential treatment when high quality external legal counsel is involved.

Hypothesis 3 - Propensity to Amend Periodic Filings

We test our third and final formal hypothesis regarding the likelihood of disclosure amendments consequent to an SEC disclosure request using the following model:

$$\begin{aligned} \text{Amend} = & \alpha + \beta_0 \text{HQLC} + \beta_1 \text{Mrkt_Cap} + \beta_2 \text{Company_Age} + \beta_3 \text{Domestic} + \beta_4 \text{Big4} + \\ & \beta_5 \text{Tier2} + \beta_6 \text{Recent_Litigation} + \beta_7 \text{Restate} + \beta_8 \text{N_Analysts} + \beta_9 \text{IO} + \beta_{10} \text{10-K WC} + \quad (4) \\ & \beta_{11} \text{R\&D} + \beta_{12} \text{10-K Competition} + \beta_{13} \text{adjROA} + \beta_{14} \text{BHAR} + \beta_{15} \text{STD_RET} + \\ & \beta_{16} \text{Delaware} + \beta_{17} \text{Request_Amend} + \beta_{18} \text{Reference_Amend} + \beta_{19} \text{CL_WC} + \\ & \beta_{20} \text{N_Filing} + \beta_i \text{CL_Issues} + \varepsilon \end{aligned}$$

Table 7 presents the results of estimating Equation (4). The dependent variable in Equation (4), Amend, is an indicator variable set equal to one if the company made any 10-K or 10-Q amendment between the first comment letter and three months after the last comment letter, and zero otherwise. We identify amendments using the SEC Edgar Index. As before, the primary independent variable of interest is HQLC, or high quality external legal counsel. Similarly, Column 1 presents standard probit (OLS) regression analysis, Column 2 presents the second stage of a two-stage Heckman analysis, and Column 3 presents a propensity score matched sample analysis, with matching based on comment letter characteristics. We note that in the amendment analysis only, we find evidence of self-selection from unobservable characteristics impacting our analysis as the inverse mills ratio is significant ($p < 0.01$).

Across all columns, consistent with the resistance hypothesis, we find a negative and statistically significant coefficient on HQLC, which suggests that high quality external legal

counsel is associated with a lower propensity to amend deficient disclosures. In terms of economic magnitude, the coefficient of -0.679 on HQLC in Column 1 suggests that companies are 1.5% less likely to amend when high quality external legal counsel is involved, which reflects an 8% decrease relative to the unconditional likelihood of amending a deficient 10-K disclosure in the sample (19%).¹⁵

The value of high quality external legal counsel may be particularly relevant when the SEC requests an amendment. We provide additional evidence of resisting SEC inquiries by augmenting Equation (4) with an interaction term between HQLC and requests to amend (*Request_Amend*). This cross-sectional analysis evaluates whether the company is less likely to amend a period filing upon SEC request when a high quality external lawyer is involved. Table 8 presents the results of this test. Consistent with Table 7 and our third hypothesis, we find a negative and statistically significant coefficient on the interaction term (*HQLC x Request_Amend*; $p < 0.05$). This suggests that companies are more likely to resist a request to amend a filing when high quality external legal counsel is involved.

Collectively, the results across Tables 4-8 regarding H1-H3 are in opposition to the resolution hypothesis, but consistent with the resistance hypothesis. This suggests companies retain HQLC to defend their existing disclosure positions and withhold or resist disclosure deficiencies raised by the SEC. Further, in retaining HQLC, the likelihood with which companies amend their filings subsequent to an SEC comment letter is lower. In cross-sectional analyses, we bolster our primary evidence in support of the resistance hypothesis by showing that, when HQLC is involved i) companies with proprietary cost concerns are incrementally more likely to request confidential treatment and ii) companies requested to amend are incrementally less likely to actually amend.

¹⁵ We calculate the 1.5% based on the average affect across all observations in a marginal effect analysis. The effects are similar when calculating the marginal effect at the mean of the independent variables.

6. Additional Analysis

6.1. *Ex-Post Amendments*

Our empirical evidence thus far has shown that the presence of high quality external legal counsel is associated with longer resolution times for disclosure deficiencies, greater propensities to withhold information from the disclosures, and lower likelihood and intensity of amendments. That being said, there may cases where companies with HQLC may have no choice but to resolve the deficiency in their disclosure through an amendment. In other words, HQLC may not be to help companies avoid amendments when the circumstances are more severe. Evidence that companies possess more bad news when they amend their filings in the presence of HQLC is consistent with companies retaining HQLC for the purpose of withholding potentially negative information. Thus, we perform a conditional analysis on companies that amend their prior periodic filings to test whether amendments by companies with HQLC are more likely to convey bad news.¹⁶ We do this by replacing Amend with Amend_RET in Equation 4. We estimate this equation with an OLS regression, clustering standard errors by company. We measure the news in a company's amendment filing as the size-adjusted cumulative return in the (0, 2) window of the filing (Amend_RET). Consistent with our conjecture, our results in Table 9 suggest that amendments by companies with HQLC experience incrementally negative market reactions relative to companies without HQLC.

6.2. *Prominent General Counsel*

As noted in Section 2.2, one measure commonly used by prior literature to measure variation in legal expertise among company insiders is whether any of the top five highest paid managers has the role of General Counsel (e.g., Kwak, Ro, and Suk 2012; Hopkins, Maydew, and

¹⁶ We use the first amendment in the "Amend" window if there is more than one amendment.

Venkatachalam 2014; Bird, Borochin and Knopf 2014). Conceptually, the notion is that legal expertise among top management might affect the companies' adherence to or compliance with securities laws. While we acknowledge General Counsel may be involved with financial disclosure, our empirical results reveal that companies often seek expertise from external lawyers to resolve financial disclosure issues, in particular those that relate to securities law. However, regardless of whether the company seeks external legal expertise or not, the General Counsel likely reviews the correspondence between the company and the SEC. Thus, to ensure our results are distinct from the presence of legal expertise among top management, we include an indicator (GC) if any of the top five highest paid managers have the title of General Counsel.¹⁷ In untabulated analyses, we find that the resolution of financial disclosure deficiencies identified by the SEC are not affected by the legal expertise among top management (i.e., whether the General Counsel is among one of the top five highest paid executives). Specifically, the GC indicator variable is statistically insignificant when added to Equations 2, 3, or 4 ($p > 0.10$). This evidence suggests that companies seek to retain expertise from external legal counsel rather than solely rely on the legal expertise among their general counsel in the comment letter setting.

