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## False Forward-Looking Statements and the PSLRA's Safe Harbor

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# False Forward-Looking Statements and the PSLRA’s Safe Harbor

ANN MORALES OLAZÁBAL \*

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*Voluntary public disclosure of soft information—corporate projections and predictions and other forward-looking statements—is now the norm, following a brief learning curve after the enactment of the Private Securities Litigation Reform Act’s safe harbor for forward-looking information in 1995. As a consequence, allegations of false forward-looking statements are also quite standard in today’s class action securities fraud pleading. This work addresses an emerging trend, spearheaded by the Seventh Circuit’s decision in Asher v. Baxter International, to introduce a subjective scienter or intent-like inquiry into consideration of the application of the PSLRA’s safe harbor. Numerous district courts have followed Asher’s lead, employing a variety of semantic maneuvers to circumvent the safe*

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*harbor's straightforward, occasionally distasteful application. Bolstered by a 2009 opinion from the Fifth Circuit, this important minority view has created a circuit court split. This Article provides a definitive analysis of the Asher-inspired jurisprudential detour, concluding that it is supported neither by the statute and its legislative history, nor any sound policy argument. With this premise established, the Article then prescribes intellectually grounded ameliorative measures that can be taken by courts, which face increasingly imaginative and often appealing arguments for avoiding the prophylactic nature of the statutory safe harbor.*

#### INTRODUCTION

When can a forward-looking statement be false, and so, perhaps, fraudulent? An issuer's predictions and projections regarding future corporate conduct or performance are, by definition, *forward* looking. Yet despite the 1995 enactment of the Private Securities Litigation Reform Act's safe harbor for such forward-looking statements, plaintiffs in securities fraud class actions today routinely allege that issuers have made deliberately false projections and predictions. Setting aside what might be an interesting philosophical paradox about the potential for falsity of future events as described in the present, this Article explores that question from a legal standpoint.

Early commentary on the PSLRA's safe harbor for forward-looking statements was quick to point out that the statute may have created a "license to defraud."<sup>1</sup> Because it expressly excludes consideration of an issuer's state of mind when making forward-looking statements, the statute does appear to create an opening for

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1. *E.g.*, William H. Kuehnle, *On Scierter, Knowledge, and Recklessness Under the Federal Securities Laws*, 34 HOUS. L. REV. 121, 132 (1997) ("[I]f cautionary language is used, there is no liability even if the forward-looking statement is made with actual knowledge of its falsity. This remarkable provision appears to be the only provision of the federal securities laws that actually permits making false statements knowingly to investors."); Joel Seligman, *The Private Securities Reform Act of 1995*, 38 ARIZ. L. REV. 717, 732 (1996) ("[The safe harbor provision] appears to go far, for the first time in the history of federal securities laws, to immunize certain *deliberately* false statements." (emphasis in original)); Steven J. Spencer, Note, *Has Congress Learned Its Lesson? A Plain Meaning Analysis of the Private Securities Litigation Reform Act of 1995*, 71 ST. JOHN'S L. REV. 99, 122 (1997) ("[A]ny statement accompanied by statutorily sufficient cautionary language might be a blatant lie, and yet remain protected by the safe harbor."); *see also* Nancy J. Kim, *Proposal a 'License to Lie'? Foes Blast Reform of Securities Law*, RECORD (Bergen Cnty., N.J.), Nov. 12, 1995, at B1; *cf.* John C. Coffee, Jr., *The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Yet Sung*, 51 BUS. LAW. 975, 989 (1996) (calling "unseemly" any interpretation of the safe harbor that purports to immunize a "bald, knowing lie" or deliberately false projection, despite what he acknowledges is an inevitable reading of the plain text of the statute); Donald C. Langevoort, *Disclosures that "Bespeak Caution,"* 49 BUS. LAW. 481, 488 (1994) (noting that what he calls "strong" uses of the "bespeaks caution" doctrine—the common law doctrine from which the statutory safe harbor springs—apparently insulates from liability "even deliberate misrepresentation"). Much of this commentary echoed the polemical rhetoric in Congress before the passage of the PSLRA. *See infra* notes 77–79.

deceitful predictions and projections.<sup>2</sup> Deemed in turn “unseemly,”<sup>3</sup> “remarkable,”<sup>4</sup> and unique “in the history of the federal securities laws,”<sup>5</sup> the safe harbor’s lack of a scienter requirement has been the subject of quite a bit of speculation and derision.<sup>6</sup> Critics feared that if courts applied the plain language of the safe harbor literally, the new statute would immunize intentional schemes to defraud as long as they were properly couched as projections. But since the initial commotion over this state of affairs dissipated, not much has been written about it.<sup>7</sup>

Instead the safe harbor has simply become an integral component of issuer disclosure.<sup>8</sup> Now, a decade and a half since the enactment of the PSLRA, so-called safe harbor “warnings” are a standard feature of issuers’ periodic reports and other

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2. The statutory safe harbor protects forward-looking statements that are “identified as [such]” and “accompanied by meaningful cautionary statements.” 15 U.S.C. §§ 78u-5(c)(1)(B)(i), 77z-2(c)(1)(B)(i) (2006). The relevant portion of the statute is quoted in Part I below.

3. Coffee, *supra* note 1, at 989.

4. Kuehnle, *supra* note 1, at 132.

5. Seligman, *supra* note 1, at 732.

6. *See supra* note 1.

7. One early article approaches the safe harbor from the standpoint of implying a duty of good faith. *See* Jennifer O’Hare, *Good Faith and the Bespeaks Caution Doctrine: It’s Not Just a State of Mind*, 58 U. PITT. L. REV. 619 (1997) (concluding that good faith should not be a consideration in connection with either the statutory safe harbor or the bespeaks caution doctrine on which it is based). More recently, a pair of student comments has addressed some of the matters studied here. *See* Veronica H. Montagna, Note, *The First Prong of the Safe Harbor Provision of the Private Securities Litigation Reform Act: Can It Still Provide Shelter from the Storm in the Wake of Asher v. Baxter International Inc.?*, 58 RUTGERS L. REV. 511 (2006) (calling for a new SEC rule); Alfred Wang, Comment, *The Problem of Meaningful Language: Safe Harbor Protection in Securities Class Action Suits After Asher v. Baxter*, 100 NW. U. L. REV. 1907 (2006) (concluding that the legislative history of the PSLRA does not support the Seventh Circuit’s position on false forward-looking statements); *see also* Hugh C. Beck, *The Substantive Limits of Liability for Inaccurate Predictions*, 44 AM. BUS. L.J. 161, 165 (2007) (arguing that a “falsity-driven” analysis of the safe harbor’s “meaningful cautionary language” requirement, one grounded in the Supreme Court’s pre-PSLRA *Virginia Bankshares* decision, is superior to traditional materiality analysis, which he posits incentivizes issuers to deluge investors with immaterial information and encourages managers to mask fraudulent statements with significant but incomplete risk disclosures). This Article disagrees with Mr. Beck’s analysis, which does not squarely address the case law treated here. Professor Horwich’s work, which was published after this Article was written, addresses some of the case law discussed here, arriving at a similar conclusion. *See* Allan Horwich, *Cleaning the Murky Safe Harbor for Forward-Looking Statements: An Inquiry into Whether Actual Knowledge of Falsity Precludes the Meaningful Cautionary Statement Defense*, 35 J. CORP. L. 519 (2010) (disagreeing with the position taken by the SEC in its amicus brief for *Slayton v. Am. Express Co.*, 604 F.3d 758, 766 (2d Cir. 2010), that “a false historical statement that is implied by the cautionary statements is not protected by the safe harbor”).

8. Karen K. Nelson & A.C. Pritchard, *Litigation Risk and Voluntary Disclosure: The Use of Meaningful Cautionary Language 3* (2nd Annual Conference on Empirical Legal Studies Paper) (Aug. 2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=998590](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=998590).

communications in which they disseminate such soft information as earnings estimates and earnings per share, growth in demand for their products, cash flow, and the like.<sup>9</sup> These safe harbor legends typically both identify such soft information as forward looking—as required by the statute—and provide for the investor’s consideration a list of risk factors that may cause a variation in the results.<sup>10</sup> As an unsurprising consequence, the applicability of the safe harbor is an

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9. A study conducted by the New York City Bar Association two years after the PSLRA’s enactment concluded that cautionary language had become routine in issuers’ periodic reports. Comm. on Sec. Reg., *A Study of Current Practices: Forward-Looking Statements and Cautionary Language After the 1995 Private Securities Litigation Reform Act*, 53 REC. ASS’N B. CITY N.Y. 723 (1998); see Marc H. Folladori, *Protecting Forward-Looking Statements: The Private Securities Litigation Reform Act of 1995 and Other Safeguards*, in PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 601, 616–17 (Practising Law Institute 2005) (discussing the New York City Bar Association study); see also Eric Talley, *Disclosure Norms*, 149 U. PA. L. REV. 1955, 1978–79 (2001) (discussing the “fairly common practice” of issuing safe harbor warnings, and quoting a typical press release).

Notably, there is and has been somewhat vigorous debate over whether the statute increased the flow of useful predictive information from issuers. *E.g.*, Stephen J. Choi, *Company Registration: Toward a Status-Based Antifraud Regime*, 64 U. CHI. L. REV. 567, 574–76 (1997) (foreseeing that frivolous suits will continue to prove costly and that additional reform will likely be necessary post-PSLRA); Harvey L. Pitt, Karl A. Groskaufmanis, David B. Hardison & Dixie L. Johnson, *Promises Made, Promises Kept: The Practical Implications of the Private Securities Litigation Reform Act of 1995*, 33 SAN DIEGO L. REV. 845, 856 (1996) (predicting that despite clear legislative directive to bar discovery pending dismissal motion based on safe harbor, “courts will be reluctant to dismiss, without some inquiry, claims that companies and their executives lied to their investors”); Richard A. Rosen, *The Statutory Safe Harbor for Forward-Looking Statements After Two and a Half Years: Has It Changed the Law? Has It Achieved What Congress Intended?*, 76 WASH. U. L.Q. 645, 645 (1998) (asserting that in its first two years, the safe harbor provision had “wholly failed” to foster more forward-looking disclosure); Marc I. Steinberg, *Securities Law After the Private Securities Litigation Reform Act—Unfinished Business*, 50 SMU L. REV. 9, 19–20 (1996) (forecasting “greater flow of ‘soft’ information to the financial markets” as a result of the statute); see also Beck, *supra* note 7; Marilyn F. Johnson, Ron Kasznik & Karen K. Nelson, *The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms*, 39 J. ACCT. RES. 297, 323 (2001); Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 928.

10. See, *e.g.*, *Baron v. Smith*, 380 F.3d 49, 53 (1st Cir. 2004) (quoting text of a safe harbor warning set forth at the end of the issuer’s press release); *In re PEC Solutions, Inc. Sec. Litig.*, 418 F.3d 379, 384 (4th Cir. 2005) (quoting text of a safe harbor warning issued at the beginning of a conference call); *Employers Teamsters Local Nos. 175 and 505 Pension Trust Fund v. Clorox Co.*, 353 F.3d 1125, 1132 (9th Cir. 2004) (same); *cf.* Robert A. Prentice, Vernon J. Richardson & Susan Scholz, *Corporate Web Site Disclosure and Rule 10b-5: An Empirical Evaluation*, 36 AM. BUS. L.J. 531 (1999) (describing use of corporate web sites to disseminate forward-looking information, which typically has been published elsewhere first). For examples of safe harbor legends in corporate disclosures, see MCDONALDS CORP., RISK FACTORS AND CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS, [http://www.aboutmcdonalds.com/etc/medialib/aboutMcDonalds/investor\\_relations.Par.70378.File.dat/2Q%202009%20Risk%20Factors%20and%20Cautionary%20Statement%20Regarding%20Forward.pdf](http://www.aboutmcdonalds.com/etc/medialib/aboutMcDonalds/investor_relations.Par.70378.File.dat/2Q%202009%20Risk%20Factors%20and%20Cautionary%20Statement%20Regarding%20Forward.pdf); LIBERTY MUTUAL GRP., CAUTIONARY

issue in most class action securities fraud suits.<sup>11</sup> Complaints allege reckless and intentional misrepresentations of both existing facts and forecasts; issuers defend by seeking to dismiss the case, in whole or in part, based on the safe harbor.<sup>12</sup>

Thus, at this point there is ample fodder for critical assessment of the concept of deceitful forward-looking statements, and for some prescriptive thoughts thereupon. The study proceeds as follows. As a backdrop, Part I briefly reviews the text of the statutory safe harbor and describes the seminal circuit court cases, which aptly and without reference to contemporaneous scienter apply the statute to allegedly deceitful forward-looking statements in corporate disclosures. Part II then introduces and examines a line of noteworthy judicial opinions that deviate from this standard, injecting a state-of-mind requirement into the safe harbor either directly or indirectly. Parts III and IV assess this unique and growing decisional subset in light of the legislative history of the statutory safe harbor on the one hand, and pertinent policy considerations on the other. This analysis supports the thesis that the judicial opinions that have incorporated a scienter or scienter-like analysis into their safe harbor determinations were incorrectly decided.

Part V then offers several remedies for this errant jurisprudence. First, to overcome their natural instinct to consider scienter, courts must drill deeper into the plaintiffs' allegations and parse purported forward-looking statements. Second, to immunize only those who comply with both the literal and the intended meaning of the safe harbor, courts must exercise extreme caution when dealing with mixed statements and mixed lists of risk factors. Finally, Part V advocates use of the judicial heuristic expressly sanctioned by the PSLRA—an objective, neutral assessment of the effect on a “reasonable investor” that a projection and its cautionary language together would have.

#### I. THE HISTORY AND LURE OF PROTECTION FOR FORWARD-LOOKING STATEMENTS

Forward-looking statements are the subset of predictive information provided by issuers to the capital markets. Such “soft” information includes earnings estimates and projected earnings per share, proposed capital expenditures, expected growth in demand for products, and likely future cash flow.<sup>13</sup> Commentators have described

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NOTICE REGARDING FORWARD-LOOKING INFORMATION, [http://www.libertymutualgroup.com/omapps/ContentServer?c=cms\\_document&pagename=LMGInvestorRelations%2Fcms\\_document%2FShowDoc&cid=1138357074055](http://www.libertymutualgroup.com/omapps/ContentServer?c=cms_document&pagename=LMGInvestorRelations%2Fcms_document%2FShowDoc&cid=1138357074055).

11. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION CASE FILINGS 2008: A YEAR IN REVIEW 21 (2009), [http://securities.stanford.edu/clearinghouse\\_research/2008\\_YIR/20090106\\_YIR08\\_Full\\_Report.pdf](http://securities.stanford.edu/clearinghouse_research/2008_YIR/20090106_YIR08_Full_Report.pdf) (reporting that in 2008, 70% of class action securities fraud suits included allegations of false forward-looking statements, compared to 63% in 2007, and 72% in 2006).

12. See Joseph De Simone, Matthew D. Ingber & Evan A. Creutz, Practitioner Note, *Asher to Asher and Dust to Dust: The Demise of the PSLRA Safe Harbor?*, 1 N.Y.U. J.L. & BUS. 799, 810 (2005) (describing the assertion of a safe harbor defense as routine and “reflexive”).

13. The statute identifies a forward-looking statement as any of the following:

- (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
- (B) a statement of the plans and objectives of management for future

this internally prepared guidance as some of the most useful and important information flowing out of a publicly traded company.<sup>14</sup> Of course, management makes such disclosures at its own risk: the company's failure to achieve a predicted target may increase investors' predisposition to sue for securities fraud.<sup>15</sup> While the appeal of forward-looking statements to investors has long been recognized, some commentators have argued that the risk of their speculative nature is outweighed by the benefit of additional disclosure.<sup>16</sup>

The following subparts briefly review the history of the PSLRA's safe harbor and examine its precise text. These provide the backdrop against which expected errors in its application can then be assessed.

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operations, including plans or objectives relating to the products or services of the issuer;

(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

15 U.S.C. § 78u-5(i)(1) (2006); *see also* Dale Arthur Oesterle, *The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Corporations: "Are We There Yet?"*, 20 CARDOZO L. REV. 135, 149 (1998) (discussing the statute's definition of "forward-looking statement").

14. For example, as a pair of authors advocating more disclosure of soft information notes:

Congress, the Commission, and the courts all agree management's best expectation for the future also may be a very useful basis for predicting the future. Indeed, in many instances, management's expectations for the future may provide a better source than historic data for predicting the future. Accordingly, the policy of encouraging companies to volunteer more reliable forward-looking information, even when disclosure of that information is not otherwise required, is a sound one.

Carl W. Schneider & Jay A. Dubow, *Forward-Looking Information—Navigating in the Safe Harbor*, 51 BUS. LAW. 1071, 1085 (1996).

15. *See id.* at 1095.

16. *See, e.g.*, Safe Harbor for Forward-Looking Statements, 59 Fed. Reg. 52,723 (Oct. 19, 1994), *available at* 1994 WL 562021 (detailing the history of the Securities and Exchange Commission's position regarding disclosure of forward-looking statements, which has ranged from prohibiting disclosure of projections because they pose a real danger of misleading, to actually encouraging their disclosure at different points in history); *see also* Union Pac. R.R. v. Chi. & N.W. Ry., 226 F. Supp. 400, 408–09 (N.D. Ill. 1964) (noting in the context of a proxy fraud action that "predictions, estimates, and opinions are more elusive [than statements of historical fact] and may present graver dangers of misleading the investing public"); Harry Heller, *Disclosure Requirements Under Federal Securities Regulation*, 16 BUS. LAW. 300, 307 (1961) ("[A]ttempts by companies to predict future earnings . . . have almost invariably been held by the Commission to be misleading because they suggest to the investor a competence and authority which in fact does not exist.").

