Did Public Attention on Notorious Accounting Improprieties Affect Securities Litigation Outcomes?
Laura E. Simmons

In the Fall of 2001, Enron Corporation disclosed massive financial restatements and accounting issues that eventually would lead to the firm’s well-publicized demise. Subsequently, a number of other large firms also reported financial restatements, leading to much negative public attention on accounting and eventually to the passage of the Sarbanes-Oxley Act of 2002.

Professor Laura Simmons hypothesizes that in the immediate post-Enron environment, defendants in securities litigation matters experienced greater exposure for cases with observable characteristics similar to those of the Enron case, leading to higher settlement amounts for those cases. She finds that the presence of accounting irregularities for cases settled during the immediate post-Enron period were associated with higher settlement amounts, relative to cases settled in the pre-Enron period. Similarly, she also finds that large cases involving financial restatements that settled during the immediate post-Enron period were associated with higher settlements, relative to cases settled in the pre-Enron period. Thus, Simmons’ results suggest that in the period immediately following revelation of the Enron and other debacles, defendants in other large securities cases involving accounting issues likely paid more to settle their cases, not necessarily because of their own culpability.

Her findings are consistent with plaintiffs and defendants perceiving lawsuits with characteristics similar to Enron and other high profile debacles as having a greater expected value at trial as a result of the increase in public attention on accounting improprieties in large matters. Accordingly, her research contributes to the general literature on accounting contagion effects and more specifically, to the growing body of research on the wide-ranging effects of the large accounting debacles that began with Enron.

The results also suggest that future events capturing public attention may cause defendants in certain securities cases to pay higher amounts. For instance, the recent crises and public attention on financial institutions could cause members of that industry to pay more in securities cases than they otherwise would. From a practical standpoint, information regarding this effect is helpful to those involved in negotiating settlements.

For regulators and policy makers, the findings provide information relevant to the long-standing dispute over whether securities litigation outcomes are based on case merits, and thus contribute to the debate over securities litigation reform. Specifically, the finding that general public perceptions can affect settlement amounts for a particular case is an example of a non-merit based factor that plaintiffs can use to coerce larger settlements from defendants. However, Professor Simmons’ research does not find that the ‘merits don’t matter at all,’ as merit-based factors are also found to be significantly associated with settlement amounts. Instead, results are consistent with both merit and non merit-based factors being important determinants of settlement amounts.

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