Corporate Litigation in Specialized Business Courts

Law Working Paper N° 302/2015
March 2016

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ECGI Working Paper Series in Law

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Keywords: Corporate litigation, Dutch Enterprise Chamber inquiry proceedings, shareholder value, M&A lawsuits

JEL Classifications: G34, K41

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March 25, 2016

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1 Introduction

Corporate litigation is a topic of much interest due to its potential effect on firm value. Prior literature shows that the cost and likelihood of litigation may have a negative impact on shareholder value (Badawi and Chen, 2014). Romano (1991), for example, assumes that derivative cases are frivolous and add little shareholder value due to the size of the awards. Supporting this view, Coffee (1986) focuses on the large fee awards that the plaintiff's attorneys expect to receive in a court settlement. While prior work has attempted to disentangle the effects of attorney fees and case merits, the analysis of derivative litigation in the absence of externalities has been largely overlooked.

One common feature of the recent literature is the suggestion that the increase of independent board directors has made it more difficult to launch successfully a derivative action because independent directors are unlikely to excuse the demand requirement (Thompson and Thomas, 2004). Better legal protections and corporate governance have also been reported to induce plaintiffs to file higher-quality suits that increase the probability of success. Supporting this view is the growing role of M&A-related litigation that has prompted attorneys to file cases in multiple jurisdictions, causing diminishing effects on shareholder wealth (Cain and Davidoff, 2012). Armour, Black and Cheffins (2012) further show that a "high-quality" filing is consistent with a pattern of negative effects due to the percentage of high damage and attorney fees awards. Additionally, Curtis and Meyers (2015) report that the merit-related factors play a role in the initiation and disposition of derivative litigation, showing that plaintiffs' attorneys are selective in cases where both the underlying legal merits and backdating of options are more egregious since

they are more likely to bring larger settlements. The focus of the current literature is to find the control forms to determine if these cases add value.

In this paper, we use a natural experiment provided by the absence of attorney fees and monetary awards to answer whether derivative litigation leads to shareholder wealth effects. If, as the literature suggests that, attorney fees and monetary awards stimulate the filing of derivative cases, we conjecture that the absence of such incentives has the potential to result in filings that may produce gains for shareholders. This is because speedy and effective conflict resolution is likely to have an important impact on a variety of the corporate finance issues that firms face. Moreover, these filings may result in settlements that may involve corporate governance reforms that would also materially benefit shareholders. The implication is that shareholder wealth effects should be observable since conflict resolution improves the alignment of management's interests with shareholders and provides new information to the market.

To set up our experiment, we select a sample of shareholder suits from a country that has a well-developed corporate litigation market that does not provide incentives for lawyers and private litigants. We carry out our analysis using 589 filings that have been collected through multiple databases from the beginning of 2002 through the end of 2013. Corporate litigation in the Netherlands is comparable to the US derivative suit since litigation costs are borne by shareholders. Moreover, shareholder litigation in the Dutch Enterprise Chamber focuses mostly on providing non-pecuniary remedies to resolving deadlocks or other intra-firm disputes. In contrast to the US, a filing in the Enterprise Chamber involves a two-step procedure in which the court first investigates the complaint and produces an independent report on the correctness of the management's decision. In the second step, the court determines if there has been mismanagement and then may take appropriate measures to remedy them.

We examine corporate litigation in two ways. First, we empirically analyze filings of listed and non-listed firms at the Enterprise Chamber. Since most plaintiffs are non-listed firms that have different governance structures and economic resources than listed firms, we would conjecture a different demand in corporate litigation. In contrast, listed firms typically have better governance mechanisms, and therefore shareholders are more likely to rely on public enforcement (OECD, 2013). To evaluate the characteristics of listed firms, we split our sample and analyze these cases. Second, we focus on filings and resolutions to determine whether acquisition-related lawsuits have an effect on firm value. To our knowledge, we provide the first empirical evidence on the effect of acquisition-related litigation on the firm value of Dutch firms.

We first begin our investigation of these questions by examining the differences in the case filings of non-listed and listed firms. We find that most plaintiffs are non-listed firms seeking to obtain injunctions or resolve intra-firm conflicts, whereas listed firms are usually involved in merger and acquisition-related corporate litigation. To proxy for the effect of corporate litigation on firm value in non-listed, we focus on the effectiveness of court mechanisms to resolve conflicts between shareholders. In this way, we consider the court's functioning in removing deadlock situations in small firms. While we cannot measure the wealth effects as with listed firms, we nevertheless conjecture using our empirical evidence that litigation adds value for small, non-listed firms. In fact, our findings strongly support the view that where the threat of litigation is high, the withdrawal effect of a case filing may add value.

Second, we examine how a selection of acquisition-related filings could generate positive abnormal returns. First, similarly to Cain and Davidoff (2013), we focus on the relationship between M&A litigation and shareholder value. We collect data on the share prices and perform an event study for the impact of case filings and court resolutions. Using event windows of varying lengths to estimate the short- and longer-term effects, we find an abnormal return of 0.5% for firms

that are subject to merger-related litigation between 2002 and 2013. Our findings imply, taking the abnormal returns on the day of the filing, that shareholders do significantly better. Our results highlight that the market responds positively to a filing since it may remove asymmetrical information and a deadlock situation between shareholders. In terms of resolution, we find a negative effect over the short-term period near the resolution. This indicates that shareholders incur actual costs from the proceedings in the Enterprise Chamber. However, over the long term, we find that resolutions have little impact on the stock price. This result confirms the previous literature.

Overall, our paper contributes to prior literature in three distinct aspects. First, this study is most clearly related to work by Kroeze (2006) that shows the Dutch model of corporate litigation has similar features to the Delaware Court of Chancery even though it is much smaller and provides few, if any, incentives to overcome lawyers' collective action problems. Second, while there are empirical studies on the effect of merit-based M&A litigation on firm value (see, e.g., Badawi and Chen, 2014), we believe that our findings are novel in this literature. To our knowledge, we are the first to show that M&A-related litigation is associated with positive shareholder wealth effects. Third, our work adds to the literature on the corporate litigation of publicly listed firms. Prior studies have often assumed that private conflict resolution is rarely launched by private parties against directors of publicly listed companies. Our findings indicate that non–listed firms are more likely to rely on private enforcement to resolve conflicts, which is complementary with earlier studies indicating that only a few public firms are subject to private corporate law enforcement actions (Armour, Black, Cheffins and Nolan, 2009).

This paper proceeds as follows. Section 2 provides a review of the trends of corporate litigation in the US and provides summary statistics of the pattern of shareholder litigation in the Dutch Enterprise Chamber. Section 3 presents the empirical analysis of the effectiveness of the

Dutch conflict resolution model. Section 4 examines the market impact of M&A-related litigation on firm value. Section 5 concludes.