*A. Protection for Issuers Making Forward-Looking Statements*

Since 1979, well before the 1995 enactment of the PSLRA, a narrow regulatory safe harbor has been in effect for some forward-looking statements.<sup>17</sup> Given that safe harbor's limited relevance to predictive statements made in reports filed with the SEC, however, few courts have applied it.<sup>18</sup> Instead, until the passage of the PSLRA, defendants in securities fraud suits involving allegedly false forward-looking statements usually sought the shelter of the broader common law "bespeaks caution" doctrine.<sup>19</sup> This judicially developed principle provides a legal vehicle for courts to dismiss securities fraud claims based on a finding that, as a matter of law, the defendant issuer's forward-looking statements include enough cautionary language or discussion of attendant risks that the defendant cannot be held liable.<sup>20</sup> As one court aptly noted, the bespeaks caution doctrine amounts to not much more than the general judicial proposition that an issuer's disclosures should be read "in context."<sup>21</sup> Nonetheless, its protections can be potent for issuer-defendants who speak frankly to the market about their plans and expectations for the future.

In 1995, the PSLRA codified the bespeaks caution doctrine, at least in part, in a safe harbor consisting of three substantive components. The pertinent text of the safe harbor is parsed in the next subpart.

*B. The Text of Prong One*

As a starting point, let us re-read the relevant statutory language and establish an operating lexicon that takes into account the complexity of the provision's structure. The safe harbor reads as follows:

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17. 17 C.F.R. § 240.3b-6 (2010). An identical safe harbor is available for projections made in offering documents, by way of Rule 175 promulgated under the Securities Act. 17 C.F.R. § 230.175 (2010). These regulations were striking when promulgated, in that they reversed the SEC's longstanding prohibition on disclosure of forward-looking information. See Disclosure of Projections of Future Economic Performance, Securities Act Release No. 5362, [1972-73 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,211, at 82,667 (Feb. 2, 1973). For a discussion of the SEC's vacillation on this policy encouraging disclosure of forward-looking information, see Bruce A. Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 MD. L. REV. 1114 (1987); John M. Olivieri, Note, *Liability for Forward-Looking Statements: The Securities and Exchange Commission's Ambiguous Stance*, 1993 COLUM. BUS. L. REV. 221 (discussing the history of change in SEC's practice).

18. See, e.g., *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309 (8th Cir. 1997); *Arazie v. Mullane*, 2 F.3d 1456 (7th Cir. 1993); *Fugman v. Arogenex, Inc.*, 961 F. Supp. 1190 (N.D. Ill. 1997).

19. See generally Langevoort, *supra* note 1, at 488.

20. *Id.* at 482-83.

21. *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994) ("[T]he 'bespeaks caution' doctrine merely reflects the unremarkable proposition that statements must be analyzed in context.").

- (c) (1) [In a private securities fraud suit brought under 10b-5, an issuer] shall not be liable with respect to any forward-looking statement, whether written or oral, *if and to the extent that*—
- (A) the forward-looking statement is—
    - (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
    - (ii) immaterial; or
  - (B) the plaintiff fails to prove that the forward-looking statement . . . was made with actual knowledge by that person that the statement was false or misleading; . . . .<sup>22</sup>

Thus the PSLRA's so-called safe harbor is a compound statutory provision consisting of (A) the safe harbor, which is itself two-pronged, and (B) a heightened scienter standard requiring plaintiffs to show actual intent when fraud is alleged in connection with forward-looking statements that are not both accompanied by cautionary language and identified as forward-looking statements, as required by the safe harbor's first prong. The instant discussion focuses on the first prong of the safe harbor, section (A)(i), which is also referred to as Prong One.<sup>23</sup> Its other prong, the "immateriality" prong set out in subsection (A)(ii),<sup>24</sup> is generally not relevant to the analysis at hand. Finally, the heightened scienter standard created by subsection (B) of the statute, to the extent relevant to this discussion, will be referred to herein as such (and not as the safe harbor or second prong, as in some other commentary).<sup>25</sup>

The statute's operative language is disjunctive.<sup>26</sup> Thus to evade liability for forward-looking statements that do not come to pass, an issuer-defendant in a private suit alleging securities fraud may avail itself of either subpart (A) or subpart (B). In fact, most courts and commentators have concluded that when the defense seeks shelter under Prong One, the plain meaning of the safe harbor's text excludes an inquiry into the subjective falsity or intent of the issuer disseminating a forward-looking statement. The following subpart discusses this case law.

22. 15 U.S.C. §§ 78u-5(c)(1), 77z-2(c)(1) (2006) (emphasis added).

23. Set out in 15 U.S.C. § 78u-5(c)(1)(A)(i), Prong One has previously been referred to variously as the "meaningful cautionary statement prong," Susanna Kim Ripken, *Predictions, Projections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements*, 2005 U. ILL. L. REV. 929, 935, the "cautionary language prong," Talley, *supra* note 9, at 1977, and the "bespeaks caution prong," Coffee, *supra* note 1, at 989. Given the unwieldy nature of these short forms and the focus of this Article, the more pointed term "Prong One" is used here.

24. 15 U.S.C. § 78u-5(c)(1)(A)(ii).

25. *Id.* § 78u-5(c)(1)(B).

26. In setting out the text of the statute, some circuit courts have emphasized its disjunctive formulation. *See* Slayton v. Am. Express Co., 604 F.3d 758, 766 (2d Cir. 2010); Helwig v. Vencor, Inc., 251 F.3d 540, 555 n.2 (6th Cir. 2001).

*C. Most Courts Respect the Irrelevance of Scienter*

Seminal circuit court opinions reiterate the irrelevance, under the PSLRA's safe harbor, of the issuer's state of mind where meaningful cautionary language accompanies the issuer's forward-looking disclosure. For instance, in the Eleventh Circuit's *Harris v. Ivax Corp.*,<sup>27</sup> plaintiffs alleged that Ivax's economic projections were fraudulent, and that the cautionary statements that accompanied the projections failed to disclose the risk factor that actually caused Ivax's actual results to differ from the projections.<sup>28</sup> Affirming the district court's ruling that Prong One protected Ivax's forward-looking statements despite the precise risk that matured not having been disclosed, the Eleventh Circuit panel stated:

All of the statements that the plaintiffs claim to be false or misleading are forward-looking. They were accompanied, moreover, by "meaningful cautionary language." Because we reach this conclusion, we need not in this case enter the thicket of the PSLRA's new pleading requirements for scienter; *if a statement is accompanied by "meaningful cautionary language," the defendants' state of mind is irrelevant.*<sup>29</sup>

Relying on the plain language of the PSLRA and on *Harris*, thereafter the Sixth Circuit in *Miller v. Champion Enterprises, Inc.*<sup>30</sup> held that "[n]o investigation of defendant's state of mind is required" where disclosures were both forward looking and accompanied by meaningful cautionary language.<sup>31</sup> And in a memorandum opinion, a panel of the Ninth Circuit has articulated the same rule,<sup>32</sup> as has the Second Circuit in dicta.<sup>33</sup>

27. 182 F.3d 799 (11th Cir. 1999).

28. *Id.* at 802.

29. *Id.* at 803 (emphasis added). The court cited H.R. REP. NO. 104-369, at 44 (1995) (Conf. Rep.) ("The first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement. Courts should not examine the state of mind of the person making the statement.").

30. 346 F.3d 660 (6th Cir. 2003).

31. *Id.* at 678. Dicta in a number of other circuit court opinions support this interpretation. *See, e.g.,* PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 681 n.3 (6th Cir. 2004) ("As to forward-looking statements accompanied by meaningful cautionary language, the PSLRA makes the state of mind irrelevant."); *Theoharous v. Fong*, 256 F.3d 1219, 1225 n.6 (11th Cir. 2001) ("[T]he PSLRA shields defendants from liability for forward-looking statements, regardless of defendant's state of mind, if [the defendant employs meaningful cautionary language or the forward-looking statement is otherwise immaterial].").

To be sure, plenty of district courts have also so held. *See, e.g., In re* Lab. Corp. of Am. Holdings Sec. Litig., No. 1:03CV591, 2006 U.S. Dist. LEXIS 31232 (M.D.N.C. May 18, 2006). Discussion of these district court opinions is outside the scope of this Article.

32. *Winick v. Pac. Gateway Exch., Inc.*, 73 F. App'x 250, 253 (9th Cir. 2003) ("[T]his statement is also forward-looking. Because it is accompanied by meaningful cautionary language, it falls within the PSLRA's safe harbor and thus is not actionable, regardless of Defendants' state of mind."), *withdrawn*, 80 F. App'x 1 (9th Cir. 2003); *Employers Teamsters Local Nos. 175 and 505 Pension Trust Fund v. Clorox Co.*, 353 F.3d 1125, 1132-33 (9th Cir. 2004) (extending safe harbor protection to forward-looking statements, without particular discussion of alleged knowledge of falsity).

33. *Slayton v. Am. Express Co.*, 604 F.3d 758, 771 (2d Cir. 2010) (finding the

Not all courts, however, have been willing or able to disregard scienter in their analysis of forward-looking statements under the PSLRA. The next Part discusses a developing group of cases that establish a contrary position.

## II. CASE LAW INCORPORATING AN ACTUAL INTENT OR SCIENTER-LIKE INQUIRY INTO APPLICATION OF THE SAFE HARBOR

Case law interpreting the safe harbor naturally considers a spectrum of issues, from the general, such as the parameters of the safe harbor's exclusions,<sup>34</sup> to the more specific: what will qualify as a forward-looking statement,<sup>35</sup> when a forward-looking statement is properly "identified as such,"<sup>36</sup> how the required cautionary language should "accompany" a forward-looking statement,<sup>37</sup> and what cautionary

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defendant's purported meaningful cautionary statements not meaningful because they were no more than boilerplate, and noting Congress's express direction that courts not inquire into the defendant's state of mind when attempting to ascertain the "meaningfulness" of cautionary statements).

34. *E.g.*, *In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 273 (3d Cir. 2005) (holding that a press release issued several months before an IPO that never took place "is not 'in connection with' an IPO" and therefore may be protected by the safe harbor).

35. *E.g.*, *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982, 990 (9th Cir. 2008) ("[A]s [the defendant] uses the term, 'backlog' isn't a 'projection' of earnings or a 'statement' about 'future economic performance.' Applied Signal's backlog is, instead, a snapshot of how much work the company has under contract right now, and descriptions of the present aren't forward-looking." (citation omitted)); *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 242 (3d Cir. 2004) ("[B]ecause the statement about collectability is a prediction of the likelihood of collection on change orders and claims, it is a classic forward-looking statement."); *see also Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999) (ruling that the entire list of factors underlying a projection or economic forecast is to be treated as a forward-looking statement); *Schultz v. Applicia Inc.*, 488 F. Supp. 2d 1219, 1230 (S.D. Fla. 2007) (refusing to deem an issuer-defendant's entire Form 10-K as a forward-looking statement entitled to safe harbor protection).

36. *E.g.*, *Slayton*, 604 F.3d at 765–73 (finding sufficient as identification issuer's blanket statement that the use of expectant language anywhere in the disclosure signaled forward-looking statements); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 558–62 (6th Cir. 2001) (holding that defendant's predictions, which were described as "forward-looking" in some documents but not in others, could not "find refuge in the safe harbor"); *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 372 (5th Cir. 2004) (refusing to apply the first prong of the safe harbor where the forward-looking statements were not "identified as [such]"); *Griffin v. GK Intelligent Sys., Inc.*, 87 F. Supp. 2d 684, 689 (S.D. Tex. 1999) (same); *Tarica v. McDermott Int'l, Inc.*, No. 99-3831, 2000 U.S. Dist. LEXIS 14144, at \*36 (E.D. La. Sept. 19, 2000) (stating that the statute does not require an "explicit identification" of the forward-looking statements as such, and that the forward-looking "meaning" of statements is sufficient to qualify them for safe harbor consideration).

37. *See, e.g., Employers Teamsters*, 353 F.3d at 1133 (holding that "the PSLRA does not require that the cautions physically accompany oral statements" where, during a conference call, the company referred potential investors to its Form 10-K filed the previous September); *Miller v. Champion Enters., Inc.*, 346 F.3d 660, 677–78 (6th Cir. 2003) (finding that a letter alleged to include false statements contained meaningful cautionary language though it referred only to risk disclosures in the company's Form 10-K); *In re Lab. Corp. of Am. Holdings Sec. Litig.*, No. 1:03CV591, 2006 U.S. Dist. LEXIS 31232 (M.D.N.C. May

statements will be deemed “meaningful.”<sup>38</sup> While some of these questions are now fairly well settled, others remain in flux. Most salient of these is the definition of “meaningful” as it relates to the cautionary statements that must attend a forward-looking disclosure for the safe harbor to protect it. Since that determination is necessarily ad hoc, there are many judicial opinions addressing this question.

Examination of the contours of the safe harbor’s “meaningful cautionary statements” requirement engenders two types of analysis. First, obviously, is the fact-specific inquiry into whether specified language effectively neutralizes the predictions made; and second—where plaintiffs have credibly alleged the issuer intentionally utilized its forward-looking statements to deceive—is whether and how those allegations should affect a court’s safe harbor determination at the motion to dismiss stage. The following subparts discuss both district and appellate court cases illustrating the latter concern.

#### *A. District Courts Articulating an Actual Intent “Exception”*

A growing body of district court cases takes the position that the issuer’s actual knowledge of falsity of a forward-looking statement will defeat application of Prong One, even where meaningful cautionary statements have been provided. Two of these bear detailed consideration. First is *Schaffer v. Evolving Systems, Inc.*,<sup>39</sup> a case involving allegedly misleading earnings guidance. The court in *Schaffer* found the defendants’ disclosure to be both forward looking and adequately supported by cautionary language.<sup>40</sup> Nonetheless, and despite an accurate recitation of the statutory safe harbor—one that correctly distinguishes between its parts and reflects an understanding that the heightened pleading standard imposed by subpart (B) applies to those forward-looking statements that are not accompanied by meaningful cautionary statements—the court then stated as follows:

Nevertheless, the Court finds that the June 17 press release does not fall within the PSLRA’s safe harbor provision. Plaintiffs correctly argue that the safe harbor provision provides no refuge for Defendants who make statements with “actual knowledge” of their falsity. Plaintiffs allege that Defendants, based upon the first-quarter decline in new business, knew that second-quarter earnings would be much worse than they reported. . . .

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18, 2006) (“[W]hile Defendants’ 2010 Form 10-K may not have been ‘readily available’ to investors at the time these [oral forward-looking] statements were made [because it had not yet been filed with the SEC], the older documents cited by Defendants included similar cautionary language.”).

38. See, e.g., *Baron v. Smith*, 380 F.3d 49, 54 (1st Cir. 2004) (finding cautionary language in press release sufficient); *Rombach v. Chang*, 355 F.3d 164, 176 (2d Cir. 2004) (applying safe harbor and concluding that cautionary statements in offering documents “as a whole . . . provided a sobering picture of [issuer’s] financial condition and future plans”); *Ehlert v. Singer*, 245 F.3d 1313, 1320 (11th Cir. 2001) (concluding that cautionary statements were sufficient where “the warnings actually given were not only of a similar significance to the risks actually realized, but were also closely related to the specific warning which Plaintiffs assert should have been given”).

39. 29 F. Supp. 2d 1213 (D. Colo. 1998).

40. *Id.* at 1224.

