Texas Law Review *See Also*

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Response

A Reply to "Mind the GAAP"

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In *Mind the GAAP: Moving Beyond the Accountant–Attorney Treaty*, author Jamie Yarbrough contends that investors are often left unprotected by current disclosure requirements for financially material litigation.[1] To cure that ill, the author proposes that issuers be required to disclose the settlement offers they make in all material litigation, reasoning, in part, that they are already voluntarily disclosing those assessments of the case to their opponent.[2] Unfortunately, the author applies a flawed method of evaluating the benefits of the proposed regulatory change, supports the argument for change by examples that contradict it, and fails to recognize the serious negative consequences of reporting settlement offers on both the settlement and judicial processes. A more focused application of current rules or the creation of a presumption of fraud in the event of underreporting is more likely to protect investors than the proposed change.

I. Do We Have A Problem?

Rather than proving that underreporting of major litigation events and resultant stock price changes are common, the author merely claims that the possibility of such losses "is hardly a fantasy."[3] To compel change, particularly one as potentially disruptive as the author proposes, more should

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1. Jamie L. Yarbrough, Note, *Mind the GAAP: Moving Beyond the Accountant–Attorney Treaty*, 92 TEXAS L. REV. 749, 749 (2014).

2. *Id.* at 760.

3. *Id.* at 749.

be required and the paucity of proof put forward by the author is surprising. A look at the numbers puts the matter in perspective. Public issuers whose equities are carried on national exchanges must issue both annual and quarterly reports of their operations and financial status.[4] Since the 1985 verdict in *Texaco v. Pennzoil*[5] roughly 5,000 public issuers made roughly 145,000 annual reports and nearly 600,000 quarterly reports.[6] Yet, the author supplies but two examples in which investors supposedly lost funds because of the failure of the public issuer to make proper litigation disclosures.[7] A claimed fraud occurring .00027% of the time hardly qualifies as an epidemic requiring corrective action.[8] The secondary authorities cited by the author merely refer only to losses due to all "surprise" events, not losses grounded solely in the underreporting of litigation risk.[9]

A closer look at the examples cited by the author also substantially undermines the case for regulatory change. *Texaco v. Pennzoil* is far more a testament to the intransigence of management and the unpredictability of litigation—at least Texas litigation circa 1987—than to intentional underreporting of litigation risks.[10] Any analysis of that event must start with an analysis of Texaco management, which has been roundly described as "an unusually closed and autocratic company, dogged in the oil patch by a reputation for imperiousness, parsimony and reactionary management."[11] If the entire affair proves anything, it is that management can systematically err

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4. Securities Exchange Act of 1934 § 13(a), 15 U.S.C. § 78m(a) (2012); 17 C.F.R. § 240.13a-1 (2013) (requiring annual reports); 17 C.F.R. § 240.13a-13 (2013) (requiring quarterly reports).

5. 729 S.W.2d 768 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

6. *See* Matt Krantz, *Investors Face a Shrinking Stock Supply*, USA TODAY, Mar. 17, 2013, http://www.usatoday.com/story/money/personalfinance/2013/03/17/public-companies-vanishing-fewer-stocks/1920681/, *archived at* http://perma.cc/T3DG-EBDA (charting the number of public companies in America from 2000 to 2012 as moving from 6,639 to 3,687).

7. Yarbrough, *supra* note 1, at 756–59.

8. The two examples cited by the author are divided by the sum of quarterly reporting events (580,000) and annual reporting events (145,000). Announcements under Rule 8k, though numerous, are excluded because they cannot be easily tracked. If included, the incidence of purported fraud would drop further.

9. *See* Yarbrough, *supra* note 1, at 756 n.54 (citing James. S. Johnson, Comment, *The Accountable Attorney: A Proposal to Revamp the ABA's 1976 Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information,* 14 TEX. WESLEYAN L. REV. 27, 30–32 (2007)). Johnson is referring to larger issues of nondisclosure including a "recent spate of public reporting scandals, including Enron, WorldCom, Global Crossing, Adelphia Communications and HealthSouth . . . ." Johnson, *supra*, at 30. Even Johnson does not advocate reporting of settlements, but instead the use of an "Independent Legal Counsel" to evaluate pending litigation. *Id.* at 28.

10. At least one author has concluded that even after the verdict the *Texaco v. Pennzoil* matter would have been extraordinarily difficult to settle. Stephen M. Bundy, *Commentary on "Understanding* Pennzoil v. Texaco*": Rational Bargaining and Agency Problems,* 75 VA. L. REV. 335, 336 (1989) ("*Pennzoil v. Texaco* would have been hard to settle even in the absence of information asymmetries or agency problems. The outcome on appeal was difficult to predict, the stakes were vast, and the expected costs of continued litigation, insofar as they can now be determined, were initially relatively moderate.").