2 Corporate Litigation

In this section, we review recent trends in corporate litigation in the United States. We organize the theoretical discussion into the factors that can lead to externalities in derivative lawsuits. We also discuss the related empirical literature on multi-jurisdictional litigation. We continue by looking at how corporate litigation can from a theoretical perspective limit agency costs in a public firm. Finally, we describe the structure and characteristics of shareholder litigation in the Dutch Enterprise Chamber during the period of 2002–2013. This analysis will serve as the foundation for our hypotheses.

2.1 Trends in Corporate Litigation

The Delaware Court has been widely recognized as the main forum of corporate litigation in the US.[1] Recent studies have identified two major trends in corporate litigation that complicate the analysis of shareholder wealth effects. The first trend reveals the number of acquisition-related cases strongly dropped in the period before 2009 (Armour, Black and Cheffins, 2010). Since acquisition–related litigation is the predominant source of lawsuits filed in Delaware, this sharply reduces the court influence on corporate litigation. As Thompson and Thomas (2004) report, the majority of cases filed in the years 1999–2000 against public firms were acquisition oriented class actions. A second trend indicates an increase of multi–jurisdiction lawsuits between 2005 and 2010. In addition to identifying the increased role for foreign jurisdictions in adjudicating leveraged

[1] For an overview of the role of Delaware in corporate litigation see, e.g., Romano (2010).

buyout and merger transactions, empirical evidence lends support to the view that litigation in Delaware appears to have contracted earlier in the decade due to a variety of factors. Thus, in an increasingly competitive and transparent litigation environment, it becomes harder for any jurisdiction to maintain the competitive advantage while providing the same quality and fairness in litigation.

Several theories have been put forward for the shift out of Delaware. The first theory reflects the pro-defendant orientation of the Delaware Chancery. Armour, Black and Cheffins (2010) argue that the sentiment has turned away plaintiffs to more favorable jurisdictions. While Armour, Black and Cheffins (2010) report the Vice Chancellor's quotes that capture the sentiment against plaintiffs, they are unable to locate a shift in Delaware law that would lead to precedents favoring defendants. Conversely, a second theory holds that plaintiffs' attorneys have a direct financial incentive to file cases outside Delaware. The implication is that factors, such as attorney fee cuts by the Delaware court in agreed settlements, create strong incentive to file cases outside Delaware. As attorneys seek out more profitable fees outside Delaware, state courts accelerate this trend by competing for acquisition-related cases. Cain and Davidoff (2012) show that states compete on attorneys' fees and settlement rate. As such, to compensate for the loss of market share of cases, courts adjust these factors to account for their losses.

Filing cases in multiple jurisdictions allows for additional strategic advantages. First, attorneys can press for expedited proceedings, allowing for fast track litigation. Second, filing cases in other jurisdiction can support objections made in previous filed cases. These advantages increase the pressure for the defendants to settle and increase the leverage of the plaintiffs. Collectively, these factors will accelerate the move out of Delaware and affect the results of measuring the shareholder wealth effect.

However, Delaware still remains an important corporate litigation forum as it signals the determination of the plaintiff. Armour, Black and Cheffins (2010) report that plaintiffs' counsel still favors Delaware as the leading forum for acquisition related and derivative litigation. Given the stature of the court, plaintiffs filing cases in Delaware over competing jurisdictions still have credibility. In fact, over the period 2009–2011, the number of cases strongly increased. It is likely, moreover, that this trend will continue, particularly in light of the Delaware State Legislature's recent approval of amendments to the Delaware General Corporation Law authorizing forum selection clauses in the charters and bylaws that designate Delaware as the sole forum for litigation.

2.2 Measuring Wealth Effects of Corporate Litigation

This section examines the factors motivating corporate litigation and the effect of litigation on shareholder value. Absent externalities, corporate litigation is a mechanism that can improve the alignment of interests between shareholders and management. This alignment is typically conjectured to play an important role in generating value for shareholders. Two important factors influence shareholder value as lawsuits tend to limit the negative effect of principle-agent problems between shareholders and management (Jensen and Meckling, 1976). First, as the early literature has established, asymmetric information may prevent from an efficient outcome. In typical shareholder lawsuits, such as merger & acquisitions (M&A), information known to the board, but unknown to shareholders, may prevent the shareholders from fully valuing and assessing a bidder's offer. Litigation can add value theoretically by removing the information asymmetry between parties. Second, inequality in bargaining power between the two parties may lead to inefficient outcomes. Hence, corporate litigation works to protect minority shareholder rights and improve shareholder value by limiting externalities in settlement procedures

Empirically, the relationship between corporate litigation and generating shareholder value

is less well established. Early literature has moved from a focus on case studies of corporate litigation (Cutler and Summers, 1987) to measuring wealth effects of intra–firm litigation (Bhagat, Brickley and Coles, 1994). One important strand of recent empirical evidence stems from studies that have focused on lawsuits related to M&A. An observation of M&A transactions is that most deals lead to litigation. Cain and Davidoff (2012) report that in 2005 only 38.7% of significant sized deals were subject to litigation, whereas in 2011 this rose to 94.2%. There is also evidence that, during the same period, the cases filed in multiple jurisdictions increased from 8.6% to 47.4%. Overall, the growing role of M&A-derivative litigation has led to the heavy use of fee–shifting and minimum-stake-to-sue provisions, as well as attorneys filing cases in multiple jurisdictions, which is consistent with diminishing effects on shareholder wealth.

Some writers argue that the strategy of plaintiffs' law firms is to settle claims rather than pursue strong law suits (Thomas and Thompson, 2012). There is also evidence that top plaintiffs' law firms are more likely to gain success in M&A lawsuits, suggesting the value enhancing mechanism of filing plaintiff's law suits (Krishan, Solomon and Thomas, 2014). The implication of this study is that litigation offsets the fall in probability of deal completion with an increase in expected takeover premiums generating economic value for target shareholders.

On the other hand, target stock price reactions to bid announcements do not fully anticipate the positive effect from the potential ligation. One strand of the literature focuses on how settlements appear to have negative effects on share prices, whereas court rulings have a positive effect (Haslem, 2005). Typically, firms with weak corporate governance structures are willing to settle, signaling to investors they are vulnerable due to high agency costs. Thompson and Thomas (2004) find evidence that M&A lawsuits suits have high levels of litigation agency costs. As a consequence of high costs, investors might a priori withhold information about the success rate of their case. As a consequence, we would expect to see a weak response of the share price. Since

litigation may remove asymmetric information, Thompson and Thomas (2004) argue that in 1999-2000 merger litigation had a role in reducing managerial agency costs.