6.3. Alternate Measure of HQLC

Our proxy for high quality external legal, HQLC, relies on law firms ranked by the *American Lawyer's* listing of top law firms. Similar to *American Lawyer*, the *National Law Journal* also ranks law firms by the number of full time equivalent lawyers employed. Using the *National Law Journal's* rankings, we find that 30% of companies in our sample retain external legal counsel (as opposed to the 28% found using *American Lawyer*). To ensure that our results and inferences are

¹⁷ This is primarily defined following Kwak et al. (2012) as the presence of the following terms in the employee's title: legal, law, general counsel, counsel, etc. In addition, we use several databases to obtain employee titles among the top five employees with the highest salary to maximize our sample (Execucomp, Boardex, Equilar, and Capital IQ). Requiring general counsel data from one of these databases reduces our sample size by 9%.

not driven by the proxy chosen for high quality external legal counsel, we re-run all of our results using the *National Law Journal's* rankings and find that our inferences are unchanged (untabulated).

6.4. Changes Analysis

In our analyses, we attempt to mitigate endogeneity concerns pertaining to a company's ability to self-select whether and what law firm to engage in several ways. Specifically, we include controls for company and comment letter characteristics, use a Heckman procedure to address unobservable characteristics of choosing to involve high quality lawyers in the comment letter process, and we match on observable characteristics of the comment letter that capture the complexity of the issues raised. While our results are robust to these three approaches, we further mitigate the possibility that either observable, time-varying company characteristics or unobservable time-invariant characteristics that could be correlated omitted variables are driving our results. Specifically, many board characteristics, manager characteristics, and auditor characteristics tend to be time-invariant such that the changes analysis should provide some assurance that our results are robust to many other parties that could be involved with disclosure that have cross-sectional variation.¹⁸ We accomplish this through additional, untabulated robustness tests that involve a changes specification for Equations 2, 3, and 4. We find that the changes analyses yield results of similar signs and significance as those tabulated.

7. Summary and Conclusion

In this paper, we examine how the participation of high quality external legal counsel (HQLC) affects company disclosure by studying the impact HQLC has on the resolution of

¹⁸ Anecdotal discussions with a partner from a big 4 Auditing firm suggest that the audit engagement letters typically specify that the auditor is notified of any comment letter the client receives from the SEC, and helps to resolve the issue as part of the audit service when it relates to financial reporting.

disclosure deficiencies identified in SEC comment letters. The lack of research on external counsel's involvement with company disclosure is largely a result of researchers' inability to identify and observe the extent to which such counsel advises the company on strategic disclosure issues. Our setting of SEC comment letters uniquely overcomes these issues. We provide some of the first evidence that external legal counsel are directly and frequently involved with periodic disclosures and that their participation impacts disclosure through the resolution of disclosure deficiencies.

We find that companies with less experience, more reliance on other external experts, greater financial statement scrutiny, greater financial reporting complexity, and higher proprietary costs are more likely to retain high quality external counsel. These results are consistent with the costs and benefits of retaining high quality legal counsel relating to the value of outside expertise to the company. We also find that HQLC is more commonly associated with redacted comment letter correspondence and are associated with a lower propensity to amend existing periodic filings consequent to the comment letter filing review. These results are not sensitive to various techniques used to address endogeneity concerns. Further, when HQLC is involved, we find that companies with proprietary cost concerns are incrementally more likely to request confidential treatment and companies requested to amend are incrementally less likely to actually amend. Collectively, these results are consistent with high quality external legal counsel primarily defending existing disclosure practices and withholding information from the public (i.e., the resistance hypothesis) rather than improving compliance (i.e., the resolution hypothesis).

The results of the paper contribute to our understanding of how a largely unexplored expert – external legal counsel - affects financial disclosure and specifically deficient disclosures identified by the SEC. We contribute to a small but growing literature on the role of experts by

examining the on-going role of external legal counsel in facilitating compliance. Our evidence contrasts with the extant empirical evidence on the presence of internal legal expertise among company insiders as well as the role of general counsel. Second, we contribute to the growing literature on comment letters. We build on this literature by examining an important player in this process. That is, we provide evidence regarding how external legal counsel influences the comment letter process; namely, whether and how external legal counsel facilitates the resolution of disclosure deficiencies identified by the SEC.

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Variable Appendix

Variable	Description
<i>Primary Variables</i>	
HQLC	Set to one if the company's comment letter correspondence includes an American Lawyer ranked external legal counsel and zero otherwise
Rounds	The number of correspondence letters exchanged between the SEC and the registrant
CTR	Set to one if the company made a confidential treatment request in response to a comment letter and zero otherwise
High R&D	Set to one if a company's ratio of R&D to assets is in the top quartile of the sample and zero otherwise
N_Amend	The number of 10-K or 10-Q amendments the company made between the first comment letter and 3 months after the last comment letter
Amend_Ret	Signed size adjusted cumulative return in the (0,2) window of a company's amendment filing
<i>Company Control Variables</i>	
Mrkt_Cap	The log of the market cap at the end of the most recent fiscal year in millions
Company_Age	The log of one plus the public age of the company based on CRSP data
Domestic	Set to one if the company is headquartered inside the US based on Compustat LOC and zero otherwise
Big4_Auditor	Set to one if the company uses a Big Four auditor and zero otherwise
Tier2	Set to one if the company uses a Tier 2 auditor and zero otherwise
Recent_Litigation	Set to one if the company had a securities class action lawsuit in the three years prior to the comment letter using the Stanford Litigation database and zero otherwise
Restate	Set to one if the company had a restatement in the three years prior to the comment letter based on Audit Analytics data and zero otherwise
N_Analysts	The log of one plus the number of analysts covering the company prior to the initial SEC comment letter using I/B/E/S
IO	The percentage of a company's shares held by institutions prior to the initial SEC comment letter using Thompson
R&D	The ratio of R&D expense to average total assets