11. STEVE COLL, THE TAKING OF GETTY OIL 337 (1987).

in its judgment and strategic choices in grand style.[12] Texaco did report that Pennzoil's claims were for $14 billion but other than saying it would vigorously defend the case, disclosed nothing about its probable outcome.[13] Pennzoil gave the case the exact same treatment.[14] What created the dramatic outcome in *Texaco v. Pennzoil* was in significant part Texaco management's errant belief that it was not reasonably probable that it would ever suffer a judgment within an order of magnitude (actually two orders of magnitude) of the ultimate $10.53 billion awarded by the jury in December of 1985.[15] Even after the judgment, Texaco management remained unconvinced, reporting to investors that it believed that "there is no legal basis for the judgment, which it believes is contrary to the weight of the evidence and applicable law."[16]

The settlement offers made in *Texaco v. Pennzoil* reflect these beliefs and illustrate why the reform proposed by the author would have affirmatively misled investors. The highest offer made by Texaco before rendition of the $10.53 billion verdict was to transfer three-sevenths of the Getty reserves to Pennzoil at its original offering price of $110 per share, a cost to it of around $238 million.[17] Even after the verdict, Texaco remained unconvinced by the appellate court decision affirming the judgment, reporting to investors that the decision "is essentially just an acceptance of the capricious lower court action . . . [and was] contrary to reason, contrary to fair play, and contrary to Constitutional and legal principles governing

12. *See id.*; Bundy, *supra* note 10, at 339–45 (describing the failures of judgment in Texaco's management); Tamar Lewin, *Pennzoil-Texaco Fight Raised Key Questions*, N.Y. TIMES, Dec. 19, 1987, at 44, *available at* http://www.nytimes.com/1987/12/19/business/pennzoil-texaco-fight-raised-key-questions.html?src=pm&pagewanted=1, *archived at* http://perma.cc/M9Z7-3SZP (reporting various criticisms of Texaco's management and trial strategies).

13. Edward B. Deakin, *Accounting for Contingencies*: *The Pennzoil Texaco Case*, 3 ACCT. HORIZONS 21, 22 (1989). Interestingly, Professor Deakin does not cite the Texaco/Pennzoil fray for justification of rule change. Rather, "[w]hile this was but one case in an environment characterized by frequent litigation, the way each party treated the events is of interest." *Id.* at 28. He clearly believed, however, that both Texaco's disclosure of liability and Pennzoil's disclosure of its newfound assets were slow. *See id.*

14. *Id.* at 22–23.

15. Bundy, *supra* note 10, at 339–45 (theorizing why Texaco's management miscalculated the likelihood it would suffer a catastrophic defeat even after the jury verdict); Lewin, *supra* note 12, at 44 (reporting that Texaco's management felt so confident it would prevail that it put on no real evidence contesting Pennzoil's damages estimate).

16. Deakin, *supra* note 13, at 23.

17. COLL, *supra* note 11, at 474. Pennzoil's "deal" was to acquire Getty for $110 per share or 3.4 billion dollars. Robert M. Lloyd, *Pennzoil v. Texas Twenty Years After: Lessons for Business Lawyers*, 6 TRANSACTIONS: TENN. J. OF BUS. L. 321, 340 (2005). Texaco's settlement proposal was evidently to sell Pennzoil three sevenths of Getty's reserves at the $110 per share price rather than Texaco's actual $128 per share closing price. This offer would imply a rough settlement value of $238 million dollars ($3.4 Billion gross Texaco purchase price x ($128 per share - $110 per share) x 3/7ths). THOMAS PETZINGER, JR., OIL AND HONOR 430–431 (1987); Lloyd, *supra* at 350 n. 181.

business activity."[18] Pennzoil itself did not record the judgment as "reasonably possible" until 1986, a year and a half after the verdict.[19] It was not until *after* Texaco filed bankruptcy on April 12, 1987 that they settled the matter for $3 billion dollars.[20] By that late date all common stockholders had already lost all value that they were to lose in the company due to the Pennzoil verdict.[21] But the lesson here is that even sophisticated management can become drunk on its own fumes in a challenging litigation environment, and reporting Texaco's approximate $238 million offer would not have caused investors to infer that Texaco was at risk of a $10.53 billion loss.