Another strand of literature that offers insight on the shareholder wealth effect of corporate litigation is derivative lawsuits. Theoretically, derivative lawsuits can increase shareholder value through the protection of shareholder rights. As noted, early empirical studies find that the filing of a derivative lawsuit does not significantly affect the stock price (Romano, 1991). This work is in line with prior findings that a negative effect can be expected with dismissals of a derivative suit and no market reaction to court decisions that overrule proposals to dismiss a case (Fischel and Bradley, 1985). More recent literature, however, indicates a negative effect on shareholder value for the filing of derivative cases, and this effect increases with case quality (Badawi and Chen, 2014). One explanation for the decrease in shareholder wealth is that markets respond to increased uncertainty about business continuity. The filing of a derivative suit signals unexpected corporate governance or management issues and information disclosed at the trial may harm future firm revenues.

An interesting recent suggestion is that shareholder litigation can increase shareholder value (Frankel, 2015). In fact, the recent $279 million settlement of a derivative suit involving Activision Blizzard and a $130 million derivative settlement of the Freeport–McMoRan action seems to reinforce the suggestion that settlements of derivative litigation will lead to direct dividend payments to shareholders, resulting in shareholder gains.

Other studies have investigated the wealth effects of corporate litigation in the pricing mechanism of IPOs. Underpricing at the IPO provides insurance for firms with high litigation risk and can lower the expected litigation costs (Lowry and Shu, 2002). In order to defend against corporate litigation, firms with high litigation risk might increase their cash holdings. Shareholders, on the other hand, would prefer higher payouts as excess cash might increase damage payments

(Gormley and Matsa, 2009). These findings suggest that while the size and impact of litigation risk is well known, the resulting effect on shareholder wealth is not entirely known due to the possible impact of externalities.

2.3 Trends in the Dutch Enterprise Chamber

In this section, we describe the development of the Dutch Enterprise Chamber from the perspective of its long-standing role in the enforcement of corporate governance. We then provide summary statistics about trends in cases filed, and withdrawn and verdicts rendered over the last decade. The data shows that while there was a decline in cases from 2004 to 2007, there has been a steady increase in new cases after 2010.

For years, the Netherlands ranked consistently behind leading countries, such as the United States and United Kingdom, with respect to corporate governance. This is reflected in much lower firm performance and increased cost of capital. In terms of the legal regime, the Netherlands ranked low in investor protection and, in the context of listed companies, Dutch firms were seen to make takeovers very difficult to achieve. The Netherlands has taken steps, over the last decade, to provide better legal protections for minority shareholders and mechanisms to monitor management's actions. Starting with the introduction of the code of conduct in 2003 and amendments to the Dutch Civil Code in 2004, Dutch firms have been committed to the implementation of higher standards of governance. The perceived pay off of better corporate governance standards was also influenced, in some cases, by firms' calculation of potential costs associated with the "Dutch discount," which refers to the fact that firms trade lower than their competitors abroad due to the lower standards of governance in the Netherlands. According to this theory, managers have tended to focus on lowering the "Dutch discount" as a motivation for their strongly held commitment to the enforcement of the Dutch corporate governance code. One of the

results of the amendments to the Dutch law is the renewed focus of the Enterprise Chamber. The Dutch Enterprise Chamber has been labelled as the European counterpart of Delaware. While there are similarities between Delaware and the Enterprise Chamber, nevertheless a closer look at the Dutch statute and procedure suggests that there may be some differences. For example, derivative lawsuits are not possible in the Netherlands. Under Dutch law, the Enterprise Chamber has jurisdiction when: (1) doubts arise as to whether a company is properly managed (the inquiry procedure);[2] (2) there are conflicts regarding the removal of a firm's Supervisory Board organized under the Structure Regime;[3] (3) shareholders are dissatisfied with financial reporting and challenge the annual account;[4] (4) a shareholder that owns at least 95% of the outstanding share capital seeks to freeze–out the remaining shareholders;[5] or (5) conflicts arise between shareholders and harm the existence of the corporation, allowing for a forced buyout of shareholders.[6] Second, in the absence of contingency fees, Dutch lawyers do not have the same incentives as US lawyers (Jitta, 2006). Hence, plaintiff's attorneys working under a fixed fee system in the Netherlands will no doubt have incentives to settle cases (Gelter, 2012).

The court, which includes three justices and two lay members with financial experience, has probably exerted most influence on the development of Dutch corporate law and the protection

[2] See Art. 344–359 of Book 2 of the Dutch Civil Code.

[3] See Art. 158 and 161a of Book 2 of the Dutch Civil Code. The Structure Regime applies to large firms in the Netherlands (roughly those with more than 100 employees and 16 million euros in capital). These firms are required to have a two-tier board structure. The directors are appointed by the supervisory board. The shareholders are only able to dismiss the entire supervisory board.

[4] See Art. 447–453 of Book 2 of the Dutch Civil Code.

[5] See Art. 92a of Book 2 of the Dutch Civil Code.

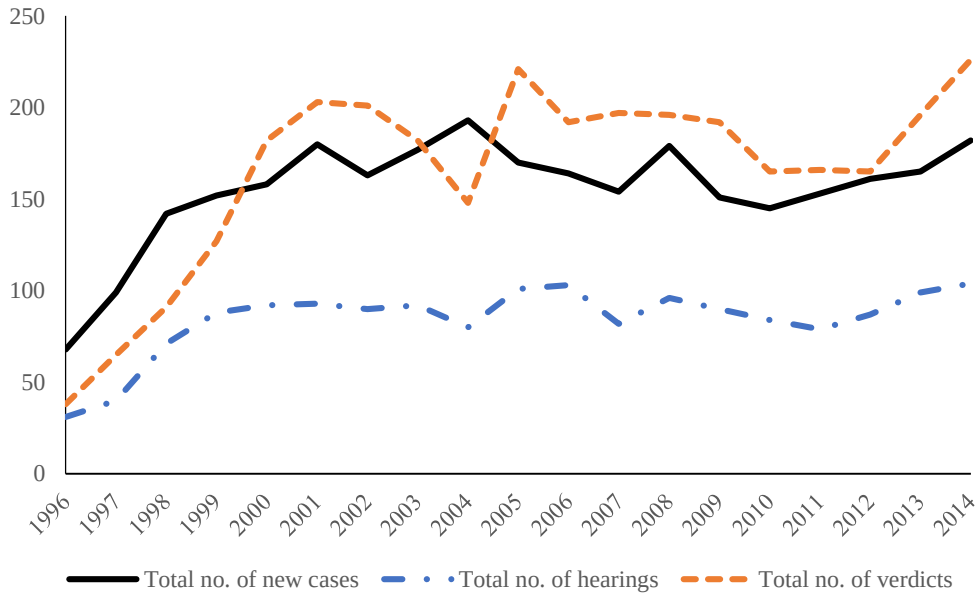
[6] See Art. 336 of Book 2 of the Dutch Civil Code for the exclusion procedure of shareholders and art. 343 of Book 2 of the Dutch Civil Code for relinquishment procedure of shareholders.

of minority shareholders through the inquiry procedure (Kroeze, 2006). Upon request, the court has the ability to initiate an inquiry into the policy, management and conduct of business in a company when there are well-founded reasons to believe that a company is or has been managed improperly and incorrectly. The inquiry procedure was first introduced in 1928 to strengthen the position of minority shareholders in Dutch listed firms, although it had no practical use until 1971, when an overhaul of Dutch company law laid the foundation for a popular dispute resolution mechanism.