The Court finds that these allegations, taken as true, create a sufficient inference that Defendants acted with “actual knowledge” that the June 17 press release was false. Thus, the Court will not dismiss Plaintiffs’ claim on this issue at this stage of litigation.<sup>41</sup>

The *Schaffer* court thus imported into safe harbor jurisprudence a rule that purports to remove forward-looking statements accompanied by meaningful cautionary language from protection under Prong One, if plaintiffs properly allege actual knowledge of their falsity. An emerging minority of other courts have reacted similarly when faced with this type of argument, including a recently convened panel of the Fifth Circuit Court of Appeals.<sup>42</sup>

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41. *Id.*

42. *E.g.*, *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 244 (5th Cir. 2009) (implicitly adopting rule that where “plaintiff adequately alleges that the defendants actually knew that their statements were misleading at the time they were made, the safe harbor provision is inapplicable to the alleged misrepresentations,” but also justifying their holding based on a subsequent finding that putative meaningful cautionary language was boilerplate); *In re IAC/InterActiveCorp Sec. Litig.*, 478 F. Supp. 2d 574, 586 (S.D.N.Y. 2007) (articulating “exception” to PSLRA safe harbor protection for forward-looking statements where plaintiffs properly allege defendants’ actual knowledge of their falsity); *In re Thoratec Corp. Sec. Litig.*, No. C-04-03168 RMW, 2006 U.S. Dist. LEXIS 30602, at \*21 (N.D. Cal. May 10, 2006) (“[H]ere, where the important factors identified in conjunction with the forward-looking statement are precisely those that the plaintiff contends caused the actual results to differ materially, it is difficult to see how the cautionary language could be inadequate. Thus, the inquiry must then move to the second test: whether defendants had actual knowledge of the falsity of their forward-looking statements.”); *In re Airgate PCS, Inc. Sec. Litig.*, 389 F. Supp. 2d 1360, 1380 (N.D. Ga. 2005) (“[T]he cautionary statements referenced by Defendants are not meaningful because—according to Plaintiffs’ complaint—Defendants knew at the time the statements were made that there were substantial problems . . . .”); *Selbst v. McDonald’s Corp.*, No. 04 C 2422, 2005 U.S. Dist. LEXIS 23093, at \*59–68 (N.D. Ill. Sept. 21, 2005) (refusing to determine whether cautionary language was meaningful at the dismissal stage, and concluding that plaintiffs had properly pled “actual knowledge” of falsity of projections); *In re Xerox Corp. Sec. Litig.*, 165 F. Supp. 2d 208, 219 (D. Conn. 2001) (“[P]laintiffs have pled facts that support a claim that is not precluded by either the PSLRA’s ‘safe harbor’ provision or the ‘bespeaks caution’ doctrine, namely, that the defendants knew that their forward-looking statements were false and made them with the intent to mislead investors.”); *see also* *Goplen v. 51job, Inc.*, 453 F. Supp. 2d 759, 768 (S.D.N.Y. 2006) (holding that earnings projections were not false or misleading since plaintiffs had not shown that defendants knew or should have known that they were misleading when made); *Yellen v. Hake*, 437 F. Supp. 2d 941, 968 (S.D. Iowa 2006) (“Plaintiff has not offered any *facts* from which the Court could legitimately infer that Defendants lacked a reasonable foundation for the projections at the time they were made. Accordingly, Defendants are entitled to the protections of the Safe Harbor rule of the PSLRA.” (emphasis in original)).

And, a pair of pre-PSLRA opinions has spawned a line of cases that uses bespeaks caution analysis to decide safe harbor cases. Applying the bespeaks caution doctrine and quoting *Huddleston v. Herman & MacLean*, 640 F.2d 534, 544 (5th Cir. 1981), the court in *Rubinstein v. Collins*, 20 F.3d 160 (5th Cir. 1994), reminded us that “[t]o warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.” *Id.*

Perhaps more significant than *Schaffer* and its ilk, however, is the Central District of California's analysis and holding in *In re SeeBeyond Corp. Securities Litigation*<sup>43</sup> denying a motion to dismiss based on Prong One, but employing a different analysis. The *SeeBeyond* suit involved, inter alia, alleged misrepresentations contained in earnings estimates disseminated in a press release one day after the end of the first quarter of 2002.<sup>44</sup> The court expressly considered the fit of these forecasts within the statutory safe harbor in light of plaintiffs' allegations that defendants had actual knowledge their estimates were false.<sup>45</sup> Holding that the subject earnings forecasts were not protected by Prong One, the *SeeBeyond* court reasoned:

If the forward-looking statement is made with actual knowledge that it is false or misleading, the accompanying cautionary language *can only be meaningful if it either states the belief of the speaker that it is false or misleading or, at the very least, clearly articulates the reasons why it is false or misleading.* These are undeniably "important factors that could cause actual results to differ materially from those in the forward-looking statement . . . ."<sup>46</sup>

A footnote accompanying this part of the court's opinion sheds light on its rationale, which is important to the instant discussion:

It may be argued that this reading of [the safe harbor] improperly imports a state of mind element into [it]. Both Congress and courts have focused on the fact that, unlike [the heightened scienter standard for forward-looking statements that are not accompanied by cautionary

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at 171. The intuitive appeal of this argument was more colorfully amplified by the venerable senior district judge of the Southern District of New York, Milton Pollack, in *In re Prudential Securities Inc. Ltd. Partnerships Litigation*: "[t]he doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away." 930 F. Supp. 68, 72 (S.D.N.Y. 1996).

A number of post-PSLRA safe harbor cases, to which the bespeaks caution doctrine is inapplicable, can be traced to these bespeaks caution doctrine-based authorities. *E.g.*, *In re Evcu Colls. Holding Corp. Sec. Litig.*, 469 F. Supp. 2d 88 (S.D.N.Y. 2006); *In re Viropharma, Inc., Sec. Litig.*, No. 02-1627, 2003 U.S. Dist. LEXIS 5623 (E.D. Pa. Apr. 3, 2003); *In re Cell Pathways, Inc., Sec. Litig.*, No. 99-752, 2000 U.S. Dist. LEXIS 8584 (E.D. Pa. June 20, 2000); *Walsingham v. Biocontrol Tech., Inc.*, 66 F. Supp. 2d 669 (W.D. Pa. 1998); *In re Mobilemedia Sec. Litig.*, 28 F. Supp. 2d 901, 930 (D.N.J. 1998). While not exactly like the error made by the court in *Schaffer*, this is a similar conflation of the pre-PSLRA bespeaks caution doctrine, which very clearly permits and requires consideration of the defendant's good faith and reasonableness of the basis upon which the projections are made, and the PSLRA safe harbor, which does not. *See In re World Access, Inc. Sec. Litig.*, 119 F. Supp. 2d 1348, 1357–58 (N.D. Ga. 2000) (noting in dicta that safe harbor is inapplicable "when Defendants are aware . . . of the facts that render their statements untrue when made").

43. 266 F. Supp. 2d 1150 (C.D. Cal. 2003).

44. *Id.* at 1162–63.

45. *Id.*

46. *Id.* at 1165 (emphasis added) (quoting 15 U.S.C. § 78u-5(c)(1)(A)(i) (2000)).

language], [the safe harbor's first prong] does not require an investigation into the speaker's state of mind.

However, something like a "state of mind" element . . . is already clearly present in the statute. Whether cautionary language is meaningful, in that it identifies important factors, can only be understood with reference to the defendant's knowledge of relevant factors. This result follows from the fact that courts and Congress have made clear that mere boilerplate cautionary language will not do. . . . Moreover, whether a specific factor is "important" and therefore should be listed, likely should not be evaluated by an objective standard (i.e. what the defendant should have known). If an objective standard is adopted for determining whether a factor is "important," then it seems this would heighten the bar of the first prong of the safe harbor provision, making it more difficult for defendants to take advantage of its grant of immunity. This result seems contrary to congressional intent. Instead, it appears as though a determination of whether "important" factors have been identified should be made with reference to those factors of which the speaker is aware—things that the speaker believes may cause actual results to vary. Therefore, it appears as though the cautionary statement cannot be evaluated without reference to the defendant's knowledge.<sup>47</sup>

Thus, under *SeeBeyond*, where actual knowledge of falsity of the forward-looking disclosures is properly alleged,<sup>48</sup> Prong One does not provide the issuer with the important protection from discovery and further litigation that Congress sought to enact. This is because no cautionary language accompanying forward-looking disclosures can be meaningful if the issuer is not honest in its assessment and disclosure of those risk factors that it believes could, as the statute requires, "cause actual results to differ materially from those in the forward-looking statement."<sup>49</sup> In essence, this view adds a good faith requirement to Prong One.

*SeeBeyond* is not the only district court opinion to have applied such a rule.<sup>50</sup> To date, no federal court of appeals has articulated the *SeeBeyond* rule using its exact terms, though there is a pair of reported decisions from the Seventh Circuit that are closely related to *SeeBeyond* and which achieve its same end. There is also some weak support in dicta from a number of other circuit court opinions for a *SeeBeyond*-like result. The next subpart discusses this case law.

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47. *Id.* at 1165 n.8 (emphasis omitted) (citations omitted).

48. The PSLRA requires that scienter be alleged with particular facts, and the complaint as a whole must give rise to a strong inference of the requisite intent to defraud. 15 U.S.C. § 78u-4(b) (2006).

49. 15 U.S.C. § 78u-5(c)(1)(A)(i).

50. *See, e.g., In re Nash Finch Co. Sec. Litig.*, 502 F. Supp. 2d 861, 873 (D. Minn. 2007) (relying on *In re SeeBeyond*); *cf. Freeland v. Iridium World Comm'ns, Ltd.*, 545 F. Supp. 2d 59, 72–74 (D.D.C. 2008) (holding that there remained a question of fact as to whether the risk factors listed by defendant-issuer were meaningful where plaintiff properly alleged defendants' knowledge that several of them had already occurred, citing *SeeBeyond* and *Nash Finch*).

*B. The Seventh Circuit's Asher v. Baxter and Similar Dicta in Other Circuits*

Although the prevailing circuit court view, as expressed in *Harris* and *Miller*, recognizes the irrelevance of the issuer's state of mind under the PSLRA's safe harbor, more than one appellate opinion can be read to incorporate an intent inquiry. Indirect support for this proposition can be found in the Fifth Circuit's opinion in *Rosenzweig v. Azurix Corp.*,<sup>51</sup> which implies that substantial allegations of scienter might defeat Prong One even where sufficient cautionary language is present.<sup>52</sup> And dicta in a few other circuit court opinions are certainly susceptible of, perhaps unwittingly, supporting the outcomes in *Schaffer* and *SeeBeyond*.<sup>53</sup>

51. 332 F.3d 854, 870 (5th Cir. 2003).

52. The court first notes that all of the forward-looking disclosures fall within the statutory safe harbor:

We note initially that plaintiffs have failed to address the district court's holding that all of the forward-looking representations are protected under the PSLRA's safe harbor provisions. A review of the record indicates that all of the challenged documents, except for the Dow Jones News Service article, contained cautionary language which specifically referred to the PSLRA safe harbor.

*Id.* at 869. However, the court then addresses the plaintiffs' actual-knowledge argument by comparing the *Rosenzweig* plaintiffs' allegations to those set forth in the pre-PSLRA case of *Rubinstein v. Collins*, 20 F.3d 160 (5th Cir. 1994), noting: "Plaintiffs are correct that predictive statements can be actionable, but, as explained above, their pleadings fall short of the necessary allegations." *Rosenzweig*, 332 F.3d at 870. It is unclear exactly what is meant by this, since the *Rosenzweig* court acknowledges that *Rubinstein* involved disclosures that were more in the nature of verifiable statements of fact (not forward looking), and the *Rubinstein* plaintiffs successfully pleaded scienter. *Id.*

53. Indeed, the starting point for the *SeeBeyond* safe harbor analysis was the Ninth Circuit's statement in *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*:

The [safe harbor] provisions provide that a person shall not be liable for any "forward-looking statement" that is "identified" as such, and is accompanied "by meaningful cautionary statements["] . . . . However, a person may be held liable if the "forward-looking statement" is made with "actual knowledge . . . that the statement was false or misleading."

320 F.3d 920, 936 (9th Cir. 2003) (citations omitted). At least one district court in California has already misread this statement. *See In re LDK Solar Sec. Litig.*, 584 F. Supp. 2d 1230, 1250 (N.D. Cal. 2008) (holding that actual knowledge defeats Prong One of safe harbor, citing *America West* in support). Notably, the *SeeBeyond* court aptly disagrees with this statement in the Ninth Circuit's *America West* opinion as contrary to the text of the statute, but then the *SeeBeyond* court goes on to develop its own equally flawed rule incorporating intent into the definition of "meaningful cautionary statements." *See In re SeeBeyond Techs. Corp. Sec. Litig.*, 266 F. Supp. 2d 1150 (C.D. Cal. 2003); *see also supra* Part II.A.

Other circuit court judges have used similar loose language in their opinions. For example, a panel of the Fifth Circuit stated, "[t]o avoid the safe harbor, plaintiffs must plead facts demonstrating that the statement was made with actual knowledge of its falsity," but in the same breath the court properly applied the heightened pleading standard of the safe harbor's second prong only to those forward-looking statements that were not identified as such, and therefore not qualified for protection under the safe harbor's bespeaks caution

More on point and precedentially significant, however, is the Seventh Circuit's holding in *Asher v. Baxter International, Inc.*,<sup>54</sup> which expressly injects a subjective analysis into the threshold determination of Prong One's application.<sup>55</sup> The *Asher* plaintiffs alleged that healthcare manufacturing giant Baxter International made intentionally false "rosy . . . predictions" about its 2002 sales, earnings per share, and operational cash flow, none of which later materialized.<sup>56</sup> Despite a finding that the plaintiffs had alleged sufficient facts to show that Baxter's disclosures were "misleading and not made in good faith or with a reasonable basis,"<sup>57</sup> the district court properly dismissed the case because the predictions were both forward looking and accompanied by meaningful cautionary statements, and thus were protected by Prong One.<sup>58</sup>

The Seventh Circuit Court of Appeals reversed, holding that the district court had prematurely concluded that the cautionary statements accompanying Baxter's

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prong. *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 371 (5th Cir. 2004). Similarly vulnerable to being misquoted is the description of "the safe harbor" by another panel of the Fifth Circuit—in passing, in the context of a discussion of the PSLRA's heightened scienter requirements generally—as protecting forward-looking statements "if plaintiff cannot demonstrate that they were made with 'actual knowledge' that the statements were false or misleading at the time they were made." *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 409 (5th Cir. 2001). And, a panel of the Ninth Circuit has said, "Under the PSLRA's 'safe harbor' provisions, plaintiffs must prove that 'forward-looking' statements were made with 'actual knowledge' that they were false or misleading," without discussing whether the predictive disclosures at issue were identified as such and/or accompanied by meaningful cautionary language. *In re Daou Sys., Inc.*, 411 F.3d 1006, 1021 (9th Cir. 2005) (quoting from Judge Browning's separate opinion in *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 993 (9th Cir. 1999)). Similarly vague and subject to possible misinterpretation is the Sixth Circuit's *Zaluski v. United Am. Healthcare Corp.*, 527 F.3d 564, 572 (6th Cir. 2008) ("Where a company does disclose that its statement is forward-looking, liability may still attach to the extent that the company made the statement in a misleading manner.").

*See also In re Advanta Corp. Sec. Litig.*, 180 F.3d 525 (3d Cir. 1999). *Advanta* involved application only of the heightened pleading standard of 15 U.S.C. § 78u-5(i)(1)(B), presumably because the forward-looking statements were either not identified as such or not accompanied by cautionary language. But without so stating or distinguishing between the two prongs of the safe harbor provision other than by precise citation to statutory subsection, the court stated broadly that "the safe harbor will not apply if the statement was made with 'actual knowledge' that the statement was false or misleading." *Id.* at 536.

Commentators, too, are guilty of publishing verbiage that could easily be misconstrued out of context. *See, e.g., De Simone et al., supra* note 12, at 808 ("[T]he safe harbor for an oral forward-looking statement applies if the plaintiff ultimately fails to prove that the statement was made with actual knowledge that it was false or misleading.").

54. 377 F.3d 727 (7th Cir. 2004), *cert. denied*, 544 U.S. 920 (2005).

55. *See also Makor Issues & Rights v. Tellabs, Inc.*, 437 F.3d 588, 599 (7th Cir. 2005) (invoking *Baxter's* requirement that "the principal or important risks" be identified, but ultimately ruling that the issuer's cautionary language was insufficiently particularized, i.e., boilerplate, and therefore Prong One of the safe harbor was inapplicable to shield it from an intent inquiry), *vacated on other grounds*, 551 U.S. 308 (2007).

56. *Asher v. Baxter Int'l Inc.*, No. 02 C 5608, 2003 U.S. Dist. LEXIS 12905, at \*4–10 (N.D. Ill. July 17, 2003), *rev'd*, 377 F.3d 727 (7th Cir. 2004).

57. *Id.* at \*27.

58. *Id.* at \*37–43.

forward-looking statements were sufficient.<sup>59</sup> According to the panel, in an opinion authored by Chief Judge and noted Chicago School jurist Frank H. Easterbrook:

There is no reason to think—at least, no reason that a court can accept at the pleading stage, before plaintiffs have access to discovery—that the items mentioned in Baxter’s cautionary language were those *thought at the time to be* the (or any of the) “important” sources of variance. The problem is not that what actually happened went unmentioned; issuers need not anticipate all sources of deviations from expectations. Rather, the problem is that there is no reason (on this record) to conclude that Baxter mentioned those sources of variance that (at the time of the projection) were the principal or important risks.<sup>60</sup>

Because discovery is, according to the *Asher* decision, required to flesh out the issuer’s knowledge of risk factors actually facing the company at the time of its disclosures, the case was remanded.<sup>61</sup> Notably, a little over a month later the court amended its opinion to replace the phrase italicized above “thought at the time to be” with the presumably more objective phrase “that at the time were.”<sup>62</sup>

In both its original and amended forms, the *Asher* opinion introduces a subjective, factual, discovery-generating inquiry into Prong One. Though the Seventh Circuit (on second thought) ostensibly eschewed an inquiry into the issuer’s intent—fraudulent or otherwise—Judge Easterbrook’s subjective issuer-focused rationale for reversing the district court nonetheless echoes the footnoted analysis in *See Beyond*, quoted above. As a practical matter, it requires that the issuer have had a reasonable factual basis for its choice of risk factors to disclose.<sup>63</sup>

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59. *Asher*, 377 F.3d at 734–35.

60. *Asher v. Baxter Int’l Inc.*, No. 03-3189, slip op. at 13 (7th Cir. July 29, 2004) (emphasis added).