10-K Competition	Ratio of competition-related words (e.g. “competition, competitor, competitive, compete, competing”) to total words in the 10-K as in Li et al. (2013)
adjROA	Income after depreciation before R&D and advertising expense scaled by average total assets
BHAR	Raw buy and hold return for the 12 months prior to the SEC comment letter
Std_Ret	The standard of raw returns for the 12 months prior to the SEC comment letter
Delaware	Set to one if the company is incorporated in Delaware based on Compustat INCORP and zero otherwise
<i>Comment Letter Control Variables</i>	
Request_Amend	Set to one if the SEC requested the company amend a filing and zero otherwise
Reference_Amend	Set to one if the SEC's initial comment letter references amend and zero otherwise
CL_WC	The log of one plus the number of words in the SEC's initial comment letter
N_Filings	The log of one plus the number of filings referenced in the initial comment letter
N_AccStd	The log of one plus the number of Accounting Standards issues in the initial comment letter based on Audit Analytics data
N_OpCR	The log of one plus the number of Operational, Controls & Risk Assessments issues in the initial comment letter based on Audit Analytics data
N_SECRReg	The log of one plus the number of Securities Regulations issues in the initial comment letter based on Audit Analytics data
N_NstdOth	The log of one plus the number of Non Standard and Other Disclosures issues in the initial comment letter based on Audit Analytics data
N_NewReg	The log of one plus the number of New and Secondary Registration issues in the initial comment letter based on Audit Analytics data

Table 1 – Descriptive Statistics

Variable	N	Mean	S.D.	Q1	Median	Q3
<i>Primary Variables</i>						
HQLC	10,094	0.28	0.45	0.00	0.00	1.00
Rounds	10,094	4.85	2.47	3.00	4.00	6.00
CTR	10,094	0.17	0.38	0.00	0.00	0.00
Amend	10,094	0.19	0.39	0.00	0.00	0.00
Amend_Ret	1,867	0.00	0.06	-0.03	0.00	0.02
<i>Company Variables</i>						
Mrkt_Cap	10,094	5600	21000	176	740	3100
Firm_Age	10,094	19.04	17.24	7.00	14.00	25.00
Domestic	10,094	0.97	0.18	1.00	1.00	1.00
Big4	10,094	0.77	0.42	1.00	1.00	1.00
Tier2	10,094	0.10	0.30	0.00	0.00	0.00
Recent_Litigation	10,094	0.08	0.27	0.00	0.00	0.00
Restate	10,094	0.21	0.40	0.00	0.00	0.00
N_Analysts	10,094	7.18	6.89	2.00	5.00	11.00
IO	10,094	59.91	29.45	36.64	65.85	83.74
10-K WC	10,094	54,000	31,000	34,000	46,000	64,000
R&D	10,094	0.04	0.10	0.00	0.00	0.04
10-K Competition	10,094	0.00	0.00	0.00	0.00	0.00
adjROA	10,094	0.17	0.18	0.06	0.14	0.24
BHAR	10,094	0.09	0.56	-0.25	0.02	0.30
Std_Ret	10,094	0.13	0.08	0.07	0.11	0.16
Delaware	10,094	0.61	0.49	0.00	1.00	1.00
<i>Comment Letter Variables</i>						
Request_Amend	10,094	0.37	0.48	0.00	0.00	1.00
Reference_Amend	10,094	0.07	0.26	0.00	0.00	0.00
CL_WC	10,094	1200	678	786	1100	1500
N_Filings	10,094	2.11	1.38	1.00	2.00	3.00
N_AccStd	10,094	4.54	4.30	1.00	3.00	7.00
N_OpCR	10,094	1.46	1.43	0.00	1.00	2.00
N_SECRReg	10,094	2.61	2.77	0.00	2.00	4.00
N_NstdOth	10,094	1.82	1.38	1.00	2.00	3.00
N_NewReg	10,094	0.44	0.94	0.00	0.00	1.00

Table 1 presents descriptive statistics for the variables used in the study. Please see the variable appendix for definitions.