Over the years from 1996, the demand for the court in conflict resolution has increased substantially. Figure 1 shows that the arrival of new cases has mostly increased from the period 1996-2001. In this period, the number of new cases grew 165%, from 68 cases in 1996 to 180 in 2001. The large increase in these cases can be attributed to changes in the law. In the subsequent period, the number of cases started to decline. Several theories have been put forward to explain this trend. First, changes in the law and the appointment of a new president of the court may be one of the contributing factors. Other factors contributing to the decline include the rapid and transparent proceedings of the Enterprise Chamber itself. Studies have indicated that plaintiffs' that prefer less transparent proceedings typically will lodge actions in Dutch civil courts to prevent negative publicity following from a lawsuit with the Enterprise Chamber.

The two periods of decline in new cases seem to imply that the improved incentives to bring litigation in the first period may have had the unintended effect of increasing the costs of this style of litigation for some parties. Our evidence suggests that Enterprise Chamber's highly public exposure of the details of the litigation, often involving weak cases and corporate governance practices may have triggered the migration of cases away from the Enterprise Chamber to civil courts. The "reputation theory" holds that some shareholders tend to pursue claims in civil court to the extent that they wish to avoid the impact of negative publicity on firm value.

Figure 1: The Enterprise Chamber's proceedings



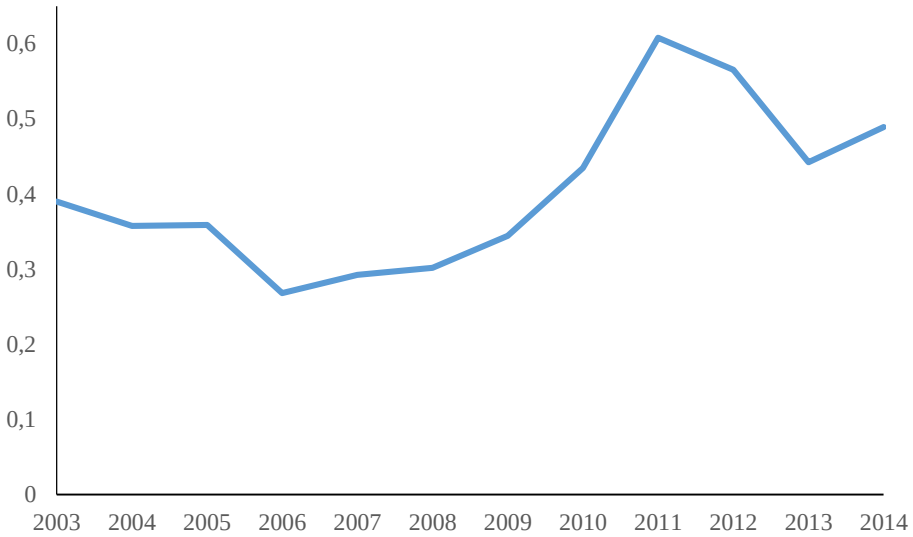
Source: Data from the Enterprise Chamber.

We also find some evidence that the pick up in new cases after 2010 is consistent with the corporate governance hypothesis that shareholders have incentives to litigate code violations to influence the quality of the firm's internal governance regime. This data is also consistent with Figure 3 below, which shows the increase in inquiry procedure requests from 2010 to 2014.

We also ask whether the Enterprise Chamber, like Delaware, is delivering settlements between shareholders, and decreasing the costs of litigation to all parties. To understand the role of the Dutch Enterprise Chamber in facilitating agreements, Figure 2 shows the number of withdrawn cases. Over the period from 2003 to 2014, an average of 40.4% of new cases has been withdrawn. There are various ways to interpret the increasing trend of settlements. First, it is quite possible that the economic downturn of 2008 and the following crisis may have triggered an increase in the number of settlements. Since most plaintiffs are unlikely to have recovered economic damages or costs, it is more likely that parties would focus on the potential to resolve

conflicts through other channels. Similarly, since attorney fees are typically proportional to the length of procedure, plaintiffs clearly had an incentive to settle. To be sure, there is another possibility that plaintiffs simply filed claims as a threat, which had lost its effectiveness, during the financial crisis, to induce a settlement.

Figure 2: The Number of Cases Withdrawn in the Enterprise Chamber



Source: Data from the Enterprise Chamber.

3 Dutch Conflict Resolution Model

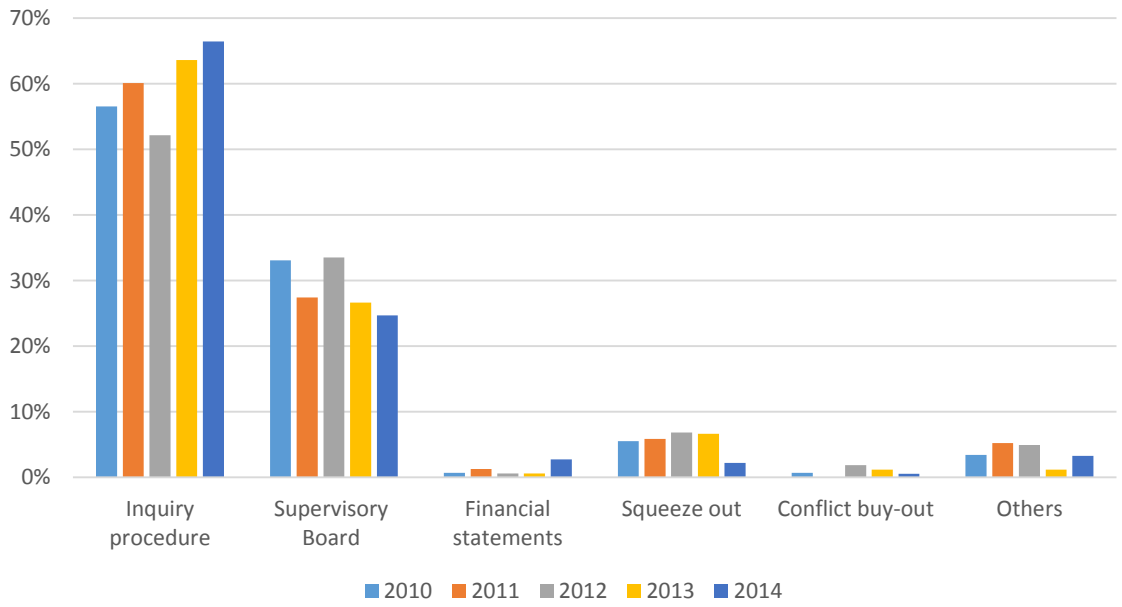
This section examines the two stages of the inquiry procedure and the injunction relief, which are the two main functions of the Dutch corporate court mostly sought after by firms. We analyze the number of inquire procedure requests and measures that have been brought to the Enterprise Chamber by listed and non–listed companies.[7] Finally, we investigate the impact of the court on the Dutch governance model.