61. *See Asher*, 377 F.3d at 734–35. On remand, defendants argued that, assuming the safe harbor did not apply, plaintiffs had not adequately met the heightened pleading requirement for forward-looking statements set forth in 15 U.S.C. § 78u-5(c)(1)(B). The court disagreed. *Asher v. Baxter Int’l Inc.*, No. 02 C 5608, 2005 U.S. Dist. LEXIS 2131, at \*11, \*23–24 (N.D. Ill. Feb. 3, 2005). Subsequently defendants unsuccessfully sought judgment on the pleadings based on a purported failure of loss causation, an inquiry that is unrelated to the thesis of this Article. *Asher v. Baxter Int’l Inc.*, No. 02 CV 5608, 2006 U.S. Dist. LEXIS 4821 (N.D. Ill. Feb. 7, 2006).

62. *Asher*, 377 F.3d at 734; *see* Allan Horwich, *Is There a Breach in the Breakwater of the Statutory Safe Harbor for Forward-Looking Statements?*, WALL ST. LAW., Sept. 2004 (noting that the amended opinion is likely “more pernicious than the original” in that it permits plaintiffs to argue “that any risk that in fact materialized necessarily was one that was ‘objectively faced’ at the time the forward-looking statement was made, thus eliminating from the liability calculus the factor introduced—albeit erroneously—in the original opinion of what management ‘thought at the time’ in the absence of perfect foresight”).

63. The Second Circuit considered this type of argument in a recent case. *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010) (“May an issuer be protected by the meaningful cautionary language prong of the safe harbor even where his cautionary statement omitted a major risk he knew about at the time he made the statement?”).

With a single stroke of the pen (actually two, taking into account the amendment) the Seventh Circuit discarded the PSLRA's discovery ban,<sup>64</sup> just as *SeeBeyond* did.<sup>65</sup> *Asher*, therefore, is clearly of a piece with *SeeBeyond* and its sort, cases that import a subjective inquiry into the safe harbor's Prong One and vitiate its intended power to enable early dismissal of private securities fraud suits.<sup>66</sup>

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This remarkable subset of safe harbor case law perhaps may best be explained by the relevant courts' instinctual aversion to faithful application of Prong One,<sup>67</sup> which could result in the immunization of deceptive statements in apparent contradiction of the purpose of the federal securities laws. But this repeated, multiform judicial repugnance to straightforward application of the safe harbor invites deeper analysis. Is there some ground on which these decisions can be justified? Is there some other policy basis upon which courts can rationalize their unfaithfulness to the statute?

The following Parts of this Article look more closely at the *Schaffer*, *SeeBeyond*, and *Asher* opinions, explaining their error—with reference to preexisting case law, the text and legislative history of the PSLRA, and policy arguments drawn from the specific context in which fraudulent forward-looking statements arise. Together these demonstrate the need to interpret the two prongs of the safe harbor strictly, no matter if counterintuitively, in the fashion articulated by the majority of circuit courts that have thoughtfully considered the question.

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However, the panel was able to dodge the question because it deemed the cautionary statements made by the issuer to be “boilerplate,” partly in light of their failure to change over time despite the nature of the risks facing the issuer changing. *Id.* at 772–73. Finding insufficiently particularized allegations of actual knowledge, the defendants thus prevailed under the heightened pleading standard established by the third prong of the safe harbor, 15 U.S.C. § 78u-5(c)(1)(B). *Id.* at 775–78.

64. Mr. Beck argues there are still circumstances in which discovery might be denied, even under an *Asher* analysis. *See* Beck, *supra* note 7, at 201 n.132 and accompanying text.

65. The opinion thus has drawn some critical ink. *See, e.g.,* Joseph De Simone, Matthew D. Ingber & Evan A. Creutz, *Stormy Waters in PSLRA's Safe Harbor: Will the Supreme Court Hear the Appeal from the Seventh Circuit's Recent 'Asher' Decision?*, N.Y. L.J., Feb. 22, 2005, at S4; Sarah S. Gold & Richard L. Spinogatti, *Corporate and Securities Litigation: The Not-So-Safe Harbor*, N.Y. L.J., Oct. 13, 2004, at 3; Horwich, *supra* note 62. It has also catalyzed discussion and disagreement amongst practitioners. *See* De Simone et al., *supra* note 12, at 799 (“*Asher* has] ignited a raging debate in the federal securities bar.”).

66. *See also In re Evcil Colls. Holding Corp. Sec. Litig.*, 469 F. Supp. 2d 88 (S.D.N.Y. 2006); *Cent. Laborers' Pension Fund v. Sirva, Inc.*, No. 04 C 7644, 2006 U.S. Dist. LEXIS 73375 (N.D. Ill. Sept. 22, 2006); *Ryan v. Flowserve Corp.*, 444 F. Supp. 2d 718, 730 n.6 (N.D. Tex. 2006); *Selbst v. McDonald's Corp.*, 04 C 2422, 2005 U.S. Dist. LEXIS 23093 (N.D. Ill. Sept. 21, 2005); *Wu Group v. Synopsys, Inc.*, No. C 04-3580 MJJ, 2005 U.S. Dist. LEXIS 42351 (N.D. Cal. Aug. 10, 2005).

67. The possibility that the courts in *Schaffer* and *Asher* were guided more by instinct than by precedent is certainly plausible given that neither of the cases cites to authority in the pertinent sections of the opinion. *SeeBeyond* does cite to precedent, but as noted *infra*, it is misguided.

### III. THE LEGISLATIVE HISTORY OF THE PSLRA AND POSSIBLE EXPLANATIONS FOR ERRANT CASE LAW

As discussed above, the plain text of Prong One, disjunctive as it is, does not support the results or analysis presented in *Schaffer*, *SeeBeyond*, or *Asher*. Nor does the legislative history of the PSLRA support either *Schaffer*'s "exception" to Prong One or *SeeBeyond* and *Asher*'s wayward interpretations of its "meaningful cautionary statements" requirement. The next subpart reviews the legislative history of the PSLRA, demonstrating that the result in these cases is fairly unambiguously precluded.<sup>68</sup> Then, an analysis of where and why the errant cases went wrong further elucidates the issues at hand.

#### A. Legislative History: The Safe Harbor and the PSLRA Generally

Despite its analytical drawbacks,<sup>69</sup> congressional intent still is paramount in interpreting a statute.<sup>70</sup> Though there are "many different and potentially

68. This review of the legislative history also disposes of any argument that today's corporate and regulatory climate perhaps calls for a reading of the safe harbor that would permit a more punitive reaction to even a hint of fraud. *SeeBeyond* and *Asher* are recent cases; both were decided in the wake of Enron, WorldCom, and other massive corporate frauds. Perhaps they merely embody a newly heightened sense of corporate accountability to shareholders, a reading of the legislative intent that is consistent with a post-Enron view? The answer to this possibility is that even those who endorse dynamic interpretation of statutes, *see generally* William N. Eskridge, Jr., *Dynamic Statutory Interpretation*, 135 U. PA. L. REV. 1479 (1987) (advocating that federal statutes be viewed not only from textual and legislative purpose perspectives, but also from an "evolutive" perspective, which requires they be interpreted "dynamically," that is, in light of their present societal, political, and legal context"), would be unlikely to approve of an interpretation of the word "meaningful" that upends the clear legislative intent of a recently enacted statute, *see id.* at 1554–55 ("Dynamic interpretation is most appropriate when the statute is old yet still the source of litigation, is generally phrased, and faces significantly changed societal problems or legal contexts. [It] is least appropriate when the statute is recent and addresses the issue in a relatively determinate way.").

69. Many have criticized legislative intent as meaningless. *See, e.g.*, William T. Mayton, *Law Among the Pleonasm: The Futility and Aconstitucionality of Legislative History in Statutory Interpretation*, 41 EMORY L.J. 113, 116 (1992) ("Reliability, however, is probably not the main problem. The main problem is that legislative history swamps and muddies some important functions of legislatures and courts and statutes."); Kenneth W. Starr, *Observations About the Use of Legislative History*, 1987 DUKE L.J. 371, 379 ("[B]enefits accruing from the use of legislative history are marginal when weighed against the potential for abuse and the enormous effort involved."). Most prominent among them, Justice Scalia has warned that reliance on certain aspects of a statute's history—the Statement of Managers contained within a Conference Committee Report notably *not* among them—is dangerous:

Of course even if all the Court's invocations of legislative history were not utterly irrelevant, I would still object to them, since neither the statements of individual Members of Congress (ordinarily addressed to a virtually empty floor), nor Executive statements and letters addressed to congressional committees, nor the nonenactment of other proposed legislation, is a reliable indication of what a majority of both Houses of Congress intended when they voted for the statute before us.

*Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 390 (2000) (Scalia, J., concurring).

70. *See, e.g.*, *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984). The *Chevron* Court noted, in the context of review of an agency's

inconsistent sources of legislative history,”<sup>71</sup> the Supreme Court’s own practice legitimates the conference committee report as the most authoritative of all the documents comprising a statute’s archives.<sup>72</sup> The PSLRA’s conference committee report (“the Report”) is both expansive and explicit, directly addressing the question of applying Prong One to dismiss an allegedly fraudulent forward-looking statement.<sup>73</sup> In fact, as demonstrated in the paragraphs that follow, it quite unequivocally rejects the *Schaffer*, *SeeBeyond*, and *Asher* courts’ rules.

Though the Report does not provide detailed guidance as to what the isolated term *meaningful* signifies, it does have the following to say about the “meaningful cautionary statements” the statute requires as a precondition to dismissal:

The cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statement, such as, for example, information about the issuer’s business.

As part of the analysis of what constitutes a meaningful cautionary statement, courts should consider the factors identified in the statements. “Important” factors means the stated factors identified in the cautionary statement must be relevant to the projection and must be of a nature that the factor or factors could actually affect whether the forward-looking statement is realized.

The Conference Committee expects that the cautionary statements identify important factors that could cause results to differ materially—

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interpretation of a federal statute, that courts are first to ask whether Congress has “directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” *Id.*

71. Joseph A. Grundfest & A.C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 STAN. L. REV. 627, 643–44 (2002) (noting that the Supreme Court has relied on most sources of legislative history and that “legislative reports, particularly conference committee reports, carry the most weight with the Court”).

72. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 320–22 (2007) (referring to the Statement of Managers from the Joint Conference Committee Report in interpreting the “strong inference” standard of the PSLRA); *see also* *Thornburg v. Gingles*, 478 U.S. 30, 43 n.7 (1986) (“We have repeatedly recognized that the authoritative source for legislative intent lies in the committee reports on the bill.”); Randall W. Quinn, *The Supreme Court’s Use of Legislative History in Interpreting the Federal Securities Laws*, 22 SEC. REG. L.J. 262, 265–66 (1994) (“The materials discussed by the Court [in securities cases], in order of frequency of occurrence, include committee reports, hearings, prior drafts, post-enactment materials, and floor statements.”); Jane S. Schacter, *The Confounding Common Law Originalism in Recent Supreme Court Statutory Interpretation: Implications for the Legislative History Debate and Beyond*, 51 STAN. L. REV. 1, 13 (1998) (“The interpretive resources that appear in Supreme Court opinions help to set the boundaries for statutory interpretation by legitimating particular resources and approaches.”); Nicholas S. Zeppos, *The Use of Authority in Statutory Interpretation: An Empirical Analysis*, 70 TEX. L. REV. 1073, 1093 (1992) (reporting that the Supreme Court referred to congressional reports in thirty-two percent of the cases in his random sample of cases from 1890 to 1990 in which it sought to determine statutory intent).

73. H.R. REP. NO. 104-369 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730. The conference report includes the “Statement of Managers.” *Id.* at 31.

but not all factors. Failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor. The Conference Committee *specifies that the cautionary statements identify “important” factors to provide guidance to issuers and not to provide an opportunity for plaintiff counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made.*

The use of the words “meaningful” and “important factors” are intended to provide a standard for the types of cautionary statements upon which a court may, *where appropriate, decide a motion to dismiss, without examining the state of mind of the defendant.* The first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement. *Courts should not examine the state of mind of the person making the statement.*<sup>74</sup>

From this, two things are clear. First, the Report makes plain that the requirement to disclose important risk factors was not intended to open the door to “discovery on what factors were known to the issuer at the time the forward-looking statement was made.” The revised opinion in *Asher* purports to circumvent this prohibition, but only in something of a cute way. Discovery into what factors existed at the time of the projection is a half-step removed from discovery into (and allegations about) management’s knowledge of those factors. Permitting this type of subjective inquiry will improve hindsight and the power of the hindsight bias ultimately will prove irresistible to some courts.<sup>75</sup> This is precisely the result Congress sought to foreclose with the safe harbor.

Second, the Report makes quite clear that assessment of the issuer’s intent was to be excluded from a court’s application of Prong One. A review of earlier drafts of the PSLRA cements this notion. As first drafted in the Senate, the safe harbor provision did contain a state of mind requirement.<sup>76</sup> But notably this was altered by

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74. *Id.* at 43–44 (emphasis added). Further, in discussing Prong One and the discovery bar to which the statute entitles a defendant when a motion to dismiss is filed alleging the application of the safe harbor, the Report emphasizes, again: “The applicability of the safe harbor provisions under subsections (c)(1)(A)(I) . . . shall be based upon the sufficiency of the cautionary language under those provisions *and does not depend on the state of mind of the defendant.*” *Id.* at 47 (emphasis added).

75. See Mitu Gulati, Jeffery J. Rachlinski & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773, 774 (2004) (“The hindsight bias thus creates a considerable obstacle to the fundamental task in securities regulation of sorting fraud from mistake.”).

76. S. 240, the initial Senate version of the bill, provided that (presumably any) forward-looking statement “knowingly made with the expectation, purpose, and actual intent of misleading investors” would not be protected by the safe harbor. S. 240, 104th Cong. § 105 (1995); see also S. REP. NO. 104-98, at 27 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 706.

Paradoxically, the Committee Report accompanying the Senate bill acknowledged that the safe harbor is based on the bespeaks caution doctrine as articulated in the Third Circuit’s *In re Donald J. Trump Casino Securities Litigation*, 7 F.3d 357 (3d Cir. 1993), which opinion affirmed dismissal of a complaint alleging that the issuer did not believe its

the Conference Committee, and the modified version prevailed after heated debate<sup>77</sup> and President Clinton's veto,<sup>78</sup> which Congress overrode.<sup>79</sup> Thus the final form of the statute that enacted Prong One and Prong Two disjunctively had broad bipartisan support,<sup>80</sup> despite the original sentiment in the Senate that the issuer's state of mind ought to be relevant to safe harbor protection.<sup>81</sup>

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own forward-looking statements. S. REP. NO. 104-98, at 17 (quoting *Trump* court's articulation of the doctrine).

77. A number of members of Congress argued vehemently against a safe harbor that did not import a state of mind requirement. See 141 CONG. REC. 38,211 (1995) (statement of Sen. Boxer) (describing the safe harbor as a "pirate's cove" for "sharks and barracudas"); 141 CONG. REC. 37,804 (1995) (statement of Rep. Collins) (portraying the safe harbor as an injustice to Americans, which would allow them to "fall victim to corporate misconduct and fraud" by "unethical corporate wolves"); 141 CONG. REC. 37,799 (1995) (statement of Rep. Markey) (calling it "simply wrong" to enact a safe harbor that permits issuers to "intentionally lie to the investing public"); 141 CONG. REC. 35,299 (1995) (statement of Sen. Biden) (calling "outrageous" the proposal to enact a safe harbor without an inquiry into intent); 141 CONG. REC. 35,243 (1995) (statement of Sen. Sarbanes) (noting that under the safe harbor as proposed "fraudulent statements will receive protection under the Federal securities laws"); 141 CONG. REC. 17,432 (1995) (statement of Sen. Wellstone) (describing safe harbor as an open invitation to "crooked corporations . . . to promise the Sun, Moon, and stars in their forward-looking statements"); 141 CONG. REC. 17,427 (1995) (comments of Sen. Cohen) (expressing concern that "a few carefully placed disclaimers could provide a legal protection for misleading statements that were made knowingly"); see also 141 CONG. REC. 35,283 (1995) (statement of Sen. Boxer) (stating that "any swindler can . . . make some cautionary statement about a forward-looking prediction, and find cover in this new safe harbor").

78. In his veto message, President Clinton said,

[W]hile I support the language of the Conference Report providing a "safe harbor" for companies that include meaningful cautionary statements in their projections of earnings, the [Conference Report's] Statement of Managers—which will be used by courts as a guide to the intent of the Congress with regard to the meaning of the bill—attempts to weaken the cautionary language that the bill itself requires.

Message to the House of Representatives Returning Without Approval the Private Securities Litigation Reform Act of 1995, 31 WEEKLY COMP. PRES. DOC. 2210, 2210-11 (Dec. 19, 1995).

79. Eighty-nine Democrats voted with 230 Republicans in the House to override the President's veto. In the Senate, twenty Democratic senators joined forty-eight Republicans in supporting the override. Lynne Bolduc, *A Case Without a Client: The Private Securities Litigation Reform Act of 1995*, FED. LAW., May 1996, at 33, 35; see also John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335 (1996) (discussing the legislative enactment of the PSLRA step by step). And, for more on the political will behind the final version, see Wang, *supra* note 7.

