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Does Voluntary Disclosure Reduce Or Increase Litigation Risk?

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When disclosure is not mandated, companies must confront the question whether to disclose or not disclose. Some may hold that issuers minimize the risk of securities litigation by making early and voluntary disclosures. By doing so, they cabin a potential class period and start the clock on a statute of limitations defense. Others may say that the physics of voluntary disclosure is iatrogenic as it exposes the company to lawsuits based on alleged misstatements in the disclosure itself. How do companies react to changes in litigation risk? If litigation risks decline, do they disclose more or less? A recent study provides an answer.

In *Litigation Risk and Voluntary Disclosure: Evidence from Legal Changes* (forthcoming in *The Accounting Review*)

Professor [Joel F. Houston](#) (with Chen Lin, Sibio Liu, and Lai Wei)

found "firms tend to make fewer (more) management

earnings forecasts relative to the control firms when they expect litigation risk to be lower (higher) following the legal event". Interestingly, the authors focused in part on changes in behavior by Nevada corporations after Nevada amended its exculpatory statute in 2001. Oddly, they assert "Relative to managers in the other states, Nevada executives are now protected by higher pleading standards on all types of securities actions following this amendment." A state law change, however could not, and did not, change the pleading standards for securities fraud suits based on federal law. The Nevada amendment ([Chapter 601, SB 577](#)), moreover, expressly excluded civil liability under Nevada's securities act (NRS 90.660).

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