[7] Parts of this section are adapted from McCahery and Vermeulen (2010).

3.1 The Inquiry Procedure

As we have noted, the inquiry procedure is one of the most important mechanisms of the Dutch Enterprise Chamber. It is generally recognized that the certainty, speed, and predictability of the Enterprise Chamber increased as precedent expanded. Figure 3 shows that over the period 2010–2014 about 60% of the new cases were seeking conflict resolution within the scope of the inquiry procedure. The bulk of the remaining actions involve conflicts about the supervisory board, financial statements, squeeze-outs, and buy-outs. As we might expect, Table 1 shows that while the length of these procedures can vary, the Enterprise Chamber is able to deliver fast-track conflict resolution.

Figure 3: Characterization of the inflow of new cases



Source: Data from the Enterprise Chamber.

Table 1: Average Length of Procedures

This table shows the average length of the main procedures in the Enterprise Chamber in days. The length is measured between the filing of the case and a court ruling.

Period	Inquiry procedure stage 1	Inquiry procedure stage 2	Supervisory Board	Squeeze out	Conflict buy–out
2012	25	232	26	108	125
2013	37	245	43	103	125
2014	64	108	46	132	–

Source: Data from the Enterprise Chamber.

Dutch corporate law provides that only a narrow range of individuals are entitled to request an inquiry procedure.[8] Besides the public prosecutor (for reasons of public interest) and labor unions (for employees' interests), the most important constituency allowed to request an inquiry procedure is shareholders (or depository receipt holders) alone or collectively owning at least 10% of the outstanding shares (or depository receipts, respectively) of a company or shares with a nominal value of €225,000, or such a lesser amount as is provided by the articles of association. The inquiry procedure contains two stages. In the first stage, parties may request an inquiry into the affairs of the corporation to determine whether the firm has been mismanaged. If the Enterprise Chamber shares the applicant's concerns, it will appoint one or more individuals who will conduct an investigation and file a report with the court.[9]

[8] Art. 345, 346 and 347 of Book 2 of the Dutch Civil Code.

[9] See Art. 350 of Book 2 of the Dutch Civil Code.

In the second stage, the Enterprise Chamber may be requested to take certain measures provided that improper conduct and mismanagement follows from the report.[10] These measures include (1) the suspension or dismissal of board members; (2) the nullification or suspension of board or shareholder resolutions; (3) the appointment of temporary board members; (4) the temporary transfer of shares; (5) the temporary deviation of provisions of the articles of association; and (6) the dissolution of the company.[11] The firm or the applicants may appeal to the Supreme Court on legal grounds.[12] On appeal, the Supreme Court will not review the factual findings and background of the case.

Table 2 summarizes the number of inquiry procedure requests and measures that have been brought by listed and non-listed companies to the Enterprise Chamber.

[10] Each case could generate several decisions, such as a preliminary measure, a final measure, the appointment of one or more persons to undertake an inquiry into the policy and conduct of the company, or the determination of the maximum amount of the costs of the inquiry.

[11] See Art. 356 of Book 2 of the Dutch Civil Code. Table 1 shows that only 6% of the requests in the context of listed companies (this is 13% in the context of non-listed companies) will result in a final measure. If we analyze our dataset for the period 2002–2008, we find that the appointment of temporary board members is the most popular measure (28%), followed by the suspension or dismissal of board members (23%), the temporary transfer of shares (18%), the nullification or suspension of board or shareholder resolutions (17%), the temporary deviation of provisions of the articles of association (11%), and the dissolution of the company (3%).

[12] See Art. 359 of Book 2 of the Dutch Civil Code.

Table 2: Inquiry Requests and Measures

This table presents the number of cases for the inquiry procedure over a period from 1971–2007. The cases have been separated for the first and second stage of the procedure.

	First stage		Second stage		
	Written request	Request sustained	Request to rule on mismanagement	Mismanagement found by court	Final injunction relief sustained
Listed companies	31	22	15	9	6
Non–listed companies	479	294	92	71	61

Source: Adapted from K. Cools, P.G.F.A. Geerts, M.J. Kroeze and A.C.W. Pijls, Het recht van enquête, een empirisch onderzoek, 2009.

Judging from the number of cases in the period 1971–1994, the inquiry procedure initially played a modest role in the development of company law and the reduction of managerial agency costs. First, the lengthy and formalistic two stage procedure rendered immediate responses to practical needs in a dynamic and ever–changing business environment impossible. Second, the limitation on the number of measures that the Enterprise Chamber could order constituted another reason for initial caution in employing the inquiry procedure. If, for instance, a conflict between shareholders caused the mismanagement of a company, the court's discretion was limited to ordering the temporary transfer of shares to a nominee. This prevented the court from effectively resolving the dispute. Finally, the uncertainty about the application of the open 'improper management' standard tempered the initial success rate of the inquiry procedure. Interestingly, as case law expanded, the certainty, predictability and speed of the inquiry procedures increased (see Table 3). Table 1 shows that the length of the inquiry procedure has been considerably shorter in

the recent period of 2012–2014. The results highlighted here may partly explain the spur for new case demands in the same period, as shown in Figure 1.

An analysis of the decisions into the inquiry procedures shows that the Enterprise Chamber defined a number of situations in which there are reasonable doubts whether a company is properly managed. A large percentage of these actions involve conflicts with minority shareholders in non–listed firms. Most actions arising in the Enterprise Chamber involve the following conflicts: (1) a deadlock in the decision–making process of the company; (2) management has failed to disclose vital information to the minority shareholders; (3) if conflicts of interest between managers and shareholders have arisen or have not been properly countered by the company; (4) if the company does not comply with the disclosure and accounting requirements; (5) if the company has no or an unfair dividend policy; (6) if assets are being removed or reallocated to the detriment of the shareholders or other stakeholders of the company; or (7) if decisions of management are challenged as being inconsistent with the rules of the Dutch Corporate Governance Code.

Table 3: Length of the Inquiry Procedure

This table presents the number of cases involving the inquiry procedure and the length of the procedure (days) for different time periods. The cases are split in non–listed and listed firms.