80. The Securities and Exchange Commission also supported the statute as enacted. See 141 CONG. REC. 38,323 (1995).

81. The Senate Report accompanying the PSLRA naturally includes statements to the effect that the issuer's state of mind must be considered in affording safe harbor protection for forward-looking statements. For example: "Although the Committee believes that market discipline will most likely provide sufficient disincentives for using the safe harbor as a 'license to lie,' the safe harbor does not protect forward-looking statements 'knowingly

Indeed, the only language that purports to require an analysis of the issuer's intent in this connection is in the Report's discussion, here quoted in full, of Prong Two, sometimes known as the the actual knowledge prong:

The *second prong* of the safe harbor provides an alternative analysis. *This* safe harbor also applies to both written and oral forward-looking statements. Instead of examining the forward-looking and cautionary statements, *this prong* of the safe harbor focuses on the state of mind of the person making the forward-looking statement. A person or business entity will not be liable in a private lawsuit for a forward-looking statement unless a plaintiff proves that person or business entity made a false or misleading forward-looking statement with actual knowledge that it was false or misleading. The Conference Committee intends for this alternative prong of the safe harbor to apply if the plaintiff fails to prove the forward-looking statement (1) if made by a natural person, was made with the actual knowledge by that person that the statement was false or misleading; or (2) if made by a business entity, was made by or with the approval of an executive officer of the entity with actual knowledge by that officer that the statement was false or misleading.<sup>82</sup>

The Report's last sentence quoted above might have been more helpful had it more patently set out the domain of the second prong of the safe harbor, rather than simply echoing the text of the statute's heightened scienter standard for forward-looking statements not accompanied by meaningful cautionary language. Nevertheless, the paragraph as a whole reinforces the disjunctive quality of the safe harbor's two prongs. Only when taken out of context might a statement such as the third sentence of the paragraph quoted above be read to imply that the safe harbor's two prongs are cumulative. Thus, the rule in *Schaffer* is flatly prohibited.

Turning to *Asher* and *SeeBeyond*, bolstering the conclusion that the legislature expressly intended to exclude consideration of the issuer's (1) good faith in connection with forward-looking statements or (2) reasonable factual basis for its risk factors, the Senate Report attendant to the PSLRA observes that SEC Rule 175—which does contemplate a good faith and reasonable basis inquiry—had failed to provide “meaningful protection from litigation.”<sup>83</sup> Admittedly, nothing in the text of the safe harbor mandates a finding that the issuer's cautionary statements are meaningful per Prong One—and so that the case (or portion of the case) may be dismissed as a matter of law—at the dismissal stage, as opposed to the summary judgment stage as suggested by the court in *Asher*.<sup>84</sup> However, early dismissal so as

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made with the expectation, purpose, and actual intent of misleading investors.” S. REP. NO. 104-98, at 18.

82. H.R. REP. NO. 104-369, at 44 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 743 (emphasis added).

83. S. REP. NO. 104-98, at 16.

84. The Senate Report expressly contemplates application of the safe harbor at the summary judgment stage. *Id.* at 18. However, this is because the Senate version of the bill included “good faith” and “reasonable basis” considerations. The Senate's version of the safe harbor was never promulgated. Instead, the Conference Committee adopted its own version of the PSLRA, incorporating the safe harbor as we know it, along with the admonitions in its Report to avoid looking into issuer intent. *See Avery, supra* note 79.

to avoid protracted and expensive discovery comports with the overall thrust of the reforms sought to be accomplished by the PSLRA.

*B. Flaws in the Errant Subset of Safe Harbor Decisions*

The statute's legislative history is abundantly precise and directive with regard to how Prong One is to operate. This specific congressional intent is reinforced by the broader goals behind the PSLRA, which is widely understood to have had as its genesis a desire to reduce if not eliminate abusive private securities fraud litigation practices, including: "the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action," and "the abuse of the discovery process to impose costs so burdensome that it is often economical for the [defendants] to settle."<sup>85</sup> The safe harbor is one of the procedural and substantive reforms comprising the PSLRA that is targeted at ameliorating this perceived problem.<sup>86</sup>

As we have seen, the *Schaffer*, *SeeBeyond*, and *Asher* opinions are supported by neither the plain text of Prong One nor by the legislative history of the PSLRA. So where did these cases go wrong and why? Though their intellectual approaches are slightly different, the jurisprudential root of each of the decisions in *Schaffer*, *SeeBeyond*, and *Asher* is clear. At the hub of these three opinions sits the pre-PSLRA bespeaks caution doctrine.

1. Specific Analytical Deficiencies

Though it provides no rationale for the exception it articulates, *Schaffer* improperly conflates Prong One and the bespeaks caution doctrine.<sup>87</sup> *SeeBeyond* and *Asher*, and their progeny, have the same effect but do so with a more subtle approach, using the mantle of statutory interpretation to effectuate results more

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85. H.R. REP. NO. 104-369, at 31.

86. *See infra* note 133 and accompanying text.

87. There is no dispute that the statutory safe harbor is based in part upon the bespeaks caution doctrine. Indeed, the Statement of Managers within the Conference Committee Report accompanying the PSLRA explicitly states, "The Conference Committee safe harbor, like the Senate safe harbor, is based on aspects of SEC Rule 175 and the judicial [sic] created 'bespeaks caution' doctrine." H.R. REP. NO. 104-369, at 43. The Conference Report also emphasizes that the statutory safe harbor is not intended "to replace the judicial 'bespeaks caution' doctrine or to foreclose further development of that doctrine by the courts." *Id.* at 46; *see also* O'Hare, *supra* note 7, at 620, 638-40 ("[T]he bespeaks caution doctrine and the statutory safe harbor offer issuers two separate, though related, protections from liability stemming from forward-looking statements.").

SEC Rule 175, even more limited in scope, applies to documents filed with the Commission and provides limited immunity for forward-looking statements. 17 C.F.R. § 230.175 (2010). Like the bespeaks caution doctrine, Rule 175's safe harbor does not extend to forward-looking statements that are shown to have been "made or reaffirmed without a reasonable basis" or which were "disclosed other than in good faith." *See* 17 C.F.R. § 240.3b-6(a) (2010).

consistent with the bespeaks caution doctrine than is intended by the statutory safe harbor. The remainder of this Part critiques these approaches.

a. The Problem with *Schaffer* and Similar Case Law

The *Schaffer* opinion, as mentioned earlier, is one of a number of district court opinions that essentially collapse the two prongs of the safe harbor. Where a plaintiff class convincingly pleads fraudulent intent, these courts refuse to apply the first prong of the safe harbor to dismiss that portion of the case notwithstanding the presence of meaningful cautionary statements, without much or any explanation. The *Schaffer* opinion cites no authority, nor does it mention the bespeaks caution doctrine.<sup>88</sup> It is possible that the court misread the disjunctive nature of the statute or considered portions of the legislative history out of context. Equally plausible is that the court simply rankled at the prospect of dismissing a case in which there was an indication that the defendants used their forward-looking statements to perpetrate a fraud.

The most likely cause of its error, though, is that the court actually applied the familiar bespeaks caution doctrine out of habit and without citation, assuming the statutory safe harbor was a straight codification thereof.<sup>89</sup> Other courts that utilize the *Schaffer* approach to allegedly fraudulent forward-looking statements do tend to cite, in the same breath, to the statutory safe harbor and the older common law bespeaks caution doctrine that underpins the PSLRA's safe harbor.<sup>90</sup>

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88. *Shaffer v. Evolving Sys., Inc.*, 29 F. Supp. 2d 1213, 1223 (D. Colo. 1998).

89. The court's statement, "Plaintiffs correctly argue that the safe harbor provision provides no refuge for Defendants who make statements with 'actual knowledge' of their falsity," indicates that the court may have just misread the disjunctive nature of the statutory safe harbor, perhaps informed by its own understanding of the older bespeaks caution doctrine. *Id.* at 1224.

90. See, e.g., *In re Alliance Pharm. Corp. Sec. Litig.*, 279 F. Supp. 2d 171, 192 (S.D.N.Y. 2003) ("[N]either the bespeaks caution doctrine nor the Safe Harbor provision of the PSLRA protects a defendant from liability if a statement was knowingly false when made [even if defendants gave adequate warnings]."); *In re Indep. Energy Holdings PLC Sec. Litig.*, 154 F. Supp. 2d 741, 756 (S.D.N.Y. 2001) (holding that the bespeaks caution doctrine does not protect forward-looking statements sub judice because "[n]o degree of cautionary language will protect material misrepresentations or omissions where defendants knew their statements were false when made" and also, similarly, under the PSLRA that "plaintiffs have pled that the forward-looking statement was made with actual knowledge of its falsity. . . . Such allegations render the statements actionable"); cf. *In re Duane Reade Inc. Sec. Litig.*, No. 02 Civ. 6478 (NRB), 2003 U.S. Dist. LEXIS 21319, at \*18 (S.D.N.Y. Nov. 25, 2003) (citing *In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 141 (S.D.N.Y. 1999), a pre-PSLRA case).

b. The Problem with *SeeBeyond*, *Asher*, and Similar Case Law<sup>91</sup>

*SeeBeyond* and *Asher* interpret the term “meaningful” to require a factual inquiry into the issuer’s state of mind or subjective environment. Like *Schaffer*, the *Asher* court cites no authority for its interpretation of the first prong of the safe harbor,<sup>92</sup> nor does it acknowledge or make any attempt to distinguish contrary results in other circuits.<sup>93</sup> For its part, *SeeBeyond* misunderstands the precedent it does cite.<sup>94</sup> In the end, both *SeeBeyond* and *Asher* simply chart their own courses out of the safe harbor, each interpreting the word “meaningful” in a slightly different but functionally similar way. The *SeeBeyond* court reads it to say that no statement of caution accompanying a fraudulent forward-looking statement can be meaningful, in the most basic sense of that term, if it does not articulate the ways in which the forward-looking statement is deceptive.<sup>95</sup> *Asher* reads it to say that

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91. Unsurprisingly, a good number of courts within the Seventh Circuit, typified by *Ong ex rel. Ong Ira v. Sears, Roebuck & Co.*, 388 F. Supp. 2d 871 (N.D. Ill. 2004), follow the *Asher* rule. More alarmingly, however, a number of district courts outside the Seventh Circuit have also followed *Asher*’s lead. See case cited *infra* note 164.

92. Though not cited therein, the basis for Judge Easterbrook’s opinion in *Asher* is reminiscent of a Seventh Circuit precedent predating the statutory safe harbor’s enactment. See *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1333 n.8 (7th Cir. 1995) (“[P]redictions that don’t pan out can lead to Rule 10b-5 liability only if the prediction was unreasonable *in light of the information available at the time the statement was made.*” (emphasis added) (citing *Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1132 (7th Cir. 1993))).

93. The seminal case articulating the rule that an issuer’s cautionary language need not “mention the factor that ultimately belies a forward-looking statement” is *Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999). See also *Helwig v. Vencor, Inc.*, 251 F.3d 540, 558 (6th Cir. 2001); *In re XM Satellite Radio Holdings Sec. Litig.*, 479 F. Supp. 2d 165, 177–78 (D.D.C. 2007); *Yellen v. Hake*, 437 F. Supp. 2d 941, 964–66 (S.D. Iowa 2006).

94. The *SeeBeyond* court misunderstands acknowledged dicta from a Ninth Circuit opinion, disagrees with it, and then articulates a rule that can only have been inspired by the Supreme Court’s *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), which predated the enactment of the PSLRA. The Court in *Virginia Bankshares* affirmed a jury’s finding, in a proxy case, that directors of a company fraudulently opined that a proposed freeze out merger price was fair to shareholders, where the directors knew that the price was unfair. The Court engaged in a good deal of discussion about the facts and beliefs implied by an opinion. On the effect of cautionary facts disclosed along with the misleading statement of opinion, the Court ventured that they might render the statement of opinion inactionable, but cautioned that “not every mixture with the true will neutralize the deceptive.” *Id.* at 1097. To the extent that *Virginia Bankshares* might have been read to require courts to look at the good faith or honest belief a corporate issuer of securities, as an entity, has in its publicly disclosed projections and predictions, it was superseded by Prong One of the PSLRA’s safe harbor.

95. *In re SeeBeyond Techs. Corp. Sec. Litig.*, 266 F. Supp. 2d 1150, 1165 (C.D. Cal. 2003) (“If the forward-looking statement is made with actual knowledge that it is false or misleading, the accompanying cautionary language can only be meaningful if it either states the belief of the speaker that it is false or misleading or, at the very least, clearly articulates the reasons why it is false or misleading. These are undeniably ‘important factors that could cause actual results to differ materially from those in the forward-looking statement . . . .’”); see also *Beck*, *supra* note 7, at 200–01.

cautionary language accompanying forward-looking statements cannot be meaningful if the issuer does not refer to—not just “important factors that could cause actual results to differ materially from those in the forward-looking statement” as required by the statute—but instead “the principal or important risks [of deviations from expectations]”<sup>96</sup> that actually faced the company at the time it made the projection.<sup>97</sup>

While they do not cite to either, both *SeeBeyond* and *Asher* echo the bespeaks caution doctrine and its regulatory half-sister, Rule 3b-6—the SEC’s safe harbor rule for projections—which is applicable only to filings with the Commission.<sup>98</sup> Rule 3b-6 expressly incorporates, inter alia, a “good faith” component as well as a “sound factual basis” component. Many courts applying the bespeaks caution doctrine outside the context of SEC filings have also incorporated these two concepts.<sup>99</sup> Interestingly, *SeeBeyond* (good faith) and *Asher* (sound factual basis)

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96. *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 734 (7th Cir. 2004).

97. We need not guess at Judge Easterbrook’s rationale or his own views on corporate disclosure and statutory construction. In fact, his views have been clearly articulated in other forums. See FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 302 (1991) (expressing concern that firms cannot know until sometime after their disclosures whether or not they were sufficient, proper, and within the boundaries of existing law); Frank H. Easterbrook, *Text, History, and Structure in Statutory Interpretation*, 17 HARV. J.L. & PUB. POL’Y 61, 68 (1994) (“When the text has no answer, a court should not put one there on the basis of legislative reports or moral philosophy—or economics! Instead the interpreter should go to some other source of rules, including administrative agencies, common law, and private decision.”). Judge Easterbrook posits that statutes either resolve a problem with a clear rule or they invite the development of common law by judges. Frank H. Easterbrook, *Statutes’ Domains*, 50 U. CHI. L. REV. 533 (1983). Further, he argues, where it is clear that the legislature sought to “pursue[] Goal X by Rule Y,” the role of the judge is not to preempt the legislature’s selection of the rule. *Id.* at 546. The PSLRA generally and the text of the safe harbor provision in particular, as informed by the display of unusual bipartisan will behind enacting this legislation in an effort to reduce expensive strike suits (overriding the President’s veto), appear to reflect Congress’s choice to use this set of both substantive and procedural rules to accomplish that goal. Instead, Judge Easterbrook seizes on the arguably ambiguous word “meaningful” as a portal to judicial construction of the type he so vehemently warns against, that which sets aside a rule chosen by the legislature. This is especially curious in this particularly setting, where his decision paves the way for discovery. See Frank H. Easterbrook, *Discovery as Abuse*, 69 B.U. L. REV. 635 (1989) (comparing discovery to trench warfare in World War I).

98. See 17 C.F.R. § 240.3b-6 (2010); cf. Homer Kripke, *Rule 10b-5 Liability and “Material” “Facts,”* 46 N.Y.U. L. REV. 1061, 1075 (1971) (advocating, in light of the vagaries of defining materiality and even what constitutes a fact in the context of securities disclosures in which accounting treatment figures prominently and the SEC takes differing stances on liability depending on whether it speaks for sellers or buyers, the following standard: “[W]hether, after reasonable investigation under the circumstances, the persons accused of misrepresentation reasonably believed that the presentation which they made was a fair one” (emphasis omitted)).

99. See, e.g., *In re Int’l Bus. Machs. Corp. Sec. Litig.*, 163 F.3d 102, 107 (2d Cir. 1998); *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1333 (7th Cir. 1995); *Exeter Bancorporation, Inc. v. Kemper Sec. Grp., Inc.*, 58 F.3d 1306, 1313 (8th Cir. 1995); *Kowal v. MCI Commc’ns Corp.*, 16 F.3d 1271, 1277 (D.C. Cir. 1994); *Isquith v. Middle S. Utils.*,

map loosely onto these two considerations. They are, nonetheless, inapt to analysis of the application of the PSLRA's statutory safe harbor.

## 2. Differences Between the Bespeaks Caution Doctrine and the Statutory Safe Harbor Render Resort to the Doctrine Inappropriate

While there is nothing wrong with use of the bespeaks caution doctrine in some circumstances, in the particular context of a motion to dismiss brought under Prong One of the statutory safe harbor—in a case where the forward-looking disclosures were allegedly fraudulently made—the bespeaks caution doctrine is inapposite from logical, theoretical, and practical perspectives. First, as a statutory matter, the safe harbor supersedes the bespeaks caution doctrine within its realm. And, the theoretical bases for the two constructs are different. Finally, as a practical matter, the use of the bespeaks caution doctrine enables and even encourages undesirable hindsight bias.