Table 2 – Correlation Matrix

	HQLC	Rounds	CTR	Amend	Mrkt_Cap	Firm_Age	Domestic	Big4	Tier2	Recent_Litigation	Restate	N_Analysts	IO
HQLC	1												
Rounds	0.0815*	1											
CTR	0.0983*	0.2939*	1										
Amend	0.0267*	0.1469*	0.0258*	1									
Mrkt_Cap	-0.0384	0.0276	-0.0121	.	1								
Firm_Age	-0.0478*	0.0888*	0.0712*	-0.0519*	0.0229	1							
Domestic	-0.1409*	0.0131	0.0228*	-0.0807*	0.0103	0.3032*	1						
Big4	-0.0535*	-0.0495*	0.0214*	-0.0597*	-0.022	0.0254*	0.0862*	1					
Tier2	0.0326*	-0.0305*	0.0573*	-0.1689*	0.0017	0.1314*	0.1399*	0.0356*	1				
Recent_Litigation	0.0133	-0.0018	-0.0329*	0.0466*	0.0019	-0.0819*	-0.0678*	0.0327*	-0.6174*	1			
Restate	0.0307*	0.0606*	0.0517*	0.0117	-0.0021	0.1307*	0.0187	0.0040	0.0802*	-0.0371*	1		
N_Analysts	0.0588*	0.0299*	0.0158	0.0789*	0.0173	-0.0434*	-0.0684*	-0.0258*	-0.0400*	0.0190	0.1041*	1	
IO	0.0025	0.0277*	0.0773*	-0.1355*	0.0152	0.4138*	0.2110*	0.0027	0.3848*	-0.2032*	0.1497*	-0.0844*	1
10-K WC	0.0030	-0.0015	0.0656*	-0.1673*	0.0021	0.0609*	0.1157*	0.0698*	0.4769*	-0.1666*	0.0792*	-0.0324*	0.4678*
R&D	0.0087	0.0640*	0.0677*	-0.0318*	-0.0035	0.1623*	0.1123*	-0.0382*	0.2158*	-0.1087*	0.1442*	0.0391*	0.2521*
10-K Competition	0.1703*	0.0044	0.0621*	0.0112	0.0175	-0.0371*	-0.1453*	0.0213*	0.0119	-0.0067	0.0199*	-0.0255*	-0.0444*
adjROA	0.1082*	-0.0249*	-0.0041	-0.0016	0.0209	-0.0510*	-0.2015*	0.0268*	-0.0488*	0.0587*	-0.0122	0.0066	-0.0649*
BHAR	0.0972*	-0.0260*	0.0510*	-0.0775*	0.004	0.0708*	-0.007	0.0009	0.1554*	-0.0389*	-0.0101	-0.0760*	0.1880*
Std_Ret	-0.0025	-0.0091	-0.0037	-0.0168	0.0044	0.0198*	0.0266*	0.0228*	0.0537*	-0.0230*	-0.0385*	-0.0288*	0.0202*
Delaware	0.0863*	0.0692*	0.0695*	0.0932*	-0.0295	-0.1608*	-0.2046*	-0.0488*	-0.1402*	0.0729*	0.0734*	0.0835*	-0.2574*
Request_Amend	0.1315*	0.0161	0.0505*	-0.0141	-0.0211	-0.0038	-0.1783*	0.1509*	0.1428*	-0.0486*	0.0505*	0.0364*	0.0960*
Reference_Amend	0.1138*	0.1829*	0.0613*	0.2694*	0.0255	-0.0224*	-0.1052*	-0.0439*	-0.0675*	0.013	0.0137	0.0597*	-0.0574*
CL WC	0.0868*	0.1252*	0.0463*	0.2294*	0.0094	-0.0324*	-0.0506*	-0.0374*	-0.1007*	0.0387*	-0.0066	0.0463*	-0.0858*
N_Filings	0.0581*	0.2845*	0.1817*	0.0841*	-0.0337	0.0065	-0.0041	-0.0307*	-0.0461*	0.0194	0.0312*	0.0592*	-0.0501*
N_AccStd	0.0830*	0.3416*	0.1510*	0.1520*	-0.0055	-0.0011	-0.0348*	-0.0155	-0.0614*	0.0311*	0.0267*	0.0313*	-0.0594*
N_OpCR	-0.0459*	0.2053*	0.0386*	0.0369*	-0.0081	-0.01	0.0072	-0.004	-0.0205*	0.0027	0.0201*	0.0963*	-0.0510*
N_SECRReg	0.0441*	0.2001*	0.1453*	0.0449*	-0.0249	-0.0074	0.0079	-0.0222*	0.0015	0.0139	0.0204*	0.0367*	-0.0313*
N_NstdOth	0.0558*	0.1455*	0.1336*	0.0846*	-0.0302	-0.0506*	-0.0220*	0.0024	-0.0359*	0.0394*	-0.0414*	0.0326*	-0.0754*
N_NewReg	0.0177	0.1029*	0.1235*	0.0547*	-0.0453	-0.0303*	-0.0005	-0.0038	-0.0367*	0.0367*	-0.0135	0.0732*	-0.0686*
	0.1428*	0.0373*	0.0954*	0.1067*	-0.0167	-0.0323*	-0.0315*	-0.015	-0.0725*	0.0395*	-0.0199*	0.0000	-0.0785*

Table 2 – Correlation Matrix (cont.)

	10-K WC	R&D	10-K Competition	adjROA	BHAR	Std_Ret	Delaware	Request_Amend	Reference_Amend	CL WC	N_Filings	N_AccStd	N_OpCR	N_SECRReg	N_NstdOth	N_NewReg	
10-K WC	1																
R&D	0.1590*	1															
10-K Competition	-0.1023*	-0.0286*	1														
adjROA	-0.013	-0.3737*	0.1974*	1													
BHAR	0.1688*	-0.0786*	0.5160*	0.2082*	1												
Std_Ret	0.0205*	-0.0204*	0.015	0.0094	0.0895*	1											
Delaware	-0.1862*	-0.0218*	0.2050*	0.0820*	-0.0761*	0.0123	1										
Request_Amend	0.1419*	0.0618*	0.1382*	0.0929*	0.1072*	0.0164	0.0753*	1									
Reference_Amend	-0.0937*	-0.0112	0.1271*	0.0568*	0.0441*	-0.0212*	0.0932*	0.0215*	1								
CL WC	-0.1034*	-0.0073	-0.0008	0.0112	-0.0592*	0.0024	0.0942*	0.0005	0.1815*	1							
N_Filings	-0.0197*	0.0391*	-0.0691*	-0.0317*	-0.0803*	-0.0612*	0.1208*	-0.0044	0.1547*	0.1769*	1						
N_AccStd	-0.0452*	0.0039	-0.0370*	0.0063	-0.0531*	-0.0174	0.1096*	-0.0038	0.1819*	0.3889*	0.4044*	1					
N_OpCR	-0.0064	-0.0082	-0.0469*	0.0147	-0.0428*	-0.0453*	0.0022	0.002	0.0607*	0.0265*	0.4414*	0.1683*	1				
N_SECRReg	0.0198*	0.0064	-0.0482*	-0.0159	-0.0331*	-0.0596*	0.1491*	0.0287*	0.0639*	0.0923*	0.5142*	0.2388*	0.1714*	1			
N_NstdOth	0.0074	-0.0773*	-0.0622*	0.0525*	0.0091	0.0023	0.0706*	0.0152	0.1136*	0.1210*	0.4119*	0.2829*	0.1307*	0.4511*	1		
N_NewReg	0.0102	-0.0477*	-0.0781*	0.0530*	-0.0211*	-0.0269*	0.0952*	0.0054	0.0301*	0.1221*	0.4606*	0.3285*	0.2217*	0.2987*	0.4603*	1	
	-0.0849*	-0.0191	-0.0174	-0.0007	-0.0555*	0.0241*	0.0872*	-0.0028	0.1700*	0.2631*	0.3138*	0.2664*	-0.1046*	0.1716*	0.2521*	0.1608*	1

Table 2 presents a Spearman correlation matrix for the primary variables investigated in the study along with those found in the determinants model.