	Non–Listed firms		Listed firms	
Period	Number	Length	Number	Length
1971–1994	99	–	4	–
1994–1999	80	mean 704 median 490	4	mean 1858 median 2024
2000–2007	300	mean 440 median 265	23	mean 564 median 447

Source: Adapted from K. Cools, P.G.F.A. Geerts, M.J. Kroeze and A.C.W. Pijls, Het recht van enquête, een empirisch onderzoek, 2009.

3.2 Injunctive Relief

So far, we have looked at the number of inquiry procedure requests and measures that have been brought by listed and non-listed firms in the two stage proceedings of the Enterprise Chamber. In this section, we analyse requests for injunctive relief covering the period 2000–2008 and also examine the factors contributing to the high settlement rate of these actions.

In 1994, the implementation of injunctive relief in Art. 349a (2) BW gave rise to the current popularity of the Enterprise Chamber (see Figure 4). Pursuant to Art. 349a (2) BW: where an immediate remedy is required in connection with the condition of the company or in the interest of the inquiry, the Enterprise Chamber may at any stage of the proceedings, upon the application of the persons that requested the inquiry, order preliminary injunctions for the duration of the proceedings at most. Since then, an application for injunctive relief was the rule rather than the exception. In the period 2000–2007, out of 23 inquiry requests with respect to public firms, injunctive relief was requested in 21 of these cases; a preliminary remedy was granted in 57% of these cases. In the context of closely held firms, the number reached 234 requests for injunctive relief in 300 cases with a 'success rate' of 47%.

Recall that the 'fast-track' procedure, under Art. 349a (2) BW, is characterized by speed and informality. Even though the formalistic two stage inquiry continues after the court has granted an injunctive relief, the preliminary nature of the decision furthered the judiciary's ability to assist in resolving the issues caused by the alleged improper management of the firm. Data on the number of days before an injunctive relief bears this out. During the period of 2002–2008, the average number of days before injunctive relief was granted was 5 days for listed and 72 for non-listed companies (see Table 4). On both counts, the procedure offered is clearly efficient for shareholders. Additionally, the process of injunctive relief is much quicker for publicly listed companies due to

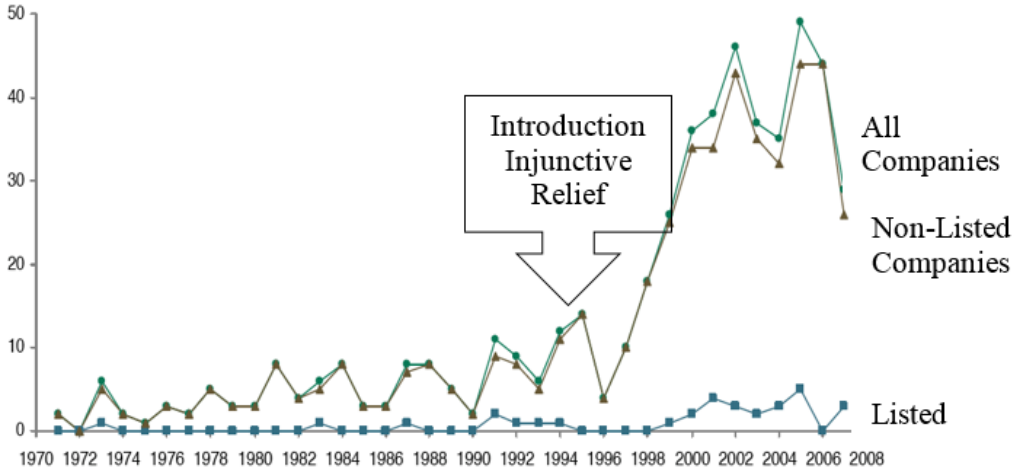
the amount of media attention and greater pressure that can be exerted by institutional investors involved in the litigation.

Table 4: Injunctive Relief
This table presents the time length (day) before injunctive relief is granted by the Enterprise Chamber. These statistics are calculated over the period 2002–2008.

	Mean	Median
Listed Companies	5 days	4 days
Non–listed Companies	72 days	65 days

Source: Adapted from K. Cools, P.G.F.A. Geerts, M.J. Kroeze and A.C.W. Pijls, Het recht van enquête, een empirisch onderzoek, 2009.

Figure 4: Popularity of the Dutch Inquiry Procedure



Source: Adapted from K. Cools, P.G.F.A. Geerts, M.J. Kroeze and A.C.W. Pijls, Het recht van enquête, een empirisch onderzoek, 2009.

In terms of relief, the Enterprise Chamber has full discretion to order any preliminary remedy as it sees fit. The most popular remedies for publicly listed firms are: (1) the appointment of independent board members; (2) the prohibition of voting on particular agenda items; and (3)

deviation from the articles of association.[13] Conversely, the preliminary remedies that are most popular for non–listed companies include: (1) suspending directors; and (2) suspending shareholder resolutions.[14] These results confirm our hypothesis that the inquiry procedure is not limited to mere after-the-fact adjudication. The evidence, moreover, indicates that the Enterprise Chamber procedure assists the parties in overcoming their differences by promoting informal and supposedly efficient solutions. These non formalistic remedies offer parties an additional round of after-the-fact bargaining either by themselves or under the supervision of independent observers. The principle of fast, informal and what we call judge-initiated 'mediation' or 'conciliation' appears to be very attractive to minority shareholders.[15] In many cases, after the injunctive relief, the firm and its shareholders tend to follow the preliminary relief or settle their disputes amicably under the 'supervision' of the Enterprise Chamber. In the context of non-listed firms, 120 out of 309 disputes in the period 2002–2008 were settled and published by the Enterprise Chamber.

3.3 Impact on Governance Model

In this section, we document the dramatic differences in case characteristics of listed and non-listed firms. We use hand-collected from lawsuits of the Dutch Enterprise Chamber. Our dataset consists of all the 589 cases for the period from 2002-2013. Most of the cases consist of non–listed companies that seek to obtain injunctions or resolve conflicts through an effective and

[13] The list is derived from our dataset including both listed and non-listed firms that were not involved in bankruptcy proceedings. In the period 2002–2008, the Enterprise Chamber granted more than 130 preliminary reliefs.

[14] Since the inquiry proceeding is often used in non-listed firms to resolve deadlock situations and minority squeeze-outs, the majority of resolutions that are either withdrawn or suspended include shareholder resolutions.

[15] This is true for both listed and non-listed companies, It appears that the inquiry proceeding is a very attractive mechanism to resolve deadlock situations in closely held firms.

efficient conflict resolution process. Recall that listed firms typically have better governance mechanisms and shareholders are more likely to rely on public enforcement (OECD, 2013). To explore the different dynamics of listed and non–listed firms, we split our sample and analyze the case characteristics.