### a. Distinctions in Domain and Analytical Underpinning

The statutory safe harbor and the bespeaks caution doctrine are both liability-limiting constructs, but they differ in material respects. First, the safe harbor is more restricted—applying only in the context of private securities litigation—to certain defined types of statements, made by enumerated entities, and subject to a number of exclusions.<sup>100</sup> By definition, the statute prevails in the quite limited field in which it reigns. The bespeaks caution doctrine may apply in all other situations in which liability for projections is at issue, and therefore it is broader in its overall scope.<sup>101</sup>

On the one hand, the bespeaks caution doctrine, as applied in many courts, expressly contemplates consideration of the speakers' good faith and reasonable factual basis for their projections.<sup>102</sup> These fact-intensive matters will typically require discovery, precluding early dismissal based on this defense. On the other hand, the statutory safe harbor is potentially more powerful than the bespeaks caution doctrine, contemplating as it does an early ruling that meaningful

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Inc., 847 F.2d 186, 204 (5th Cir. 1988); *Eisenberg v. Gagnon*, 766 F.2d 770, 776 (3d Cir. 1985); see also Lawrence A. Cunningham, "Firm-Specific" Information and the Federal Securities Laws: A Doctrinal, Etymological, and Theoretical Critique, 68 TUL. L. REV. 1409 (1994) (discussing the use, in suits based on forward-looking disclosures made outside SEC filings, of Rule 3b-6-like reasoning).

100. The safe harbor explicitly excludes from protection forward-looking statements included in financial statements prepared in accordance with generally accepted accounting principles, statements contained in registration statements, or statements made in connection with a tender offer or initial public offering. 15 U.S.C. § 78u-5(b)(2) (2006). Further, for instance, the statutory safe harbor does not apply to entities with a recent history of securities fraud. *Id.* § 78u-5(b)(1)(A).

101. It has something of an inverse relationship to the "buried facts" doctrine. See *Kohn v. Am. Metal Climax, Inc.*, 322 F. Supp. 1331, 1362-65 (E.D. Pa. 1970), *modified*, 458 F.2d 255 (3d Cir. 1972).

102. See *supra* note 99.

cautionary statements immunize an issuer's projections without regard to contemporaneous intent.

The conceptual foundations for the two concepts differ. Court opinions based on the bespeaks caution doctrine express different rationales for it and the result it dictates.<sup>103</sup> Some courts have noted that at its core the doctrine is simply an approach to determining whether or not forward-looking disclosures are materially *misleading*.<sup>104</sup> Other courts have viewed the doctrine as implicating the *reliance* element of the 10b-5 claim, namely that no investor would reasonably rely on predictions that are tempered with admonitory language.<sup>105</sup> Last, led by the Third Circuit's oft-cited *In re Donald J. Trump Casino Securities Litigation*,<sup>106</sup> many courts applying the doctrine conclude that cautionary language renders predictions and projections *immaterial*.<sup>107</sup>

Unlike the bespeaks caution doctrine, which is not only more expansive in terms of its application but which also may be both urged and applied from three distinct theoretical perspectives, Prong One of the statutory safe harbor is expressly rooted in *Trump's* materiality analysis.<sup>108</sup> This suggests that the determination of Prong One's applicability should not hinge on the definition of the term "meaningful" vis-à-vis the issuer crafting the cautionary statements, and even less so on exactly what "the principal risks" were that the issuer faced at the time it crafted and delivered the cautionary language accompanying its forward-looking statements. Instead, the court's analytical goal should be to conduct a "careful and contextual"<sup>109</sup> reading of the forward-looking statements and their accompanying cautionary language to determine whether, considered together, they materially mislead a reasonable investor and therefore are actionable. This argument is discussed further in Part V.

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103. See generally Langevoort, *supra* note 1, at 483 (discussing, in passim, the three different rationales and noting that, at least in its infancy, the doctrine is "more a collection of cases linked by a common phrase or quotation than a set of analytically homogeneous holdings"); O'Hare, *supra* note 7, at 647–53 (discussing separately the "false or misleading," "materiality," and "reliance" versions of the bespeaks caution doctrine).

104. See, e.g., *Moorhead v. Merrill Lynch*, 949 F.2d 243, 245 (8th Cir. 1991); *I. Meyers Pincus & Assocs., P.C. v. Oppenheimer & Co.*, 936 F.2d 759 (2d Cir. 1991); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875 (1st Cir. 1991).

105. See, e.g., *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1414 (9th Cir. 1994) (citing unreasonableness of reliance as one basis for a finding that forward-looking disclosures bespeak caution and are therefore inactionable); *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994) (same).

106. 7 F.3d 357 (3d Cir. 1993).

107. See also *Saltzberg v. TM Sterling/Austin Assocs., Ltd.*, 45 F.3d 399 (11th Cir. 1995).

108. H.R. REP. NO. 104-369, at 44 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 743 (noting, after pointing out the irrelevance of the issuer's state of mind to the determination of the first prong's application, that "[c]ourts may continue to find a forward-looking statement immaterial—and thus not actionable . . . —on other grounds"); see also Beck, *supra* note 7, at 194–96 (noting the influence of *Trump's* materiality analysis on legislative deliberations preceding the enactment of the PSLRA); O'Hare, *supra* note 7, at 641 (addressing the legislative history in support).

109. Langevoort, *supra* note 1, at 503.

## b. Subjective Inquiry Promotes Fraud-by-Hindsight

The approach taken in *Schaffer*, *See Beyond*, and *Asher* encourages the hindsight bias that muddies the distinction between fraud and innocent error or misrepresentation.<sup>110</sup> Predictions of uncertain future events will often prove to be wrong.<sup>111</sup> Given what we know about the prevalence of the safe harbor defense, predictions that fail to materialize in fact drive most private securities litigation today. This raises two possibilities. Either plaintiffs see fraud ex post, building a weak case around dashed expectations, or, in anticipation of the safe harbor defense, plaintiffs allege not only that contrary facts existed at the time of the forward-looking statements but also allege facts that they hope will demonstrate management was aware of the contrary circumstances.<sup>112</sup> It stands to reason that the more facts are emphasized in connection with the motion to dismiss, the more likely a plaintiff class will be able to use inferences only made possible by hindsight to bootstrap itself past a motion to dismiss.<sup>113</sup> Unfortunately, this is probably happening more often than it should in the district courts.<sup>114</sup>

Thus, the interjection into the statute of a subjective inquiry into the issuer's state of mind or environmental circumstances is not only contrary to the purview of the statute and theoretically unsound, it also encourages a form of fraud-by-hindsight—something the federal courts have so often rejected.<sup>115</sup> But before

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110. Gulati et al., *supra* note 75.

111. See, e.g., *Raab v. Gen. Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993); Gulati et al., *supra* note 75. The Senate Report quoted a letter from a large institutional investor: "A major failing of the existing safe harbor [Rule 175] is that while it may provide theoretical protection to issuers from liability when disclosing projections, it fails to prevent the threat of frivolous lawsuits that arises every time a legitimate projection is not realized." S. REP. NO. 104-98, at 16 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 695.

112. See *supra* note 12 and accompanying text.

113. *Langevoort*, *supra* note 1, at 494 ("Courts pass judgment moreover, knowing that this particular reliance was indeed unwise. In hindsight, it is easy to find fault with reliance on self-interested others.").

114. *In re Compuware Securities Litigation*, 301 F. Supp. 2d 672 (E.D. Mich. 2004), and *In re FirstEnergy Corp. Securities Litigation*, 316 F. Supp. 2d 581 (N.D. Ohio 2004), provide good examples of cases in which the plaintiffs successfully bootstrap allegations of defendants' actual knowledge of incorrect facts or assumptions into a finding that the putative meaningful cautionary statements issued by defendants were not meaningful. While not an exact parallel to the Seventh Circuit's *Asher*, this type of reasoning is the danger the *Asher* ruling enables and encourages.

115. E.g., *Philadelphia v. Fleming Cos., Inc.*, 264 F.3d 1245, 1260 (10th Cir. 2001) ("[A]llegations that the defendant possessed knowledge of facts that are later determined by a court to have been material, without more, is not sufficient to demonstrate that the defendant intentionally withheld those facts from, or recklessly disregarded the importance of those facts to, a company's shareholders in order to deceive, manipulate, or defraud."); *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000) ("[A]llegations that defendants should have anticipated future events and made certain disclosures earlier than they actually did do not suffice to make out a claim of securities fraud."); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 538 (3d Cir. 1999) ("Rule 10b-5 liability does not attach merely because '[a]t one time the firm bathes itself in a favorable light' but '[l]ater the firm discloses that things are less rosy.'" (quoting *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990)), *abrogated*

determining that the *Schaffer*, *SeeBeyond*, and *Asher* decisions are fatally flawed, let us review some relevant policy considerations to assess whether there is any other normative support for the jurisprudential detour these cases have established.

#### IV. POLICY ARGUMENTS

We have reviewed the text of the statute and its legislative history, which together make clear Congress's purpose to block the road taken by *Schaffer*, *SeeBeyond*, and *Asher*. We also have considered the weakness of the *Schaffer/SeeBeyond/Asher* approach from an analytical standpoint and the additional hindsight burden this perspective creates. Now we move to a more normative analysis of the *Schaffer* and *SeeBeyond/Asher* results. The following subparts review some additional policy considerations surrounding the PSLRA, concluding that despite the perhaps counterintuitive nature of a strict application of Prong One, this is exactly how courts must apply it.

##### *A. The Tradeoff Between Ad Hoc Adjudication and a Statutory Presumption*

Legal scholars have sometimes, like those conducting statistical analysis, divided errors into two types.<sup>116</sup> A type I error is the error of rejecting a true hypothesis, one that should have been accepted.<sup>117</sup> A type II error is the error of accepting a hypothesis that should have been rejected.<sup>118</sup> Whether a type I error is preferable to a type II error in this context is discussed below, but first let us use this rubric to assess the validity of the dismissal of a securities fraud complaint based on the safe harbor, in the setting where predictions and projections turn out to be incorrect or the plans or objectives of management change—in other words, in those cases where litigation is likely to ensue. Table 1, which follows, categorizes the possible legal outcomes in terms of type I and type II errors. Note that where the predictions or projections—or the plans and objectives of management—turn out to be correct, or they in fact materialize as disclosed, there is no liability trigger,

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by Institutional Investors Grp. v. Avaya, Inc., 564 F.3d 242 (3d Cir. 1999); see also *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (“The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions. But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause.” (citations omitted)).

116. See, e.g., Kenneth B. Davis, Jr., *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U. L. REV. 1, 25–30 (1985) (discussing tradeoff between type I and type II errors in the context of invalidation of a fiduciary's good faith decision on the one hand, and validation of bad faith decisions on the other); see also Robert E. Thomas, *Debugging Software Patents: Increasing Innovation and Reducing Uncertainty in the Judicial Reform of Software Patent Law*, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 191, 236 n.336 (citing RICHARD J. LARSEN & MORRIS L. MARX, AN INTRODUCTION TO MATHEMATICAL STATISTICS AND ITS APPLICATIONS 299 (2d ed. 1986)).

117. Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711, 711 (1996) (discussing false positives and false negatives as they relate to the heightened pleading standards of the PSLRA).

118. *Id.*

that is, no securities fraud suit would be filed regardless of whether either scienter or meaningful cautionary language was present or absent. Accordingly, in this setting, the relevant variables are the issuer's intent to defraud and the issuer's effort to utilize the safe harbor by supplying cautionary statements.

Table 1. Validity of dismissal of securities fraud complaint based on the PSLRA's safe harbor, considering the presence of cautionary statements (MCS), and the issuer's actual intent.

	<b>Intent to defraud present</b>	<b>Intent to defraud absent</b>
<b>Safe Harbor Inapplicable</b> (i.e., no MCS ∴ no dismissal)	Intent to defraud + no MCS = true positive (i.e., scienter, case not dismissed)	No intent to defraud + no MCS = false positive (i.e., no scienter, yet case not dismissed) <b>type I error</b>
<b>Safe Harbor Applies</b> (i.e., MCS ∴ case dismissed)	Intent to defraud + MCS = false negative (i.e., scienter, but case dismissed) <b>type II error</b>	No intent to defraud + MCS = true negative (i.e., no scienter and case dismissed)

This table demonstrates that in the context of motions to dismiss based on the PSLRA safe harbor, the false positive (type I error) is denial of the motion to dismiss when the issuer has no intent to defraud, and the false negative (type II error) is granting the motion to dismiss when the securities issuer intends to defraud.

Finding an innocent person guilty is a classic type I error, while acquitting a guilty person is a type II error.<sup>119</sup> Using what we know about this most “axiomatic and elementary” legal principle—the presumption of innocence until guilt is proven<sup>120</sup>—we could assume that our legal system generally prefers type II errors over type I errors.<sup>121</sup>

119. Cf. Merritt B. Fox, *Insider Trading Deterrence Versus Managerial Incentives: A Unified Theory of Section 16(b)*, 92 MICH. L. REV. 2088, 2118 (1994) (calling the *likelihood* of finding an innocent trade based on inside information a type I error, and calling the *likelihood* of finding a trade based on inside information to be an innocent trade a type II error).

120. Coffin v. United States, 156 U.S. 432, 453–56 (1895) (“Blackstone (1753–1765) maintains that ‘the law holds that it is better that ten guilty persons escape than that one innocent suffer.’” (quoting 4 WILLIAM BLACKSTONE, COMMENTARIES \*352)).

121. See, e.g., Davis, *supra* note 116, at 38 (discussing the law's propensity to create

In the criminal arena, this preference is justified. A look at the outcomes and associated costs provides the rationale for the criminal (both substantive and procedural) laws' preference for eliminating type I error. An innocent person found guilty faces loss of her liberty or perhaps even her life; both of these are deemed to be far more valuable than any general loss of faith in the legal system and its constitutional protections that might be engendered by the occasional acquittal of a known guilty person.

But type I error is not always preferred over type II.<sup>122</sup> Indeed, commentators have noted that the decreased burden of proof in the general civil context exhibits a preference for limiting type II error, perhaps at the expense of an increase in type I error.<sup>123</sup> And, presumably, error reduction in itself is not a goal. But as legislation inevitably balances the interests of various constituencies, it is likely that one goal will be advanced at the expense of another—hence the type I/type II analysis here.

Professor Stout considers hypothesis rejection in her critique of the PSLRA's heightened pleading standards.<sup>124</sup> She argues that the PSLRA wrongly targeted reduction of type I errors at the expense of increasing type II errors because Congress failed to consider the relative costs of each type of error.<sup>125</sup> By Professor Stout's rough calculations, the loss of investor confidence caused by unremedied fraud in the marketplace (type II error) is approximately 100 billion dollars, far greater than the cost of strike suits (type I error), which many have estimated to be in the hundreds of millions of dollars.<sup>126</sup> While she concedes that strike suits are problematic, she ultimately suggests that the lead plaintiff provision of the PSLRA is the better method of reducing the incidence of strike suits in the civil securities fraud arena.<sup>127</sup> Implicit in her argument is that the PSLRA's heightened pleading

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bright line rules designed to create certainty and to eliminate type I error at the expense of increased type II error, in the context of fiduciaries' opportunism).

122. Just using common sense, we can intuit several situations outside the law in which it would be far more important to minimize type II errors than type I. In the instance of airport screening for weapons, we would prefer to endure the additional delay and invasion of privacy associated with a full-scale search of our carry-on luggage than bear the thought that more lax screening might permit a terrorist to bring a deadly weapon onboard. And in the field of medical diagnostics, type I errors—after which additional testing can reveal the false nature of the initially positive result—generally are also preferred over type II errors, which are likely to give the patient a false sense of security and result in his foregoing necessary medical treatment. We see that in both of these cases, the cost of a false negative can be much higher than the cost of a false positive.

123. Jeffrey W. Stempel, *New Paradigm, Normal Science, or Crumbling Construct? Trends in Adjudicatory Procedure and Litigation Reform*, 59 BROOK. L. REV. 659, 698 (1993) (explaining scientists' general preference for type II errors over type I and discussing these in the context of burdens of proof).

124. Stout, *supra* note 117, at 714–15.

125. Professor Stout assessed direct costs of false positives and false negatives. Understandably, she made no attempt to assess error costs using the traditional formula, which would involve assessment of the probability of error and the magnitude of error, as well as the fraction of defendants who are actually liable and the total quantity of litigation. *See generally* Thomas R. Lee, *Pleading and Proof: The Economics of Legal Burdens*, 1997 BYU L. REV. 1, 5.

126. Stout, *supra* note 117, at 714–15.

127. *Id.*

standards for private securities suits are wrongheaded because they improperly prefer to eliminate type I error rather than costlier type II error.

Professor Stout's law-and-economics-based arguments raise two interrelated points. First, her rough cost comparison is convincing, if her estimate of a reduction in the value of the market capitalization of one percent due to type II errors<sup>128</sup> is even close to accurate. However, while this calculation may be well-suited to analysis of the costs of the heightened pleading standard, her thesis (Congress's preference to eliminate type I errors rather than type II errors is misguided) does not persuade in—nor does she attempt to extend it to cover—the context of the safe harbor for forward-looking statements. That is because the safe harbor provision was not targeted solely at reduction in strike suits as were many of the other substantive and procedural provisions of the PSLRA.<sup>129</sup> Instead it had another express purpose, that of promoting corporate disclosure of forward-looking information.<sup>130</sup>

Second, Professor Stout's argument strengthens the supposition made earlier that the policy considerations as articulated by the legislative history should control. In fact, based on the legislative history of the PSLRA, we know that the purpose of the safe harbor was to encourage disclosure of forward-looking information by reducing the very real threat of expensive litigation (regardless of its outcome). This purpose was clearly expressed by both chambers of Congress, with the support of the SEC.<sup>131</sup> In other words, Congress was seeking, with Prong

128. *Id.* at 714.