The author also cites Anadarko Petroleum Corporation's treatment of the Deepwater Horizon platform blowout in the Gulf of Mexico during 2010 as a case of underreporting of litigation risk in the modern regulatory environment.[22] Because Anadarko was a 25% owner in the project, the author reasons that Anadarko was subject to up to $5.5 billion in hard cost liability after BP established a $20 billion sinking fund and $2 billion settlement for associated costs.[23] Despite Anadarko's reported litigation risk of zero on June 30, 2011 and of $4 billion when it settled all claims with BP on October 17, 2011, the author believes that both underreporting and potential fraud were present.[24]

Anadarko's disclosures, and the public's appreciation of them, were far more extensive than the author suggests. Anadarko reported the Deepwater Horizon blowout immediately[25] and in the first quarterly report issued after the blowout, recited that material losses were probable, but could not be reasonably calculated.[26] It does not appear to have accrued reserves greater than the approximate $177.5 million in insurance proceeds against various pending governmental and private litigation risks.[27] Finally, it reported that

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18. Deakin, *supra* note 13, at 25.

19. *Id.* at 26.

20. *Id.*

21. *E.g.*, Michael A. Hiltzik, *Value of Texaco, Pennzoil Stock Falls $1.5 Billion*, L.A. TIMES, Apr. 14, 1987, 14, 19, *available at* http://articles.latimes.com/1987-04-14/news/mn-175_1_texaco-stock, *archived at* http://perma.cc/SL8H-ZASE.

22. *See* Yarbrough, *supra* note 1, at 757.

23. *Id.*

24. *Id.* at 758.

25. Anadarko Petroleum Corp., Current Report (Form 8-K), at 2 (June 18, 2010).

26. Anadarko Petroleum Corp., Quarterly Report (Form 10-Q), at 9–18, 65–66 (Aug. 2, 2010) (reporting the period ending on June 30, 2010). The underlying assumption that the loss could not be realistically estimated appears to be substantially correct, as British Petroleum itself is now discovering. It estimated and paid $20 billion into a settlement contingency fund, only to ultimately expend over $42 billion cleaning up the spill and financially responding to claims with no end in sight. Clifford Kraus & Stanley Reed, *Leaner BP Blanches at Bill for Cleanup*, N.Y. TIMES, July 12, 2013, http://www.nytimes.com/2013/07/12/business/energy-environment/bp-appealing-settlement-on-gulf-disaster-payments.html?_r=1&, *archived at* http://perma.cc/8N3V-5HTU.

27. Anadarko Petroleum Corporation, Annual Report (Form 10-K), at 104 (Feb. 23, 2011) (reporting the period ending on Dec. 31, 2010).

the blowout was preventable and BP's actions may have constituted gross negligence which might exempt it from a duty to contribute, that its percentage ownership of the project was 25%, and that it might accrue additional liability for the incident in the future.[28]

The market certainly appreciated the potential risk and various prognosticators were at work projecting the litigation risk and cost of the blowout.[29] The market reacted strongly to the blowout itself, understanding that Anadarko was at risk solely because of its participation in the project. Anadarko's stock price dropped from a high of $73.40 per share on April 19, 2010, the day before the blowout, to a low of $34.54 on June 9, 2010—a loss of more than $19 billion in market capitalization in fifty days.[30] Moreover, if underreporting occurred, one would expect that between the date of underreporting (June 30, 2011) and full reporting (October 17, 2011), Anadarko's stock would plummet with new negative revelations, but the contrary is true. On June 30, 2011 Anadarko's stock price stood at $76.76 and on October 18, 2011, the day after announcement of the BP settlement, its price was $78.91.[31] Neither week-to-week nor month-to-month stock price comparisons taken before and after the announcement reveal any appreciable change in stock price attributable to the $4 billion settlement.[32] In fact, revelation of the $4 billion settlement, coupled as it was with an indemnification by BP for further costs associated with the incident, was very positively received by the market.[33]

Finally, the author's theory that Anadarko consciously underreported its litigation liability has been put to the litigation test and found wanting. Shortly after the blowout, a complaint was filed against Anadarko alleging that it had underreported the risks associated with its liability to BP and falsely reported that "potential liability for the Macondo well would be

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28. *Id.* at 26.

29. *See* Michael Corkery, *BP Oil Spill Costs: $20 Billion? Try $63 Billion*, WALL ST. J. DEAL JOURNAL (June 16, 2010), http://blogs.wsj.com/deals/2010/06/16/bp-oil-spill-costs-20-billion-try-63-billion/, *archived at* http://perma.cc/TY29-9YNV (reporting the spill cost estimates produced almost immediately by J.P. Morgan Chase, Raymond James Financial, and Credit Suisse Group).