Table 5 highlights the differences in litigation characteristics between listed and non–listed firms. Almost 90% of the cases filed in our sample are from non-listed companies. We find that proceedings on merits and Supreme Court rulings are substantially more frequently invoked in lawsuits with listed firms. For example, 55% of the cases for listed firms proceed on the merits, while only 40% for the non-listed firms. Supreme Court rulings are more frequently invoked for listed firms, about 28% for listed firms whereas only 2% of the cases for the non-listed firms. These findings support the size-effect of the firm characteristics in our sample. Again, listed firms because of their economic resources, listed firms are considerably more involved in complex litigation proceedings. Conversely, non-listed firms are typically associated with smaller firms and fewer economic resources compared to listed firms.

Table 5: Summary Characteristics
This table presents the summary characteristics of our sample of lawsuits from 2002 to 2013.

	Listed	Non-listed
General characteristics		
Total cases 2002–2013	47	542
Average Business days between filling and resolution	106	99
Mismanagement found by court	4	31
Proceeding on the merits	26	215
Supreme court ruling	13	9
Type Conflict		
Takeover	5	16
Restructuring	33	6
Merger	0	1
Conflict	8	276
Unknown	0	243
Interim measures		
Changes in statutes	6	46
Appointment of director	3	57
Appointment member of the board	4	25
Appointment member of the board with Veto	1	15

In several lawsuit characteristics non–listed firms do not differ from the listed firms. Surprisingly, we find no differences for cases involving interim measures or the recognition of mismanagement. Theory would suggest that listed firms are more likely to establish good governance mechanism than non-listed firms. As a result, mismanagement and court intervention would naturally be deemed less likely to occur. On the other hand, listed firms may be considered mismanaged, due to the conflict of interests between managers and shareholders, in a case involving a struggle for corporate control. Indeed, it is possible to conceive of a firm as mismanaged not only if a potential conflict of interest existed, but if it failed to take protection against such a conflict. Our data suggest, however, that listed firms are equally likely to face such matters in corporate litigation.

The data shows that, together with a decrease in rulings, the duration of the cases has strongly increased from 61 business days in 2002 to 95 business days in 2013. This result is also in line with our previous conclusion from Table 1 on the average length of the inquiry procedure. While the average durations of court cases through the years have varied in specific years, the trend seems to be increasing. This leads to a lower efficiency level in the Dutch model of corporate litigation.

Overall, these findings raise questions about the current levels of litigation and the impact of the quality of the Enterprise Chamber as a platform for conflict resolution in the Netherlands. On the other hand, the data may be explained by the fact that mediation or negotiation may have been more effective in recent years, as highlighted earlier, this would explain the notable decrease. One might expect that the Enterprise Chamber would facilitate more efficient conflict resolution outside the courtroom. Such an explanation is consistent with the evidence of longer case duration.

Table 6: Case Characteristics of Non-listed Firms

This table presents the case characteristics of our sample of lawsuits for non-listed firms from 2002 to 2013. The duration of the case is measured in business days.

	Total Cases	**Duration**	**Proc. Merits**	**Interim Measures**	**Mismanagement**
2002	71	61	39	17	3
2003	73	109	30	12	6
2004	49	68	14	9	1
2005	84	108	39	21	5
2006	83	88	39	19	5
2007	82	97	27	9	4
2008	66	100	22	16	5
2009	17	131	4	3	1
2010	9	683	1	1	1
2011	2	41	0	1	0
2012	2	357	0	0	0
2013	4	95	0	2	0

While efficiency reductions in conflict resolution for non-listed firms have a strong and direct effect on the Dutch economy, lower efficiency for listed firms will a negative impact on international reputation and the possible establishment of international firms in the Netherlands. Table 6 shows the strong reliance of non-listed firms on the court resolution mechanism. Indeed, what is noteworthy is that the volume of cases involving non-listed firms has increased over time, while case characteristics remain relatively unchanged.

Table 7 confirms a similarly negative effect for the listed firms. While we have established differences in the characteristics of conflicts brought to court, our data shows a similar time trend to that of non-listed firms. In absolute terms, the number of cases for non-listed firms has decreased over the time period, and the duration of some cases remains extensive and is unlikely to change.

Table 7: Case Characteristics of Listed Firms

This table presents the case characteristics of our sample of lawsuits for listed firms from 2002 to 2013. The symbol "–" denotes that data was not available in our sample.

	Total Cases	**Duration**	**Proc. Merits**	**Interim measures**	**Mismanagement**
2002	8	18	3	1	2
2003	5	110	3	1	0
2004	2	163	1	0	0
2005	8	48	5	3	0
2006	6	77	3	2	0
2007	3	6	3	2	0
2008	9	15	5	1	0
2009	–	–	–	–	–
2010	4	114	2	0	0
2011	1	679	0	0	1
2012	1	877	1	0	1
2013	–	–	–	–	–

Overall, this evidence suggests that the increased duration of corporate litigation will have an effect on the market. Given the great uncertainty about interim measures, the market may

respond negatively to filings of cases. On the other hand, this pattern of filings may suggest improved efficiency obtained through litigation. Given the evidence, we cannot fully exclude the hypothesis that shareholders are more likely to settle through the litigation phase without a final court ruling. Note that as out-of-court settlements are typically conducted outside the scope of the public, empirical evidence is hard to obtain.

In this section, we have provided evidence on the important relationship between a specialized company law court and improving the quality of corporate governance at the firm level. The evidence points to the important role that the Enterprise Chamber plays in the enforcement of the Dutch Corporate Governance Code and in limiting the asymmetric information problems for non–listed companies in governance conflicts. The evidence also reveals that the popularity of the Enterprise Chamber's unique two stage inquiry procedure is linked to the success of its proceedings in balancing power in conflicts-of-interest cases, and influencing the outcome of economic problems between parties. To some extent, the data presented here shows the extent to which lawmakers' commitment to the introduction and enforcement of efficient corporate governance rules may make it possible eventually to eliminate the Dutch discount.

4 Shareholder Wealth Effects

In section 2, we discussed how corporate litigation could affect shareholder wealth through market reactions on firm value. Indeed, recent studies have focused on the filings effects of M&A-related lawsuits in Delaware on equity prices (Krishnan, Masulis, Thomas and Thompson, 2012; Badawi and Chen, 2014). In this section, we present evidence of the cumulative abnormal common stock returns around the initial announcement and the final outcome of M&A-related cases in the Enterprise Chamber.