129. *See, e.g.*, 15 U.S.C. § 77z-1(a)(2)(A) (new standards for establishing a class); *id.* § 77z-1(a)(3)(B)(v), (a)(8) (selection of lead plaintiff's counsel); *id.* § 77z-1(a)(2)(A) (heightened pleading requirements); *id.* § 77z-1(b) (discovery stays); *id.* § 77z-1(c)(2) (mandatory sanctions for improper pleading); *id.* § 77z-2(c)(1)(B)(i) (restriction of joint and several liability to those with actual knowledge of misrepresentations).

130. The safe harbor's unique contribution to the PSLRA's policy goal was double-barreled. Prong One would both reduce the costs of frivolous litigation and increase the flow of useful information into the capital markets. As the Conference Committee Report's Statement of Managers further elaborates, in a section entitled "The muzzling effect of abusive securities litigation":

Abusive litigation severely affects the willingness of corporate managers to disclose information to the marketplace. . . . "Shareholders are also damaged due to the chilling effect of the current system on the robustness and candor of disclosure. . . . Understanding a company's own assessment of its future potential would be among the most valuable information shareholders and potential investors could have about a firm."

Fear that inaccurate projections will trigger the filing of securities class action lawsuit has muzzled corporate management.

. . . .

The Conference Committee has adopted a statutory "safe harbor" to enhance market efficiency by encouraging companies to disclose forward-looking information.

H.R. REP. NO. 104-369, at 42-43 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 741-42 (quoting a former SEC chair).

131. *See id.* at 43. The Senate Report accompanying the initial version of the PSLRA speaks similarly:

One, to eliminate the type I errors that were “muzzling” corporate managers.<sup>132</sup> The statute’s major provisions thus included both procedural and substantive elements designed to enable courts to swiftly dismiss unmeritorious claims,<sup>133</sup> eliminating extortionate discovery and restoring some balance to private securities litigation, the costs of which Congress determined were out of control and injurious to the investing public and “the entire U.S. economy.”<sup>134</sup>

Perhaps only coincidentally, the safe harbor itself is also both procedural and substantive. Procedurally, it gives courts the tool with which to “acquit” those who employ the safe harbor—whether innocent or guilty<sup>135</sup>—without subjecting them to the protracted litigation that would have ensued otherwise. This procedural tool then permits the attainment of the provision’s twin substantive goals: reduction in meritless suits and increase in corporate disclosure. Thus, it is apparent that in order to promote increased corporate disclosure (i.e., to eliminate type I errors) and at the same time to reduce frivolous suits and abusive litigation practices, Congress was willing to tolerate some type II error. And where Congress has made a clear policy choice, it is not for the courts to override that.<sup>136</sup>

In short, we must not overlook the value of forward-looking information to the marketplace when assessing how the first prong of the safe harbor should be

Private securities class actions under 10b-5 inhibit free and open communication among management, analysts, and investors. This has caused corporate management to refrain from providing shareholders forward-looking information about companies. . . . As a result, investors often receive less, not more, information, which makes investing more risky and increases the cost of raising capital.

S. REP. NO. 104-98, at 5 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 684.

The SEC also supported a law that would encourage forward-looking disclosures by securities issuers. *See Safe Harbor for Forward Looking Statements*, Sec. Act Release No. 33,710 [1994–95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,436 (Oct. 13, 1994). For a good review of the Commission’s varying stances on the advisability of issuers disclosing forward-looking information, see Beck, *supra* note 7. For a more detailed history and additional pointed commentary, see generally HOMER KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* (1979).

132. The Supreme Court has also explicitly acknowledged that a primary concern of the statute is curbing strike suits, that is, type I errors. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007) (describing the purpose of the PSLRA as curbing “frivolous, lawyer-driven litigation, while preserving investors’ ability to recover on meritorious claims”).

133. The procedural provisions include the bar on discovery, restrictions on who may serve as lead plaintiff, lead counsel, and enhanced sanctions for abusive litigation. The substantive provisions include, *inter alia*, elimination of joint and several liability and a cap on recoverable damages. *Id.* at 320–21; *see also* Seligman, *supra* note 1 (outlining the provisions of the Act).

134. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (quoting H.R. REP. NO. 104-369, at 31); *see also* James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3, 15 (1999) (discussing the statute’s “goal of reducing the incidence of lawyer-driven frivolous class actions”).

135. As discussed *infra* Part IV.B., it will not be so easy for fraudsters to take advantage of this statutory formula for inoculating intentionally false forward-looking statements.

136. *Reves v. Ernst & Young*, 494 U.S. 56, 63 n.2 (1990) (“If Congress erred, . . . it is for that body, and not [the courts], to correct its mistake.”).

applied.<sup>137</sup> Further affirming Congress's preference to reduce type I error at the expense of marginally increased type II error is the fact that the amount of type II error to be tolerated is necessarily limited. This issue is discussed in the next subpart.

*B. The Limited Harm Caused by Type II Error*

Not only is Prong One a means uniquely suited to achieve its legislative goals, but the amount of type II error likely to occur as a result of this policy preference is relatively limited. For purposes of this discussion, we shall assume type II error should be minimized because in this context it is bad.<sup>138</sup> At least on the surface, it is bad in that it can lead to the "unseemly" result that the federal securities laws will appear to have granted a "license to lie."<sup>139</sup> Though precise quantification of that eventuality is not feasible, several arguments support the conclusion that the number of type II errors likely to result in this context will be few.

First, there are market incentives to speak the truth.<sup>140</sup> This is particularly true in the realm of publicly owned companies and widely traded stocks—presumably the precise arena in which Congress hoped to encourage more disclosure of forward-looking information.

Second, the defense provided by Prong One is limited in its scope and application. It relates only to specifically defined forward-looking statements, not all forward-looking statements, and even then only when these are accompanied by meaningful cautionary language. Enacted as it was, as part of the PSLRA, the safe harbor applies only to private securities litigation. Within that context, the presumption's application is not permitted in the most risky types of investments like IPOs and penny stock transactions.<sup>141</sup> Further, if an issuer succeeds in using forward-looking disclosures to defraud the market within Prong One's narrow domain, there is still the threat of SEC enforcement action. The SEC is not bound by Prong One's defense-friendly presumption of immateriality.<sup>142</sup> Therefore, there is still a significant deterrent present.

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137. Moreover, some have argued that the deterrent effect of securities regulation is lost when issuers face substantial threat of liability (or presumably any large financial penalty) whether or not they have actually committed fraud. *See Choi, supra* note 9, at 574–75.

138. The House Report on the Securities Exchange Act of 1934 pointed out the importance of providing investors with sufficient information to make intelligent investment decisions: "No investor . . . can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. . . . [T]he hiding and secreting of important information obstructs the operation of the markets as indices of real value." H.R. REP. NO. 73-1383, at 11 (1934), *reprinted in* 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1934 (J.S. Ellenberger & Ellen P. Mahar eds., 1973).

139. Coffee, *supra* note 1, at 989.

140. *See, e.g.,* S. REP. NO. 104-98, at 18 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 697 ("[T]he Committee believes that market discipline will most likely provide sufficient disincentives for using the safe harbor as a 'license to lie' . . . ."); Langevoort, *supra* note 1, at 496, 502; Talley, *supra* note 9, at 1958 & n.12.

141. *See* 15 U.S.C. §§ 78u-5(c)(1)(B)(i), 77z-2(c)(1)(B)(i) (2006).

142. The bespeaks caution doctrine, rather than the statutory safe harbor, applies in SEC

And third, an issuer perpetrating a real fraud is likely to run afoul of the securities laws in other ways. Most likely is that it will have, in committing this fraud, also or in the alternative misstated a present or historical fact.<sup>143</sup> Any such misstatement would not be protected by the statutory safe harbor. Therefore, such an issuer will be successfully prosecuted or sued irrespective of Prong One's application.

Given these facts, the amount of type II error—issuers in actuality abusing Prong One successfully—is probably quite limited.

### C. Prong One Is Valuable Despite Type II Error

Finally, we should not discount the value of the risk language that Prong One does encourage. The “meaningful cautionary statement” requirement inherent in Prong One, to pass muster, must include at least some “important factors that could cause actual results to differ materially from those in the forward-looking statement.”<sup>144</sup> The interpretation given by most courts is that the issuer need not have the prevision necessary to “explicitly mention the factor that ultimately belies the forward looking statement.”<sup>145</sup> Where the *Asher* court parts ways with the other circuits is that the others hold this to be sufficient to allow that portion of the case to be dismissed, so long as the risk factors disclosed are of equal magnitude as that which ultimately causes the results to differ materially from the projection.<sup>146</sup> This result is consistent with the legislative history on this point.<sup>147</sup> The rationale is that so long as the “investor has been warned of risks of a significance similar to that actually realized, she is sufficiently on notice of the danger of the investment to make an intelligent decision about it according to her own preferences for risk and reward.”<sup>148</sup>

Though the power of this risk language to adequately warn the average investor may be debatable,<sup>149</sup> we must assume that such risk disclosures will transmit a

enforcement actions. *See SEC v. Merch. Capital, LLC*, 483 F.3d 747, 767 n.18 (11th Cir. 2007). This is because the statutory safe harbor is expressly limited to “any private action arising under this chapter.” 15 U.S.C. § 78u-5(c)(1); *SEC v. U.N. Dollars Corp.*, No. 01 Civ. 9059(AGS), 2003 U.S. Dist LEXIS 1099 (S.D.N.Y. Jan. 27, 2003).

143. *Langevoort*, *supra* note 1, at 501. Some have suggested that as false statements of historical fact are excluded from safe harbor protection, an issuer's omission of the reasons the prediction is false might also constitute a violation of 10b-5 anyway. *E.g.*, *O'Hare*, *supra* note 7, at 651–54. Of course this *Virginia Bankshares*–inspired perspective and result vitiates the intended prophylactic nature of Prong One, as discussed here.

144. 15 U.S.C. §§ 78u-5(c)(1)(B)(i), 77z-2(c)(1)(B)(i) (2006); *see supra* text accompanying note 22 (quoting the PSLRA's safe harbor provision).

145. *See, e.g.*, *Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999).

146. *Asher v. Baxter Int'l Inc.*, 377 F.3d 727 (7th Cir. 2004).

147. *See H.R. REP.* 104-369, at 44 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 743 (“Failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor.”).

148. *Harris*, 182 F.3d at 807.

149. *See Langevoort*, *supra* note 1, at 492–97 (arguing, *inter alia*, that optimistic forward-looking messages are even more persuasive when they contain cautionary language).

cautionary message to at least some market participants, particularly those more sophisticated investors who quickly absorb issuer disclosures and drive the prices of securities.

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Some courts, when faced with the distasteful prospect of appearing to “let a guilty man go free,” have chosen instead to convert Prong One’s irrebuttable presumption into a rebuttable one, and impermissibly so. Neither the circuit court majority’s straightforward interpretation, the legislative history, nor any policy objective supports this judicial choice. To put safe harbor jurisprudence back on its proper course, the pitfalls exemplified by *Schaffer* and cases like it on the one hand, and *SeeBeyond/Asher* on the other, must be avoided.

#### V. PRESCRIPTION FOR PROPER ASSESSMENT, UNDER SAFE HARBOR PRONG ONE, OF ALLEGEDLY DECEITFUL FORWARD-LOOKING STATEMENTS

*Schaffer* and *SeeBeyond/Asher* present similar but distinct analytical problems that negatively affect safe harbor jurisprudence. But at their core, these efforts to inject an intent inquiry into the application of the safe harbor fly directly in the face of Congress’s intent in establishing it. Ultimately this wayward branch of safe harbor jurisprudence represents judicial antipathy to the safe harbor’s prophylactic effect.

As such, there may be no interpretive fix; to some the statute may simply be internally incoherent. In the years since its enactment, litigants and courts have continued to find ways to circumvent it, some of which are increasingly creative.<sup>150</sup> But dislike of the statute’s effect does not make such circumvention intellectually sound. By digging deeper into the statute and considering the safe harbor in its specific field of application, we can develop some guiding principles that will improve the integrity of ongoing application of the safe harbor. Used consistently, these guidelines will go a long way toward reducing and ameliorating the perception problem created by the type II error the statutory safe harbor introduces.

##### *A. Avoiding Schaffer’s Flaw Requires Careful Parsing of “Mixed” Statements*

*Schaffer* represents a category of opinions marred by loose interpretation—those that either collapse the two prongs of the safe harbor or conflate the statutory safe harbor and older, broader bespeaks caution concepts and authorities.<sup>151</sup> As we know, the bespeaks caution doctrine incorporates a good-faith, reasonable-basis analysis. Undoubtedly this approach is more intuitively appealing, more comfortable than that dictated by the statutory safe harbor. Indeed the bespeaks

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150. See, e.g., *Edward J. Goodman Life Income Trust v. Jabil Circuit*, 594 F.3d 783, 794 (11th Cir. 2010) (noting that to accept as true the complaint’s allegations that defendants knew of the falsity of their forward-looking statements, irrespective of the presence of meaningful cautionary statements, would automatically defeat the safe harbor in an impermissible way).

151. See *supra* Part II.A.

caution doctrine may comport more generally with fundamental notions of what constitutes fraud as well as pre-PSLRA Supreme Court jurisprudence on the subject of misleading opinions.<sup>152</sup> Therefore, it is understandable that some courts have reacted favorably to misguided arguments about the issuer's good faith and/or reasonable basis under the statutory safe harbor. Even the appearance of a license to lie runs counter to courts' natural predisposition to do justice.

For courts that are overly swayed by concerns about the fact and impact of type II error the safe harbor engenders, the most rational approach is to focus on limiting its use to truly forward-looking statements. A court that is hesitant to apply the safe harbor to allegedly false forward-looking statements can take some comfort in a strict analytical approach to "mixed" statements. Corporate disclosures being as varied as they are, both in form and substance, courts are commonly called upon to assess mixed statements—those that contain elements that are at once forward-looking and also capturing some element of present or historical fact.<sup>153</sup> Courts can and should exercise caution not to be led down a path that results in wholesale safe harbor protection of forward-looking statements that are mixed.

Putative forward-looking statements can be mixed in two ways. They can be substantively mixed projections that by definition incorporate present or historical facts. Or they can be semantically mixed, that is, present-tense language used to convey an anticipatory message, or the reverse, existing facts couched in the future tense or using anticipatory language. Each of these types of statements must be scrutinized closely and not mechanically. In cases involving purported forward-looking statements that are mixed, the court will need to parse them carefully to ascertain what portion of the statement deserves protection and what does not. To do this, the court must actively refer to plaintiffs' particular allegations of falsehood.

### 1. Substantively Mixed Statements

A good example of the substantively mixed statement and proper treatment thereof is found in the First Circuit's *In re Stone & Webster, Inc., Securities Litigation*.<sup>154</sup> In that case, the court considered the forward-looking nature of the issuer's statement to the effect that it "has on hand . . . sufficient sources of funds to meet its anticipated [needs]."<sup>155</sup> The district court had apparently ruled that this statement qualified as a projection of future economic performance. But the First Circuit dug deeper, looking not only at the dictionary definition of the word "projection" and the purpose of the statutory safe harbor as set out in its legislative history, but also at the falsity alleged by the plaintiffs.<sup>156</sup> Reasoning that the

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152. See *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991).

153. See, e.g., *Harris*, 182 F.3d at 806 (discussing a mixed list containing both forward-looking factors and non-forward-looking factors as a single "unit" or "'statement' in the statutory sense," which could provide a possible basis for liability).

154. 414 F.3d 187 (1st Cir. 2005); see also *Iowa Pub. Emps. Ret. Sys. v. MF Global, Ltd.*, 620 F.3d 137, 144 (2d Cir. 2010) (instructing that forward-looking and non-forward-looking elements of mixed disclosures are "severable").

155. *In re Stone & Webster*, 414 F.3d at 212.

156. See *id.* at 212–13.

defendants' statement was comprised of two parts—one referring to the quantity of cash on hand, and the other referring to the amount of future capital needs—the court noted that the aspect of the statement alleged to be false was the part portraying the presently existing fact.<sup>157</sup> The plaintiffs, the court found, were not contending that the issuer underestimated its future cash needs, but instead that it was lying about its present access to funds.<sup>158</sup> Thus, the statement was properly excluded from safe harbor protection.<sup>159</sup> This more critical evaluation of a mixed statement is essential to proper application of Prong One to mixed forward-looking statements.