30. *Anadarko Petroleum Corporation Historical Prices: April 19, 2010 to June 9, 2010*, YAHOO! FINANCE, http://finance.yahoo.com/q/hp?s=APC&a=03&b=19&c=2010&d=05&e=9&f=2010g=d *archived at* http://perma.cc/3PQF-6UK4 (last updated June 9, 2010).

31. *Anadarko Petroleum Corporation Historical Prices: June 30, 2011 to October 18, 2011*, YAHOO! FINANCE, http://finance.yahoo.com/q/hp?s=APC&a=05&b=30&c=2011&d=09&e=18&f=2011&g=d, *archived at* http://perma.cc/CU3E-AA2X (last updated Oct. 18, 2011).

32. *Id.*

33. Edward Klump, *Anadarko Ends Standoff, Settles with BP on Gulf Spill Costs*, BLOOMBERG BUSINESSWEEK (Oct. 18, 2011), http://www.businessweek.com/news/2011-10-18/anadarko-ends-standoff-settles-with-bp-on-gulf-spill-costs.html#p1, *archived at* http://perma.cc/EDN9-DRV8 ("Several analysts have raised their ratings on Anadarko since the settlement was announced, including new 'outperform' recommendations from Oppenheimer & Co. and Raymond James and Associates, Inc. . . . Moody's [Investors Service] said the agreement was less than its loss assumption of as much as $8 billion").

relatively small, approximately $177.5 million, and fully covered by insurance – when their true exposure was in the billions of dollars."[34] Anadarko moved to dismiss the complaint under Federal Rule of Civil Procedure 12(b)(6) and obtained dismissal of all allegations that it consciously underreported litigation liability along with most other counts of the complaint.[35]

In short, neither *Anadarko* nor *Texaco* supports the author's call for reform. The paucity of examples of the conscious underreporting of litigation risks and a more complete analysis of those examples make it apparent that no widespread underreporting problem exists warranting a change in current disclosure requirements.

II. Will Reporting Settlement Offers Help?

Even if a systematic and widespread practice of underreporting litigation risks existed, it does not follow that a rule requiring the disclosure of settlement offers would promote investor knowledge of major litigation risks. This is true both because such a rule could easily be circumvented and because the risks presented by entity-threatening litigation are not easily assessable.

A rule requiring that settlement offers be disclosed to the public is easily circumvented by issuers who simply refuse to make or delay making settlement offers. The author counters this obvious side step by arguing that decision makers know and understand the benefit of early settlement.[36] While this general proposition is true, it fails to take into account the advanced costs associated with making an offer under the new rule. If the issuer admits to an opponent that the likely cost of litigation is a billion dollars, for instance, he cannot respond to his auditors other than by agreeing to reserve a billion dollars. This step represents a real impingement on management's prerogative and perhaps on cash flow or capital expenditures as well. Further, numerous secondary costs, both real and perceived, would arise from the making of an offer and having it publicized. Such offers may be perceived as an implicit admission by management that it has erred in some way that renders the company liable.[37] And, the potential disclosure to

34. First Amended Consolidated Class Action Complaint at 7, *In re* Anadarko Petroleum Corp. Class Action Litig., 957 F. Supp. 806 (S.D. Tex. July 20, 2012) (No. 4:12-CV-00900), *available at* http://securities.stanford.edu/filings-documents/1045/APC10_01/2012720_r01c_12CV00900.pdf, *archived at* http://perma.cc/TAF8-T5C9.

35. *In re* Anadarko Petroleum Corp. Class Action Litig., 957 F. Supp. 2d 806, 832, 836 (S.D. Tex. 2013).

36. Yarbrough, *supra* note 1, at 759–60, 769.

37. It is not at all difficult to schedule settlement negotiations at the end of litigation and close to the trial or arbitral event, which is likely to require disclosure in any event. Amongst other justifications, counsel to the issuer may legitimately claim that discovery needs to be completed and all pretrial motion practice concluded before an accurate picture of risk can be formed. Even the

the trial court may undermine possible defenses and encourage opponents who may not have fully appreciated the value of the claim they pursued.

Additionally, the author's response reflects an overly optimistic vision of managers that fails to grapple with the conditions faced by management in the real world. Managers often have enormous incentives to paint the rosiest picture possible in their SEC disclosures, whether those incentives come in the form of increased stock prices, a direct bonus, or simply not getting fired.[38] Under the author's proposal, such managers may easily conclude that the benefits of avoiding or delaying a settlement offer outweigh the costs. This shows how the author frames the key issue backwards: The problem is not how the proposed rule would fare with neutral or honest management, but how it would work when applied to management who intend to ignore current disclosure regulations. A strong incentive will exist for that management to delay or avoid making settlement offers.