Table 3 – Determinants of High Quality External Legal Counsel (HQLC)

$$\text{HQLC} = \alpha + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \beta_5\text{Tier2} + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \beta_{11}\text{R\&D} + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \beta_{16}\text{Delaware} + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \beta_{20}\text{N_Filings} + \beta_i\text{CL_Issues} + \varepsilon$$

Category	Variable	Pred	HQLC
SEC Filing Experience	Mrkt_Cap	-	-0.0607*** (-3.46)
	Firm_Age	-	-0.1237*** (-5.42)
	Domestic	-	-0.4176*** (-4.01)
Other Experts	Big4	+	0.2377*** (3.66)
	Tier2	+	0.2528*** (3.48)
Scrutiny	Recent_Litigation	+	0.0760 (1.29)
	Restate	+	0.1423*** (3.67)
	N_Analysts	+	0.0862*** (2.73)
	IO	+	0.0007 (0.81)
Reporting Complexity	10-K WC	+	0.1270*** (2.79)
Proprietary Cost	R&D	+	1.3892*** (5.93)
	10-K Competition	+	187.8097*** (3.65)
Performance	adjROA	?	0.0596 (0.47)
	BHAR	?	-0.0287 (-1.04)
Operating Risk	Std_Ret	?	0.2039 (0.87)
Incorporation	Delaware	+	0.2283*** (5.32)

Comment Letter Complexity	Request_Amend	+	0.1005*** (3.00)
	Reference_Amend	+	0.1519*** (2.73)
	CL_WC	+	0.2163*** (5.02)
	N_Filings	+	0.0938* (1.95)
Comment Letter Issues	N_AccStd	?	-0.1312*** (-6.53)
	N_OpCR	?	0.0394 (1.26)
	N_SECRReg	?	-0.0470** (-2.01)
	N_NstdOth	?	-0.0450 (-1.34)
	N_NewReg	?	0.2758*** (7.44)
	Constant	?	-3.1099*** (-5.49)
	Pseudo R2		0.0939
	Area under ROC		0.7055
	Observations		10,094

Table 3 presents a model of possible factors that may influence a company to retain high quality external legal counsel (HQLC). Model fit is assessed by the area under the ROC curve. Z-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance (two-sided) is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 4 – HQLC and Comment Letter Rounds (H1)

$$\text{Rounds} = \alpha + \beta_0\text{HQLC} + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \beta_5\text{Tier2} + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \beta_{11}\text{R\&D} + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \beta_{16}\text{Delaware} + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \beta_{20}\text{N_Filing} + \beta_i\text{CL_Issues} + \varepsilon$$

	(1) Rounds	(2) Rounds	(3) Rounds
HQLC	0.3205*** (5.73)	0.3248*** (5.79)	0.3268*** (4.92)
Mrkt_Cap	0.1239*** (4.88)	0.2078*** (3.47)	0.0971*** (2.96)
Firm_Age	0.1189*** (4.09)	0.2864*** (2.63)	0.1611*** (3.97)
Domestic	-0.3453** (-2.08)	0.2030 (0.53)	-0.5143** (-2.38)
Big4	-0.4244*** (-4.71)	-0.7493*** (-3.34)	-0.4372*** (-3.48)
Tier2	-0.2665** (-2.54)	-0.6150** (-2.52)	-0.1876 (-1.24)
Recent_Litigation	0.2218** (2.09)	0.1211 (1.01)	0.3060* (1.96)
Restate	0.0221 (0.37)	-0.1686 (-1.27)	0.0779 (0.93)
N_Analysts	-0.0539 (-1.33)	-0.1710** (-1.97)	-0.0202 (-0.36)
IO	-0.0001 (-0.10)	-0.0011 (-0.88)	-0.0002 (-0.10)
10-K WC	0.0605 (1.02)	-0.1140 (-0.92)	-0.0017 (-0.02)
R&D	0.1784 (0.52)	-1.4644 (-1.38)	-0.0316 (-0.07)
10-K Competition	-25.5553 (-0.39)	-278.9048 (-1.60)	-151.1711 (-1.61)
adjROA	-0.1568 (-0.87)	-0.2436 (-1.29)	-0.2608 (-1.14)
BHAR	-0.0529 (-1.12)	-0.0143 (-0.28)	-0.0529 (-0.85)
Std_Ret	1.1254*** (3.07)	0.8581** (2.14)	0.9037* (1.79)

Delaware	0.0823 (1.60)	-0.2328 (-1.13)	0.1520** (2.08)
Request_Amend	0.4523*** (8.29)	0.3162*** (3.23)	0.4577*** (6.35)
Reference_Amend	0.1348 (1.08)	-0.0530 (-0.30)	0.1346 (0.87)
CL_WC	0.7859*** (9.96)	0.4983** (2.51)	0.7672*** (6.22)
N_Filings	1.5551*** (16.08)	1.4321*** (11.70)	1.5301*** (11.68)
N_AccStd	0.3776*** (11.55)	0.5503*** (4.77)	0.3997*** (8.91)
N_OpCR	0.1154** (2.25)	0.0622 (1.04)	0.1573** (2.14)
N_SECRReg	0.0229 (0.60)	0.0835 (1.55)	0.0130 (0.24)
N_NstdOth	-0.3085*** (-5.51)	-0.2498*** (-3.67)	-0.2719*** (-3.42)
N_NewReg	-0.4399*** (-6.43)	-0.7914*** (-3.31)	-0.5130*** (-5.79)
Inverse Mills		-1.8231 (-1.61)	
Constant	-4.0022*** (-4.99)	1.6340 (0.45)	-2.9224** (-2.45)
Observations	10,094	10,094	5,560
R Squared	0.205	0.205	0.200

Table 4 presents OLS regressions on the relation between high quality external legal counsel (HQLC) and the number of SEC comment letter rounds. Column 1 presents the base specification, Column 2 presents a Heckman-style analysis using both company and SEC comment letter characteristics to account for possible selection of HQLC on unobservables, and Column 3 presents propensity score matched analysis to account for possible selection on observable characteristics of the SEC comment letter. T-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance (two-sided) is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 5 – HQLC and Confidential Treatment Requests (H2)

$$\text{CTR} = \alpha + \beta_0\text{HQLC} + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \beta_5\text{Tier2} + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \beta_{11}\text{R\&D} + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \beta_{16}\text{Delaware} + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \beta_{20}\text{N_Filing} + \beta_i\text{CL_Issues} + \varepsilon$$