4.1 Measuring the Shareholder Wealth Effect

Three central hypotheses are routinely discussed to explain the effect of acquisition-related litigation on equity prices. One explanation for why derivative litigation has no impact on equity prices is that investors do not believe litigation will motivate management and deter misconduct (Romano, 1991). A second explanation suggests that the market's reaction is an indication that a lawsuit will be used to negotiate a higher control premium, which should have a positive impact on share prices (Fischel, 1986; Badawi and Chen, 2014). A third explanation documents how filings cause bad news, leading to lower shareholder value (Billings, Klein and Zur, 2011). This research suggests that the market's reaction to the filing of M&A-related litigation could provide us with an indication of the market's perception of the increased risk of the firm.

Our focus of analysis concerns two important events in the litigation process. The first event is the filing of the case at the Enterprise Chamber, which allows us to verify the effect of the market on the presence of a conflict between shareholders. The second event is the resolution of the matter in the Enterprise Chamber in which the conflict is settled by court intervention.

To measure the impact on shareholders wealth for both events, we employ an event study for all the cases for the listed firms in our sample (see e.g., Campbell et al., 1997). We collect the share prices[16] for each individual firm and regress the stock performance on the market index[17], using the following equation

$$Return_t^i = \alpha_i + \beta_i \, Return_t^{Market} + \epsilon_t,$$

where $Return_t^i$ denotes the daily stock returns of firm i at time t. The parameters α_i and β_i are

[16] All share prices are obtained using Datastream.

[17] For each individual firm we select the associated market, which is in our sample the AEX Index. As a robustness check for the market impact, we also use the MSCI World Index.

estimated over a period of 200 days that ends ten days prior to the court filing. In this way, our abnormal returns derived from our estimates are not influenced by the events. Next, we determine the abnormal returns of the stock, which is the difference between the predicted return using the estimated parameters and the observed return. To analyze the effect of the events, we select a number of event windows and determine the cumulative absolute return over these periods.

Table 8 presents the cumulative abnormal returns (CARs) on the day of the filing of the litigation in the Enterprise Chamber and the final outcome of the litigation, as well as during the interval in between. These results are consistent with previous studies on general corporate litigation that find an average positive market response to the filing of litigation even though the firm has lost the lawsuit (Haslem 2005). The data indicate that the day after the filing, the market reacts with a slight decrease in value, lowering its expectation.

The findings also confirm our hypothesis that a filing litigation in the Dutch Enterprise Chamber leads to a positive increase in the stock price, and hence the conflict resolution mechanism of the Dutch Enterprise Chamber ultimately adds value for shareholders. This impression is confirmed because the CAR over the event window [–2, 2] days is positive and significant.

We also find, on the longer horizon, a CAR that has a negative effect on the filing. On one hand, this might indicate that case filing might lower the shareholder value. However, the event window with a longer horizon is based on a sample with only cases that have not yet been resolved. One explanation could be that over longer periods, the results suggest that these cases signal complexity to the market, causing additional uncertainty. The result is consistent with the theory that after the filing, it is more likely that shareholder wealth will decrease as uncertainty about the settlement increases. This is interpretation is consistent with our view that speedy court procedures can add value for shareholders. Accordingly, if the time to settlement increases, the market will

react by lowering its expectation of the firm's value.

On the other hand, Table 8 shows that if the court announces a resolution in a lawsuit, the market will respond positively. Over a period of two days before the resolution and two days after, we find a negative CAR, indicating that the resolution is costly in terms of the shareholders. However, over a longer horizon there is no significant impact on the share price. This suggests that the market has already priced the resolution at the time of the filing, which is consistent with prior US literature that the resolution of cases has little market impact (Romano, 1991).

From the above analysis, it appears that the Dutch Enterprise Chamber has a reasonably similar conflict resolution process to the Delaware court. Note, however, that while Badawi and Chen (2014) find empirical evidence for the negative impact of filing a derivative suit in Delaware, we show, in contrast, a positive effect associated with the filing of merger–related litigation in Amsterdam. While cases at the Enterprise Chamber can be compared to derivative suits, as previously explained, the crucial difference is that the Enterprise Chamber is able to pursue an inquiry into management using the two stage inquiry procedure. Yet, due to the special setting and inquiry methods, the court is able to thoroughly investigate claims in a transparent and low-cost fashion. For these and possibly other reasons, this procedure could in principle help out other countries with specialized courts to litigate merger-related matters efficiently.

Table 8: The Impact of Litigation on Shareholder Value

This table shows the cumulative abnormal returns for the events of filing a case at the Enterprise Chamber and of a resolution by the court. Event window 0 is the abnormal return for the day of the event. Subsequent periods denote the cumulative abnormal returns and are either days before or after the events. The standard error of the coefficients are reported between brackets and significance at a level of 0.10, 0.05, 0.01 with respectively *,**,***. The total amount of companies used is 43 and varies across periods to avoid overlaps between filling and resolution events.

Window	Event	
	Filing	Resolution
[0]	0.48%*** (0.16%)	0.65%*** (0.15%)
[–2, 0]	0.25% (0.15%)	–0.05% (0.10%)
[–1, 0]	0.29%** (0.10%)	0.00% (0.13%)
[0, +1]	–0.30%** (0.11%)	0.26%*** (0.09%)
[–1, +1]	–0.22%* (0.10%)	–0.05% (0.11%)
[–2, +2]	0.21%* (0.11%)	–0.28%** (0.11%)
[–1, +10]	–0.14%* (0.06%)	–0.09% (0.08%)

Overall, our results are consistent with the hypothesis that the filing of a merger related lawsuit has a positive effect on shareholder wealth. Our results are robust and suggest that the Enterprise Chamber could over time attract more plaintiffs in acquisition–related cases. Further, our results suggest that speed is an important factor for the Enterprise Chamber to prevent erosion of shareholder wealth.

5 Conclusion

The main purpose of this paper is to examine if, absent of attorney fees and monetary awards, the filing of a derivative case adds value for shareholders. Using Dutch data from the Enterprise Chamber, we are able to show that a filing in an acquisition–related suit can have positive shareholder effects. This paper finds that M&A–related litigation is associated with an abnormal return for target firms on a shorter horizon, which is in contrast to the US literature. We also show that the conflict-resolution procedure of the Enterprise Chamber appears to be very effective because of its speed and reliability. We find that the data reveal a negative effect for prolonging resolutions. However, as the US evidence shows (Haslem, 2005), resolutions do not necessarily improve shareholder value over a long horizon. These results support the view that markets may not fully account for how a case is resolved or the importance of complexity for interpreting the impact of the decision.

The findings of our paper should be of interest to lawmakers and regulators who are interested in examining derivative litigation mechanisms. Our results suggest that a more effective derivative-suit mechanism can be obtained by prohibiting the use of incentives and improving speed to settlement. These findings also add further evidence as to the importance of the Dutch Enterprise Chamber's model of corporate litigation, which has significantly better outcomes in promoting shareholder wealth by relying on attorney reputation and non–pecuniary settlements.

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