Further, it is not difficult for management to avoid disclosure by couching settlement discussions in a manner that does not create a reportable offer. Compare the following inquiries by outside counsel for the issuer-defendant to counsel for the plaintiff:

> Ms. G.C.: "XCo offers your client $1 billion for a full and complete release, indemnity and the dismissal of all claims with prejudice."
>
> Versus:
>
> Ms. G.C. "What do you think your client would think about an offer of $1 billion to get rid of the case?"

The former is a reportable offer of settlement under the rule while the latter is not. Attorneys are creative and can find ways to communicate their intentions without resorting to actual offers until they are ready to conclude settlement discussions. In the example above, the second form of query might be answered by "not much, but they would think a lot better if the offer were $2 billion." In this manner, the parties may communicate without ever issuing an offer that triggers the disclosure requirement until they are ready to make it.

But by far, the more serious obstacle to settlement reporting is the nuanced manner in which large-scale litigation may threaten the profit-making ability or existence of major corporations. At least four major

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increasingly small number of courts that demand mediation of litigants are usually willing to defer to the litigants choice as to *when* mediation or structured settlement conferences shall occur.

38. *See* Eric R. Hake, *Financial Illusion: Accounting for Profits in an Enron World*, 39 J. ECON. ISSUES 595, 595–96 (2005) (discussing managerial incentives to manipulate capital assets via accounting conventions).

sources of company-ending litigation exist: (1) large scale damage claims;[39] (2) repeat litigation like mass tort litigation that collectively undermines the financial solvency of the issuer;[40] (3) litigation (such as patent litigation) in which negative outcomes impede the ability of the issuer to earn;[41] and (4) governmental investigations or proceedings that may bar practices by the issuer which are essential to its future.[42] It is much more difficult to craft and enforce a meaningful settlement disclosure rule in these distinct and complex cases. For instance, companies like Apple, Inc. may face at any one time several items of patent litigation that, if successful and coupled with an injunction, could force it to withdraw sale of its principal products, the iPhone and iPad.[43] However, investors would not be assisted by the disclosure that there are, at any given time, ten to twenty such actions pending because it is impossible for the average investor to grade the risk that any one such outcome might occur.[44] Settlement reporting by businesses facing the next round of mass tort litigation would also be particularly difficult. Do such companies report settlement of the first case or the

39. *See, e.g.*, Judith Camile Glasscock, Comment, *Emptying the Deep Pocket in Mass Tort Litigation*, 18 ST. MARY'S L.J. 977, 991–94 (1987) (noting the potential disastrous financial effect of punitive awards in mass tort cases).

40. Asbestos related litigation has caused numerous entities to file one or more bankruptcy proceedings eradicating all shareholder equity, even though the cost of any one claim might have been small compared to the net worth of the affected institution. By 2004 for instance, over $70 billion had been spent in defense costs and settlement of asbestos claims and the litigation had caused 73 bankruptcy filings. STEPHEN J. CARROLL ET AL., ASBESTOS LITIGATION, xxvii, 151–53 (2005).

41. *See, e.g.*, NTP, Inc. v. Research In Motion, Ltd., 397 F. Supp. 2d 785, 786 (E.D. Va. 2005) (asserting an intellectual property challenge to Blackberry cell phone software). The verdict and court's decision to enter an injunction against ongoing use and refusal to abate decision pending USPTO reexamination is credited with forcing a $612.5 million settlement. Rob Kelley, *BlackBerry Maker, NTP Ink $612 Million Settlement*, CNN MONEY (Mar. 3, 2006), http://money.cnn.com/ 2006/03/03/technology/rimm_ntp/, *archived at* http://perma.cc/C39B-7FKF; *see also* Kirk Teska, *The Story Behind the Blackberry Case*, IEEE SPECTRUM (Mar. 1, 2006), http://spectrum.ieee.org/ consumer-electronics/gadgets/the-story-behind-the-blackberry-case/0, *archived at* http://perma.cc/ W34V-MMUG ("Apart from the monetary damages, ultimately totaling $53.7 million, the biggest threat to RIM was an injunction, which could essentially shut down the Blackberry system.").

42. See, *e.g.*, United States v. Microsoft Corp., 253 F.3d 34, 46 (D.C. Cir. 2001) (upholding antitrust findings against Microsoft for practices largely responsible for its enormous profitability); Stan J. Liebowitz, *An Expensive Pig in a Poke: Estimating the Cost of the District Court's Proposed Breakup of Microsoft*, 9 GEO. MASON L. REV. 727, 731 (2001) (describing the profits potentially lost from the litigation).