	(1) CTR	(2) CTR	(3) CTR
HQLC	0.2331*** (6.34)	0.2340*** (6.36)	0.2383*** (5.44)
Mrkt_Cap	0.0308* (1.84)	0.0607* (1.69)	0.0145 (0.71)
Firm_Age	0.0696*** (3.25)	0.1295** (1.96)	0.0755*** (2.76)
Domestic	0.2415** (2.43)	0.4352* (1.90)	0.3049** (2.56)
Big4	0.0114 (0.18)	-0.1037 (-0.75)	-0.0175 (-0.21)
Tier2	-0.0815 (-1.08)	-0.2047 (-1.36)	-0.1724* (-1.72)
Recent_Litigation	0.0869 (1.41)	0.0508 (0.70)	0.0731 (0.94)
Restate	0.0586 (1.46)	-0.0093 (-0.11)	0.0744 (1.49)
N_Analysts	0.0774** (2.53)	0.0359 (0.67)	0.1239*** (3.15)
IO	0.0015* (1.92)	0.0011 (1.30)	0.0015 (1.50)
10-K WC	0.1032** (2.48)	0.0409 (0.53)	0.0774 (1.42)
R&D	1.0286*** (4.70)	0.4451 (0.68)	0.9255*** (3.61)
10-K Competition	23.0073 (0.48)	-67.3869 (-0.64)	-110.6305* (-1.77)
adjROA	0.2115* (1.65)	0.1791 (1.35)	0.1927 (1.26)
BHAR	0.0039 (0.13)	0.0175 (0.52)	0.0361 (0.94)
Std_Ret	0.6382*** (2.69)	0.5446** (2.13)	0.8339*** (2.79)

Delaware	0.0646*	-0.0480	0.0576
	(1.67)	(-0.39)	(1.14)
Request_Amend	0.0018	-0.0472	0.0304
	(0.05)	(-0.74)	(0.65)
Reference_Amend	-0.0763	-0.1440	-0.1006
	(-1.20)	(-1.51)	(-1.34)
CL_WC	0.3705***	0.2688**	0.3382***
	(7.05)	(2.25)	(4.82)
N_Filings	0.3147***	0.2710***	0.2617***
	(6.10)	(3.92)	(3.87)
N_AccStd	-0.0389*	0.0223	-0.0402
	(-1.70)	(0.32)	(-1.33)
N_OpCR	0.0723**	0.0530	0.0897*
	(2.12)	(1.33)	(1.95)
N_SECRReg	0.0551**	0.0766**	0.0318
	(2.17)	(2.21)	(0.94)
N_NstdOth	0.0733*	0.0940**	0.1300**
	(1.87)	(2.10)	(2.50)
N_NewReg	0.0890**	-0.0367	0.1123**
	(2.23)	(-0.26)	(2.20)
Inverse Mills		-0.6574	
		(-0.95)	
Constant	-6.3187***	-4.3036**	-5.7135***
	(-11.37)	(-1.97)	(-7.70)
Pseudo R2	0.1002	0.1003	0.1023
Observations	10,094	10,094	5,560

Table 5 presents probit regressions on the relation between high quality external legal counsel (HQLC) and confidential treatment requests. Column 1 presents the base specification, Column 2 presents a Heckman-style analysis using both company and SEC comment letter characteristics to account for possible selection of HQLC on unobservables, and Column 3 presents propensity score matched analysis to account for possible selection on observable characteristics of the SEC comment letter. Z-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance (two-sided) is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 6 – HQLC, Confidential Treatment Requests, and Proprietary Costs (H2)

VARIABLES	(1) CTR	(2) CTR	(3) CTR
HQLC	0.1818*** (4.17)	0.1821*** (4.18)	0.1868*** (3.66)
HQLC x High R&D	0.1829** (2.38)	0.1646** (2.14)	0.1958** (2.04)
Mrkt_Cap	0.0249 (1.49)	0.0757*** (3.50)	0.0095 (0.46)
Firm_Age	0.0668*** (3.12)	0.1569*** (4.83)	0.0726*** (2.66)
Domestic	0.2601*** (2.65)	0.5241*** (4.27)	0.3185*** (2.70)
Big4	0.0230 (0.36)	-0.1574* (-1.92)	-0.0033 (-0.04)
Tier2	-0.0855 (-1.14)	-0.2636*** (-2.92)	-0.1744* (-1.75)
Recent_Litigation	0.0853 (1.38)	0.0353 (0.56)	0.0703 (0.91)
Restate	0.0559 (1.39)	-0.0407 (-0.86)	0.0714 (1.42)
N_Analysts	0.0789** (2.56)	0.0133 (0.38)	0.1253*** (3.18)
IO	0.0011 (1.46)	0.0009 (1.23)	0.0011 (1.13)
10-K WC	0.1052** (2.52)	0.0076 (0.16)	0.0735 (1.34)
R&D	0.0791 (1.26)	-0.0178 (-0.26)	0.0679 (0.77)
10-K Competition	7.7143 (0.16)	-117.8895** (-2.01)	-134.3260** (-2.14)
adjROA	0.3965*** (3.42)	0.1765 (1.33)	0.3360** (2.44)
BHAR	0.0005 (0.02)	0.0237 (0.75)	0.0343 (0.90)
Std_Ret	0.7803*** (3.37)	0.5061** (2.06)	0.9739*** (3.35)
Delaware	0.0706* (1.83)	-0.1019* (-1.70)	0.0591 (1.17)

Request_Amend	0.0010 (0.03)	-0.0705* (-1.67)	0.0315 (0.67)
Reference_Amend	-0.0706 (-1.11)	-0.1738** (-2.52)	-0.0973 (-1.30)
CL WC	0.3716*** (7.08)	0.2217*** (3.33)	0.3376*** (4.81)
N_Filings	0.3125*** (6.06)	0.2494*** (4.56)	0.2607*** (3.86)
N_AccStd	-0.0382* (-1.67)	0.0521 (1.52)	-0.0398 (-1.32)
N_OpCR	0.0703** (2.06)	0.0427 (1.22)	0.0910** (1.97)
N_SECRReg	0.0516** (2.03)	0.0862*** (3.16)	0.0286 (0.84)
N_NstdOth	0.0668* (1.71)	0.1013** (2.53)	0.1207** (2.33)
N_NewReg	0.0951** (2.38)	-0.0928 (-1.44)	0.1159** (2.27)
Inverse Mills		-0.9723*** (-3.66)	
Constant	-6.2670*** (-11.28)	-3.2946*** (-3.43)	-5.5880*** (-7.54)
Pseudo R2	0.0993	0.1009	0.1022
Observations	10,094	10,094	5,560

Table 6 presents probit regressions on the relation between confidential treatment requests and the interaction of high quality external legal counsel (HQLC) and proprietary costs. Column 1 presents the base specification, Column 2 presents a Heckman-style analysis using both company and SEC comment letter characteristics to account for possible selection of HQLC on unobservables, and Column 3 presents propensity score matched analysis to account for possible selection on observable characteristics of the SEC comment letter. Z-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance is denoted by *** p<0.01, ** p<0.05, * p<0.1.