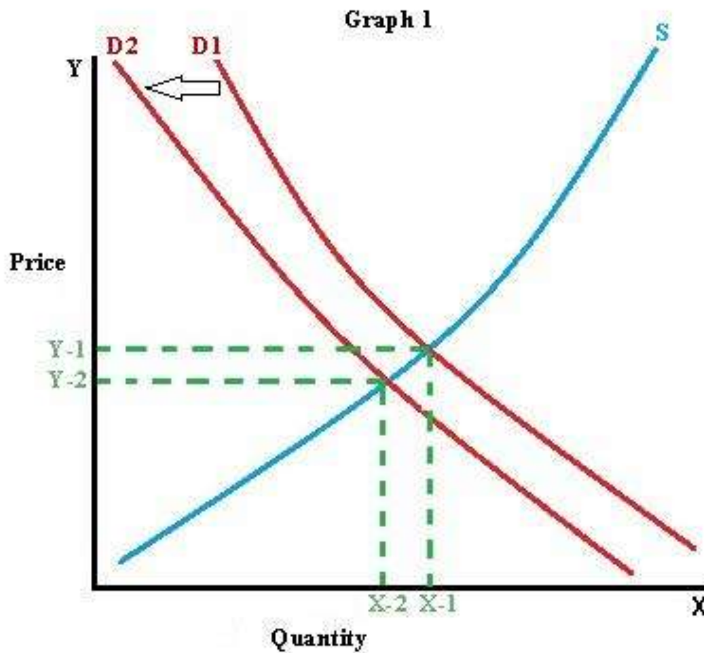
43. *See, e.g.*, Alison Frankel, *In Smartphone Wars, Apple Stalks the Elusive Injunction*, REUTERS (Jan. 18, 2013), http://blogs.reuters.com/alison-frankel/2013/01/18/in-smartphone-wars-apple-stalks-the-elusive-injunction/, *archived at* http://perma.cc/EVF3-RW75.

44. The ability to evaluate risk is further complicated by the possibility of multi-jurisdiction litigation. For example, another huge manufacturer of smartphones and tablets, HTC, recently suffered an injunction that completely banned it from selling its products in Germany. *See, e.g.,* Kris Carlon, *Complete HTC Sales Ban in Germany: Nokia Wins Another Patent Case*, ANDROIDPIT (Dec. 31, 2013), http://www.androidpit.com/complete-htc-sales-ban-in-germany, *archived at* http://perma. cc/5RW9-P2GP.

thousandth? Materiality in such instances is a difficult collective calculation.[45] Given how widely these types of cases differ and their varying nature, the one-size-fits-all rule proposed by the author, even if faithfully followed, would only marginally assist investors.

III. What Effect Would Disclosure Have?

The forced reporting of settlement offers would have a number of serious negative repercussions. Primarily, it would deter the making of such offers and potentially corrupt the judicial system or the jury deliberation process.



The author believes that because early case resolution is amongst the most sought-after objectives of our justice system that demand for it by management will remain unchanged regardless of the costs associated with making offers.[46] But the most basic economic analysis of supply and demand negates this notion. Ordinarily the laws of supply and demand are applied to the acquisition of goods but certainly also apply to the purchase of intangible property or transactional outcomes.[47] As graph one above reflects, the utility that an item brings to the buyer is reflected in a demand curve under which demand for the item drops as its price increases. (*D-1*).

45. *See, e.g.*, Matthew J. Barrett, *Opportunities for Obtaining and Using Litigation Reserves and Disclosures*, 63 OHIO ST. L.J. 1017, 1033–40 (2002) (focusing on materiality as a critical factor in determining the proper disclosure treatment of a loss contingency).

46. Yarbrough, *supra* note 1, at 759–60, 769.

47. *See generally* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 2.1 (9th ed. 2014).

Conversely, as prices increase so does supply, with buyer and sellers meeting at a price and quantity amenable to both. (*X-1, Y-1*) But what happens when the utility of the item to be purchased suddenly changes—for example, if the effective price of an automobile is increased by doubling or tripling the federal fuel tax? Demand is reduced across price offerings (*D-2*) and classic economic theory would suggest that both the price and quantity of the property sold will drop in such a situation. (*Y2, X2*) When the management of publicly traded companies consider whether to try to "buy peace" under the author's proposed standard, they face not only the ordinary costs of such settlements, but the additional costs such as management criticism, public revelation of potential blame, potential for exposure to court or jury that is imposed by the regulation. The author's presupposition appears to be that the demand for settlements by issuer's management is so inelastic that managers will always prefer to aggressively attempt to settle in any cost environment, but no support is offered for that notion.