Table 7 – HQLC and the Likelihood of Future Amendments (H3)

$$\text{Amend} = \alpha + \beta_0\text{HQLC} + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \beta_5\text{Tier2} + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \beta_{11}\text{R\&D} + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \beta_{16}\text{Delaware} + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \beta_{20}\text{N_Filing} + \beta_i\text{CL_Issues} + \varepsilon$$

	(1) Amend	(2) Amend	(3) Amend
HQLC	-0.0679* (-1.81)	-0.0628* (-1.68)	-0.0785* (-1.81)
Mrkt_Cap	-0.0376** (-2.31)	0.0700** (1.97)	-0.0443** (-2.07)
Firm_Age	-0.0367* (-1.77)	0.1776*** (2.69)	-0.0426 (-1.57)
Domestic	-0.2952*** (-3.37)	0.4084* (1.84)	-0.2476** (-2.41)
Big4	-0.3500*** (-6.54)	-0.7696*** (-5.76)	-0.3027*** (-4.38)
Tier2	-0.1932*** (-3.18)	-0.6422*** (-4.45)	-0.1799** (-2.26)
Recent_Litigation	0.1427** (2.32)	0.0132 (0.19)	0.2445*** (3.17)
Restate	0.1564*** (4.06)	-0.0872 (-1.07)	0.1740*** (3.44)
N_Analysts	-0.0288 (-0.99)	-0.1795*** (-3.38)	-0.0394 (-1.05)
IO	-0.0014* (-1.84)	-0.0027*** (-3.18)	-0.0025*** (-2.63)
10-K WC	0.0581 (1.42)	-0.1652** (-2.16)	0.0363 (0.67)
R&D	0.0665 (0.31)	-2.0612*** (-3.17)	0.0012 (0.00)
10-K Competition	-65.9360 (-1.38)	-390.1524*** (-3.70)	-55.1326 (-0.89)
adjROA	-0.2711** (-2.39)	-0.3766*** (-3.21)	-0.2462* (-1.80)
BHAR	-0.0632** (-2.08)	-0.0130 (-0.39)	-0.0519 (-1.31)
Std_Ret	0.2314 (1.01)	-0.1117 (-0.44)	0.1600 (0.53)

Delaware	0.0465 (1.28)	-0.3554*** (-2.89)	0.0086 (0.18)
Request_Amend	0.7028*** (19.10)	0.5260*** (8.35)	0.7094*** (14.65)
Reference_Amend	0.6038*** (10.69)	0.3596*** (3.97)	0.5991*** (8.78)
CL WC	-0.0805 (-1.57)	-0.4474*** (-3.76)	-0.0350 (-0.51)
N_Filings	0.1612*** (3.15)	0.0047 (0.07)	0.2091*** (3.09)
N_AccStd	0.0046 (0.20)	0.2248*** (3.30)	-0.0055 (-0.18)
N_OpCR	0.0056 (0.16)	-0.0630 (-1.54)	-0.0281 (-0.60)
N_SECRReg	0.1023*** (3.92)	0.1792*** (5.20)	0.0934*** (2.63)
N_NstdOth	-0.0220 (-0.58)	0.0535 (1.22)	-0.0449 (-0.88)
N_NewReg	0.0878** (2.13)	-0.3617*** (-2.63)	0.1236** (2.37)
Inverse Mills		-2.3579*** (-3.44)	
Constant	-0.4723 (-0.87)	6.7662*** (3.11)	-0.4361 (-0.60)
Pseudo R2	0.1489	0.1502	0.1662
Observations	10,094	10,094	5,560

Table 7 presents probit regressions on the relation between high quality external legal counsel (HQLC) and the likelihood of future amendment. Column 1 presents the base specification, Column 2 presents a Heckman-style analysis using both company and SEC comment letter characteristics to account for possible selection of HQLC on unobservables, and Column 3 presents propensity score matched analysis to account for possible selection on observable characteristics of the SEC comment letter. Z-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance (two-sided) is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 8 – HQLC and the Likelihood of Future Amendment when Requested (H3)

VARIABLES	(1) Amend	(2) Amend	(3) Amend
HQLC	0.0270 (0.52)	0.0211 (0.40)	0.0412 (0.64)
HQLC x Request_Amend	-0.1836*** (-2.61)	-0.1629** (-2.31)	-0.2191*** (-2.60)
Mrkt_Cap	-0.0373** (-2.30)	0.0639* (1.80)	-0.0435** (-2.03)
Firm_Age	-0.0360* (-1.73)	0.1657** (2.50)	-0.0414 (-1.52)
Domestic	-0.2966*** (-3.40)	0.3659* (1.65)	-0.2497** (-2.45)
Big4	-0.3505*** (-6.55)	-0.7455*** (-5.57)	-0.3039*** (-4.40)
Tier2	-0.1931*** (-3.18)	-0.6159*** (-4.26)	-0.1777** (-2.23)
Recent_Litigation	0.1445** (2.35)	0.0224 (0.32)	0.2460*** (3.20)
Restate	0.1562*** (4.06)	-0.0731 (-0.89)	0.1734*** (3.44)
N_Analysts	-0.0272 (-0.94)	-0.1693*** (-3.19)	-0.0377 (-1.00)
IO	-0.0014* (-1.80)	-0.0026*** (-3.06)	-0.0025*** (-2.59)
10-K WC	0.0566 (1.39)	-0.1534** (-2.01)	0.0355 (0.66)
R&D	0.1027 (0.48)	-1.9046*** (-2.92)	0.0393 (0.15)
10-K Competition	-67.5461 (-1.41)	-372.6410*** (-3.54)	-54.4325 (-0.88)
adjROA	-0.2742** (-2.42)	-0.3734*** (-3.19)	-0.2501* (-1.84)
BHAR	-0.0631** (-2.08)	-0.0158 (-0.47)	-0.0509 (-1.29)
Std_Ret	0.2348 (1.02)	-0.0887 (-0.35)	0.1642 (0.55)
Delaware	0.0457 (1.26)	-0.3326*** (-2.70)	0.0078 (0.17)