But by far the more serious potential implication of reporting settlement offers is that they may be misperceived or misused in the very litigation in which they are made. A strong public policy favors the confidentiality of settlement negotiations precisely to encourage them.[48] A published offer may be easily used by an opponent by exposing it to the very court in which the action is pending. Though clearly inadmissible for virtually all purposes,[49] inventive counsel may press the offer before the tribunal under the theory that it is relevant for some issue other than liability.[50] Further, as the author points out, before settlement negotiations commence, each party operates in a vacuum and the first offer of a party heavily influences the outcome of the negotiation.[51] But when settlement offers must be disclosed, it is the judge whose blank slate is rewritten by the offer, regardless how strongly she may consciously wish to avoid that outcome. If the matter is not resolved and a jury is assembled to hear the case, recent history is replete with episodes of jury curiosity—and misconduct—through the use of

48. The public policy in favor of confidential negotiations is so overwhelming that, in Texas for example, the legislature emphasizes their confidentiality seemingly every time it has the opportunity to do so. *E.g.*, TEX. R. CIV. P. 192.3(g)("Information concerning a settlement agreement is not by reason of disclosure admissible in evidence at trial."); TEX. R. CIV. P. 167.6 ("Evidence relating to [a settlement] offer made under this rule is not admissible except for purposes of enforcing a settlement agreement or obtaining litigation costs. The provisions of this rule may not be made known to the jury by any means."); TEX. CIV. PRAC. & REM. CODE ANN. § 154.073 (making all settlement negotiations in connections with alternative dispute resolution proceedings completely confidential).

49. FED. R. EVID. 408.

50. *Id.* (stating that the rule does not require exclusion when the evidence is offered for another purpose such as proving bias or prejudice of a witness or a party, negating a contention of undue delay or proving an effort to obstruct a criminal investigation or prosecution).

51. *See* Yarbrough, *supra* note 1, at 762 (stating that a settlement value suggested between Andarko and BP would reflect the "value of the settlement actually reached").

internet-based research.[52] In *Texaco v. Pennzoil*-sized disputes, the revelation of the now public offers would be just a few utterly uncontrollable clicks away from the jury considering liability and damages.

IV. Alternative Solutions

If a case could be made for change, the public would be far better served by a more focused application of the current rule or by a rule presumptively invoking penalties in the event of truly surprising litigation settlements or outcomes.

The means exist to identify company-threatening litigation as it is often identified in the business press and firms following public issuers.[53] The securities plaintiff bar monitors major day-to-day stock price movements and class actions are frequently initiated when they are accompanied by class litigation.[54] Finally, the office of judicial administration regularly tracks the types and size of damage claims made, a practice that would enable the SEC to statistically analyze that data and narrow the field of potentially material litigation.[55] It is therefore possible for the SEC to develop a small division

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52. For just a few examples, see, United States v. Lawson, 677 F.3d 629, 639 (4th Cir. 2012) ("Juror 1 stated that another juror, Juror 177, had consulted certain internet sources the morning before the jury reached its verdict. As later found by the district court, this information included the definition of the term 'sponsor' that appeared on Wikipedia."); United States v. Bristol-Mártir, 570 F.3d 29, 36 (1st Cir. 2009) ("[T]he court received another note from the jury foreman which read: 'Your Honor, one of the jurors searched the internet yesterday for federal laws and terms definitions. . . .'"); United States v. Warner, 498 F.3d 666, 711 (7th Cir. 2007) (Kanne, J., dissenting) ("A number of jurors urged Juror Peterson to search the internet and bring back to the jury information on jury deliberation."); Editorial Caballero, S.A. de C.V. v. Playboy Enterprises, Inc., 359 S.W.3d 318, 325 (Tex. App.—Corpus Christi 2012, pet. denied) ("Another juror admitted that he read on the internet the appellate decision concerning the first trial of this case . . ."). *See generally* Amanda McGee, Comment, *Juror Misconduct in the Twenty-First Century: The Prevalence of the Internet and Its Effect on American Courtrooms*, 30 LOY. L.A. ENT. L. REV. 301 (2010) (describing the litany of ways that jurors use the internet during trials, even to discover evidence suppressed by the court).

53. *See, e.g.*, Julie Bort, *A Legal Showdown With Oracle Threatens a Software Company That Just Filed a $60 Million IPO*, BUSINESS INSIDER (Feb. 18, 2014), http://www.businessinsider.com/oracle-suit-threatens-riminis-60m-ipo-2014-2, *archived at* http://perma.cc/Y276-BRG8; Joseph Galante, *EBay's Fight With Skype Founders May Threaten IPO (Update 2)*, BLOOMBERG NEWS (June 26, 2009), http://www.bloomberg.com/ apps/news?pid=newsarchive&sid=ark5.p.p7yxA, *archived at* http://perma.cc/9373-34EY.

54. *See, e.g.*, Andrew Trask, *Securities Plaintiffs' Firms: Florida SBA Beauty Contest Shows Lots of Leg*, CLASS ACTION COUNTERMEASURES (Jan. 14, 2010), http://www.classactioncountermeasures.com/2010/01/articles/lawyers/securities-plaintiffs-firms-florida-sba-beauty-contest-shows-lots-of-leg/, *archived at* http://perma.cc/G3EG-BMX3 (summarizing the practices of plaintiffs securities lawyers in the securities class action context).

55. Several organizations accumulate statistics, enabling systematic analysis of reference to the statistical accumulators of the federal courts system permitting statistical analysis of outcomes. *See* Bureau of Justice Statistics, *Courts*, http://www.bjs.gov/index.cfm?ty=tp&tid=2, *archived at* http://perma.cc/V6SW-3HBL (last updated Sept. 20, 2014); Public Access to Court Electronic Records, *Federal Court Case Statistics*, http://www.pacer.gov/announcements/general/case_stats.html, *archived at* http://perma.cc/D9AU-34MF; U.S. Dep't of Justice, *Annual Statistical*

focused solely upon material litigation. Current enforcement actions most commonly arise from the clear overreporting of revenues, underreporting of costs or other clearly measurable metrics of financial status.[56] Litigation enforcement is inherently more difficult because it requires regulators to project themselves into the minds of management facing major litigation. The relatively small number of "bet-the-company" cases should make the job more manageable. Current regulations relating to materiality are certainly broad enough to enable the SEC to subpoena documents relating to the case, including internal assessments of risk, reserve undertakings, and offers of settlement long before final litigation outcomes occur.

Alternatively the SEC might choose to adopt a rule such that, if the final settlement or litigation outcome in material litigation is substantially more adverse than previously reported by the issuer, a rebuttable presumption is created for regulatory and civil liability purposes that management intended to conceal litigation exposure and defraud investors. The difficulty in constructing such a rule is how to fairly set the trigger: Must the final outcome be twice or ten times the estimated outcome before fraud can be inferred? Rationally, the trigger should be generous enough to permit management substantial latitude in its litigation affairs and take into account the inherent difficulty of accurately estimating litigation outcomes, but be tight enough to deter intentional concealment. To this end, a study by the SEC's economics division of the market reaction to litigation revelations over the preceding ten years might create a reliable metric of unusual market reactions to final litigation outcomes. Such a rule might also be accompanied by a shift in the burden of proof of the kind found in fiduciary litigation in favor of civil litigants.[57] This proposed standard would not hinder management's decision making power but would strongly encourage management to make accurate and early assessments of exposure and then to aggressively pursue resolution in line with that assessment.

For now, investors should rest easy knowing that the risk of misleading litigation disclosures remains minimal and that the rules of the road by reporting entities are clear. Most issuers live in a relative "fish bowl" in which their every action and exposure is covered by investment advisors and several media outlets. Only a vanishingly small amount of evidence supports the need to depart from the current system. *Texaco* and *Anadarko* are isolated incidents that, if anything, demonstrate the success of the current

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Reports, http://www.justice.gov/usao/resources/reports/, *archived at* http://perma.cc/5KHW-TV4H; United States Courts, *Statistical Tables for the Federal Judiciary*, http://www.uscourts.gov/Statistics/StatisticalTablesForTheFederalJudiciary.aspx, *archived at* http://perma.cc/N2A-HVTY.

56. *See* Sec. & Exch. Comm'n, YEAR-BY-YEAR SEC ENFORCEMENT STATISTICS, https://www.sec.gov/news/newsroom/images/enfstats.pdf, *archived at* http://perma.cc/Z286-9PFT; Katherine S. Pell, Comment, *The New Enforcement Paradigm for Big Four Accounting Firms*, 78 TEMP. L. REV. 775, 777–82 (2005) (discussing the most common enforcement actions in greater depth).

57. *See, e.g.*, Bruce T. Rosenbaum, Note, *The Presumptions and Burdens of the Duty of Loyalty Regarding Target Company Defensive Tactics*, 48 OHIO ST. L.J. 273, 284 (1987).

regime rather than the promise of the proposed rule. Such trivial evidence does not warrant drastic change—and certainly not the kind that threatens to upset the delicate balances favoring settlement of major litigation.