Request_Amend	0.7550*** (18.26)	0.5828*** (8.67)	0.8166*** (12.95)
Reference_Amend	0.6046*** (10.73)	0.3746*** (4.14)	0.5975*** (8.76)
CL WC	-0.0767 (-1.49)	-0.4225*** (-3.54)	-0.0294 (-0.43)
N_Filings	0.1645*** (3.22)	0.0168 (0.24)	0.2122*** (3.14)
N_AccStd	0.0035 (0.15)	0.2109*** (3.09)	-0.0059 (-0.19)
N_OpCR	0.0051 (0.14)	-0.0595 (-1.46)	-0.0288 (-0.61)
N_SECRReg	0.1004*** (3.85)	0.1730*** (5.01)	0.0925*** (2.60)
N_NstdOth	-0.0238 (-0.63)	0.0475 (1.08)	-0.0501 (-0.98)
N_NewReg	0.0936** (2.27)	-0.3303** (-2.39)	0.1243** (2.38)
Inverse Mills		-2.2203*** (-3.23)	
Constant	-0.5129 (-0.94)	6.3074*** (2.90)	-0.5347 (-0.73)
Pseudo R2	0.1496	0.1508	0.1674
Observations	10,094	10,094	5,560

Table 8 presents probit regressions on the relation between the likelihood of future amendment and the interaction of high quality external legal counsel (HQLC) and the request to amend. Column 1 presents the base specification, Column 2 presents a Heckman-style analysis using both company and SEC comment letter characteristics to account for possible selection of HQLC on unobservables, and Column 3 presents propensity score matched analysis to account for possible selection on observable characteristics of the SEC comment letter. z-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 9 – Equity Market Response to Amendments Involving HQLC

$$\text{Amend_RET} = \alpha + \beta_0\text{HQLC} + \beta_1\text{Mrkt_Cap} + \beta_2\text{Company_Age} + \beta_3\text{Domestic} + \beta_4\text{Big4} + \beta_5\text{Tier2} + \beta_6\text{Recent_Litigation} + \beta_7\text{Restate} + \beta_8\text{N_Analysts} + \beta_9\text{IO} + \beta_{10}\text{10-K WC} + \beta_{11}\text{R\&D} + \beta_{12}\text{10-K Competition} + \beta_{13}\text{adjROA} + \beta_{14}\text{BHAR} + \beta_{15}\text{STD_RET} + \beta_{16}\text{Delaware} + \beta_{17}\text{Request_Amend} + \beta_{18}\text{Reference_Amend} + \beta_{19}\text{CL_WC} + \beta_{20}\text{N_Filing} + \beta_i\text{CL_Issues} + \varepsilon$$

	(1) Amend_Ret	(2) Amend_Ret	(3) Amend_Ret
HQLC	-0.0069** (-2.17)	-0.0068** (-2.15)	-0.0054 (-1.40)
Mrkt_Cap	-0.0015 (-1.13)	-0.0010 (-0.33)	-0.0012 (-0.66)
Firm_Age	0.0025 (1.42)	0.0035 (0.61)	0.0048** (2.16)
Domestic	-0.0098 (-1.41)	-0.0065 (-0.35)	-0.0077 (-1.04)
Big4	0.0022 (0.47)	0.0001 (0.01)	0.0031 (0.52)
Tier2	0.0018 (0.35)	-0.0004 (-0.03)	0.0051 (0.78)
Recent_Litigation	-0.0004 (-0.07)	-0.0010 (-0.15)	0.0002 (0.02)
Restate	0.0032 (0.91)	0.0020 (0.28)	-0.0001 (-0.02)
N_Analysts	0.0005 (0.21)	-0.0002 (-0.05)	-0.0014 (-0.42)
IO	0.0000 (0.55)	0.0000 (0.42)	0.0001 (0.57)
10-K WC	-0.0005 (-0.15)	-0.0016 (-0.25)	0.0015 (0.33)
R&D	0.0171 (0.79)	0.0068 (0.11)	0.0063 (0.24)
10-K Competition	1.0322 (0.28)	-0.5357 (-0.06)	3.8421 (0.74)
adjROA	-0.0069 (-0.62)	-0.0075 (-0.65)	-0.0029 (-0.20)
BHAR	0.0002 (0.06)	0.0004 (0.13)	-0.0012 (-0.30)
Std_Ret	-0.0218 (-0.92)	-0.0234 (-0.95)	-0.0182 (-0.60)

Delaware	-0.0021 (-0.70)	-0.0040 (-0.39)	-0.0038 (-0.93)
Request_Amend	0.0046 (1.54)	0.0037 (0.70)	0.0054 (1.42)
Reference_Amend	0.0029 (0.70)	0.0017 (0.23)	0.0073 (1.46)
CL WC	-0.0026 (-0.66)	-0.0044 (-0.44)	-0.0060 (-1.06)
N_Filings	-0.0025 (-0.56)	-0.0032 (-0.54)	-0.0020 (-0.32)
N_AccStd	0.0008 (0.38)	0.0018 (0.32)	0.0040 (1.49)
N_OpCR	0.0022 (0.74)	0.0019 (0.54)	0.0029 (0.74)
N_SECReg	-0.0023 (-1.02)	-0.0019 (-0.64)	-0.0047 (-1.59)
N_NstdOth	-0.0045 (-1.42)	-0.0041 (-1.13)	-0.0017 (-0.42)
N_NewReg	0.0009 (0.25)	-0.0013 (-0.11)	0.0009 (0.20)
Inverse Mills		-0.0114 (-0.19)	
Constant	0.0286 (0.69)	0.0634 (0.34)	0.0118 (0.20)
Observations	1,867	1,867	1,157
R-squared	0.027	0.027	0.036

Table 9 presents OLS regressions on the relation between high quality external legal counsel (HQLC) and equity market returns around amendments. Column 1 presents the base specification, Column 2 presents a Heckman-style analysis using both company and SEC comment letter characteristics to account for possible selection of HQLC on unobservables, and Column 3 presents propensity score matched analysis to account for possible selection on observable characteristics of the SEC comment letter. T-statistics, reported in parentheses, are robust to heteroskedasticity and clustered by company. Statistical significance (two-sided) is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.