## 2. Semantically Mixed Statements

In a similar fashion, mixed statements that employ future tense to convey a present fact must also be analyzed quite carefully to assure they are given safe harbor treatment only when truly forward looking. The Ninth Circuit, holding two semantically mixed putative forward-looking statements to be not forward looking, articulated a strong policy reason for this stricter approach to parsing mixed statements. The disclosures for which the defendant sought safe harbor protection in *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*<sup>160</sup> were (1) a press release in which the company disclosed an FAA settlement agreement and fine, stating that “the settlement agreement’s provisions will not have a material adverse effect on the Company’s operations or financial results,”<sup>161</sup> and (2) the statement, made during a conference call with analysts: “[W]e are not anticipating any major increase in maintenance costs or the cost of oversights going forward as a result of [the settlement agreement].”<sup>162</sup> Despite the use of anticipatory language and tenor, the court found these statements to amount simply to disclosure of the FAA fine and its “present effects” of their imposition on the company.<sup>163</sup> To hold otherwise, the Ninth Circuit panel said, would permit “any corporation [to] shield itself from future exposure for past misconduct by making present-tense statements regarding the misconduct and its effects on the

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157. *Id.*

158. *Id.*

159. *Id.* at 213; *see also* Institutional Investors v. Avaya, 564 F.3d 242, 247 (3d Cir. 2009) (parsing defendants' statement “we are on track to meet our goals for the year” and holding that it did not incorporate current statements of fact and therefore was, in its context, entitled to safe harbor protection); Makor Issues & Rights, Ltd. v. Tellabs, Inc., 513 F.3d 702, 705 (7th Cir. 2008) (“When [the defendant] told the world that sales of its 5500 system were ‘still going strong,’ it was saying both that current sales were strong and that they would continue to be so, at least for a time, since the statement would be misleading if [defendant] knew that its sales were about to collapse. The element of prediction in saying that sales are ‘still going strong’ does not entitle [defendant] to a safe harbor with regard to the statement’s representation concerning current sales.”).

160. 320 F.3d 920 (9th Cir. 2003).

161. *Id.* at 936.

162. *Id.* (alteration in original).

163. *Id.* at 936–37.

corporation.”<sup>164</sup> Again, this deeper approach to what qualifies as a forward-looking statement is crucial to putting safe harbor jurisprudence back on course.

### 3. Mixed Statements as Units of Liability

Finally, courts should be particularly wary of misreading the holding in the Eleventh Circuit’s seminal *Harris v. Ivax Corp.*<sup>165</sup> *Ivax* involved, in part, allegations that a list of assumptions underlying a third-quarter forecast failed to warn investors of the possibility of a goodwill write-down.<sup>166</sup> In assessing what it called the “laundry list,” which contained both present facts and projections, the court said the following:

The mixed nature of this statement raises the question whether the safe harbor benefits the entire statement or only parts of it. Of course, if any of the individual sentences describing known facts (such as the customer’s bankruptcy) were allegedly false, we could easily conclude that that smaller, non-forward-looking statement falls outside the safe harbor. But the allegation here is that the list *as a whole* misleads anyone reading it for an explanation of *Ivax*’s projections, because the list omits the expectation of a goodwill write-down. If the allegation is that the whole list is misleading, then it makes no sense to slice the list into separate sentences. Rather, the list becomes a “statement” in the statutory sense, and a basis of liability, as a unit. It must therefore be either forward-looking or not forward-looking in its entirety.<sup>167</sup>

The *Ivax* court’s ultimate basis for protecting the laundry list as forward looking emphasizes the peril of reading this somewhat blanket statement out of context. In fact, the Eleventh Circuit went on to characterize the entire laundry list as “assumptions underlying a forward-looking statement,” which themselves qualify *under the express terms of the statute* as forward-looking statements.<sup>168</sup> The *Ivax* ruling on this point was clearly limited to mixed lists of assumptions underlying predictions—and then only when the plaintiff alleges that the list as a whole is misleading by omission, not that an existing fact is there misstated.<sup>169</sup> But this express limitation has not stopped the messy process of ad hoc judicial determination from improperly applying it beyond its explicit boundaries. Indeed, a

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164. *Id.* at 937; *cf.* *Harris v. Ivax Corp.*, 182 F.3d 799, 805 (11th Cir. 1999) (holding that “a statement about the state of a company whose truth or falsity is discernible only after it is made necessarily refers only to future performance” regardless of the present or future tense—or, indeed, sense—of the language used).

165. 182 F.3d at 799.

166. *Id.* at 802–03.

167. *Id.* at 806 (emphasis in original).

168. *Id.* at 807.

169. *Id.* (“[A] list or explanation will only qualify for this treatment if it contains assumptions underlying a forward-looking statement. . . . For these reasons, we hold that *when the factors underlying a projection or economic forecast include both assumptions and statements of known fact, and a plaintiff alleges that a material factor is missing, the entire list of factors is treated as a forward-looking statement.*” (emphasis added)).

number of cases have used the quoted language to support their finding that mixed statements generally can be afforded forward-looking statement status and protected by the safe harbor.<sup>170</sup> This approach may indeed grant a license to lie and therefore must be avoided.

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The opinions discussed here illustrate the difficult but achievable task courts face in ensuring that the safe harbor does not improperly protect misstatements of historical fact. But to further ensure respect for both the text and the legislative purpose of the safe harbor, courts must be wary of extending this type of parsing into the arena of risk factors, which is the essence of the flaw in the *SeeBeyond* and *Asher* cases.

### *B. Steering Clear of the Defect in SeeBeyond and Asher*

Using different analytical processes, the *SeeBeyond* and *Asher* courts interject on the one hand a good faith requirement and on the other a factual basis requirement into Prong One. Thus, while perhaps more sophisticated than *Schaffer*'s error, these opinions similarly represent an inappropriate use of the bespeaks caution doctrine. Viewed collectively, their specific analytical and jurisprudential defect is to assess the issuer's projections and attendant risk factors from the standpoint of the *issuer* rather than from the standpoint of the recipient of the statement. The cure for this flaw is to refocus the inquiry on the reasonable investor, as discussed below.

#### 1. Focus on the Investor Rather than the Issuer

To properly apply Prong One at the dismissal stage, a court must sidestep the good-faith-belief-and-factual-basis quagmire invited by inquiry into what the issuer knew or what it actually faced when it made the projections at issue. Instead, the statute itself along with its legislative history and policy rationales dictate that the meaningfulness of cautionary language be assessed from the perspective of its effect on the investor and the market to which it was communicated. The required analysis is rooted in, but not coincident with, the traditional conception of materiality.<sup>171</sup>

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170. *E.g.*, *In re Compuware Sec. Litig.*, 301 F. Supp. 2d 672, 684–85 (E.D. Mich. 2004) (entire 10-K); *In re Smith Gardner Sec. Litig.*, 214 F. Supp. 2d 1291, 1306 (S.D. Fla. 2002) (entire press release); *In re Unicapital Corp. Sec. Litig.*, 149 F. Supp. 2d 1353, 1374 (S.D. Fla. 2001) (entire press release).

171. The now-familiar test for materiality in federal securities fraud cases comes from the definition of materiality the Supreme Court adopted in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), which is whether the plaintiff has made

a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the

As the Ninth Circuit has explained in another context, when the question is whether a disclosure is adequate, “the application of the reasonable investor test is appropriate because adequacy of disclosure, like materiality, only can be judged against an objective standard of *investor behavior*.”<sup>172</sup> In other words: would an *investor* have been misled by this forward-looking statement and its attendant risk factors?<sup>173</sup> Or: would an *investor* have relied on such a projection, accompanied as it is by admonitions of risk? Or: would the forward-looking statement have changed the reasonable *investor*’s investment decision despite the stated risks of the projection not materializing?

The first of these questions obviously speaks to the misleading nature of the statement made. The second uses the vernacular of reliance. And the third formulation may be categorized most accurately as the traditional inquiry into materiality. But at the heart of each of these questions, in the present context, is an attempt to define the effect of the statement on the reader or listener. Where the answer is unquestionably no—to any or all of these questions—the risk information has effectively neutralized the projection’s optimistic message and rendered the projection in its context *inactionable*.

The word “inactionable” is intentionally used here rather than the word immaterial, which was employed by the Third Circuit in its opinion in Prong One’s progenitor, *In re Donald J. Trump Casino Securities Litigation*.<sup>174</sup> This is because to focus here on (the element of) materiality without regard to the propensity of a projection to mislead is misguided. While the view of materiality as residing in a silo may be appropriate in some 10(b) claims of verifiably false statements, it is inappropriate in cases involving projections, which by definition are not verifiable facts, at least not without hindsight. In a case involving allegedly fraudulent projections, the plaintiffs are not alleging that the projection was false per se, but instead that the projection was misleading, due to an omission either of salient risk factors or of existing facts that, if known, would have debunked the projection, or at a minimum more appropriately deflated the projection’s optimistic tone. To

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reasonable investor as having significantly altered the “total mix” of information made available.

*Id.* at 449; see also *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988).

172. *Durning v. First Boston Corp.*, 815 F.2d 1265, 1268 n.4 (9th Cir. 1987) (emphasis added).

173. Beck, *supra* note 7, advances this hypothesis as well. Unfortunately, despite his having accurately pinpointed the critical need to assess the misleading quality of a projection when evaluating a Prong One defense, Mr. Beck’s prescription fails to correct the district courts’ misinterpretation of Prong One:

Besides maintaining a logical relationship between policy objectives and statutory means, any set of interpretations of the three safe harbor provisions ought to also satisfy at least the following three criteria: (1) each provision should protect some set of forward-looking statements that the other two provisions do not (in other words, none of the three provisions should be rendered superfluous by the other two); (2) the provisions should provide acceptable guidance to managers; and (3) the interpretations ought to be reasonable constructions of the statutory language.

*Id.* at 199 (footnotes omitted); see *Freeland v. Iridium World Commc’ns, Ltd.*, 545 F. Supp. 2d 59, 72 (D.D.C. 2008) (quoting Beck’s language).

174. 7 F.3d 357 (3d Cir. 1993).

consider the materiality element in a vacuum, or even to overuse the word materiality as a matter of diction, is to lose sight of the element's nuance, especially in this setting.<sup>175</sup>

Professor Brudney has called materiality an “open-ended concept.”<sup>176</sup> Indeed, the label “material” or “immaterial” in a securities fraud opinion can and does encompass a diversity of similar conclusions about the facts disclosed or allegedly omitted. In various contexts, an immaterial statement may be an inconsequential one<sup>177</sup> or one that is statistically insignificant.<sup>178</sup> Alternatively, an immaterial matter may be one that fails to “alter[] the ‘total mix’ of information,”<sup>179</sup> or one that in hindsight failed to move the market.<sup>180</sup> Or, an immaterial statement may be deemed so because it is too vague to be relied upon.<sup>181</sup> Similarly, it may be held to be

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175. Mr. Beck argues that since the Third Circuit's *Trump* opinion was published, bespeaks caution rhetoric has inappropriately focused on materiality, and thus to the extent the statutory safe harbor is interpreted to codify this version of the bespeaks caution doctrine, it will not encourage issuers to disclose material information. Beck, *supra* note 7, at 198. This is precisely the semantic problem identified here. An optimistic projection that has been effectively neutralized by meaningful cautionary statements, which is no longer legally too optimistic or couched in the form of a guarantee, may be called immaterial as a matter of law. But these inactionable (legally “immaterial” per *Trump*) projections may still be valuable to those professional investors that read and understand them in their dynamic, multifaceted milieu.

176. Victor Brudney, *A Note on Materiality and Soft Information Under the Federal Securities Laws*, 75 VA. L. REV. 723, 725 (1989) (defining materiality as a balance between relevance and reliability, and discussing the various normative considerations associated with assessing materiality of forward-looking statements made in a variety of contexts); see also Michael J. Kaufman, *Living in a Material World: Strict Liability Under Rule 10b-5*, 19 CAP. U. L. REV. 1 (1990) (arguing that materiality subsumes all other elements of a 10(b) action); Kripke, *supra* note 98, at 1067 (offering that “[w]e know very little about materiality,” and ruminating on various formulations of the concept).

177. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 596 (7th Cir. 2006) (“The crux of materiality is whether, in context, an investor would reasonably rely on the defendant’s statement as one reflecting a consequential fact about the company.”), *rev’d on other grounds*, 551 U.S. 308 (2007).

178. *E.g.*, *In re Carter-Wallace, Inc. Sec. Litig.*, 150 F.3d 153, 157 (2d Cir. 1998).

179. *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); see also *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (stating that determination of materiality requires delicate assessment of significance of inferences drawn by the reasonable shareholder); U.S. Securities and Exchange Commission, Staff Accounting Bulletin: No. 99—Materiality, 17 C.F.R. § 211 (1999), available at <http://www.sec.gov/interps/account/sab99.htm#body3>.

A “truth on the market” argument is functionally similar. See, e.g., *Longman v. Food Lion, Inc.*, 197 F.3d 675, 687 (4th Cir. 1999) (Murnaghan, J., dissenting) (“The majority incorrectly suggests that any public information contradicting [the issuer’s] misleading statements forecloses the possibility of finding that those statements were material.”).

180. *E.g.*, No. 84 *Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 928–30 (9th Cir. 2003); *Oran v. Stafford*, 226 F.3d 275, 284 (3d Cir. 2000).

181. See, e.g., *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 547 (8th Cir. 1997) (“[S]ome

immaterial because it was not phrased in the form of a guarantee or simply because it discouraged optimism.<sup>182</sup>

Regardless of the precise version of materiality to which a court refers, the relationship between materiality and the misleading nature of a statement is unmistakable. Courts have often logically melded the two.<sup>183</sup> This has also been true in cases alleging deceitful forward-looking statements, for example:

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statements are so vague and such obvious hyperbole that no reasonable investor would rely upon them. ‘The role of the materiality requirement is not to attribute to investors a childlike simplicity but rather to determine whether a reasonable investor would have considered the omitted information significant at the time.’” (quoting *Hillson Partners Ltd. P’ship v. Adage, Inc.*, 42 F.3d 204, 213 (4th Cir. 1994)).

182. *E.g.*, *ABC Arbitrage Plaintiffs Grp. v. Tchuruk*, 291 F.3d 336, 359 (5th Cir. 2002) (noting in discussion of materiality that “‘projections of future performance not worded as guarantees are generally not actionable under the federal securities laws’ as a matter of law” (quoting *Krim v. BancTexas Grp., Inc.*, 989 F.2d 1435, 1446 (5th Cir. 1993))).

183. *See, e.g.*, *Rombach v. Chang*, 355 F.3d 164, 172 n.7 (2d Cir. 2004) (“The test for whether a statement is materially misleading under Section 10(b) and Section 11 is ‘whether the defendants’ representations, taken together and in context, would have misled a reasonable investor.’” (quoting *I. Meyer Pincus & Assocs. v. Oppenheimer & Co.*, 936 F.2d 759, 761 (2d Cir. 1991))); *Brody v. Transitional Hosps. Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002) (noting that a statement is misleading if it would give a reasonable investor the “impression of a state of affairs that differs in a material way from the one that actually exists”).

Indeed the thrust of the *Trump* holding was to disagree with “plaintiffs’ primary argument—that the statement relating the Partnership’s belief in the Taj Mahal’s capacity to generate ample income for the Partnership to make full payment on the bonds was *materially misleading*.” *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 367 (3d Cir. 1993) (emphasis added). This is so despite the *Trump* court’s focus on the term “materiality.” *See id.* at 369 (“[T]he complaint cannot survive a motion to dismiss because ultimately it does not sufficiently allege that the defendants made a *material* misrepresentation.” (emphasis in original)). While the court’s holding is indeed expressly couched in terms of materiality, *id.* at 368 n.10 (“[O]ur analysis here is predicated on the materiality requirement . . .”), its reasoning is inevitably more mixed:

We believe that given this extensive yet specific cautionary language, a reasonable factfinder could not conclude that the inclusion of [the challenged statement] would influence a reasonable investor’s investment decision. More specifically, we believe that due to the disclaimers and warnings the prospectus contains, *no reasonable investor could believe* anything but that the Taj Mahal bonds represented a rather risky, speculative investment . . . . We hold that under this set of facts, the bondholders cannot prove that the alleged misrepresentation was material.

*Id.* at 369 (emphasis added). Later in the opinion, in discussing the consistency of its own decision with Supreme Court dicta on cautionary statements, the *Trump* court notes:

We understand *Virginia Bankshares* to indicate that if the nature of the subject matter or the manner of presentation of an alleged misrepresentation or omission or its accompanying statements is such that for a reasonable investor the accompanying statements *do not offset the misleading effect* of the misrepresentation or omission, then bespeaks caution is unavailable as a defense.

*Id.* at 373 (emphasis added).

When there is cautionary language in the disclosure, the Court analyzes “the allegedly fraudulent materials in their entirety to determine whether a reasonable investor would have been misled. The touchstone of the inquiry is not whether isolated statements within a document were true, but whether defendants’ representations or omissions, considered together and in context, would affect the total mix of information *and thereby mislead a reasonable investor* regarding the nature of the securities offered.”<sup>184</sup>

Whether intentionally or by happenstance,<sup>185</sup> this statement recognizes all of the subtleties of Prong One. It does not contemplate the issuer’s state of mind. It assesses, though not exclusively, the propensity of the statement to mislead. It also considers, but does not limit itself to, the recipient’s resultant conduct. And finally, with its reference to the reasonable investor, it accomplishes the objectivity of standard that the statutory safe harbor requires.

## 2. Defining Meaningful, and the Reasonable Investor Standard

Unquestionably, meaningful cautionary statements in this context should be defined—as the legislative history suggests—as “substantive information about factors that realistically could cause results to differ materially from those projected.”<sup>186</sup> Congress intentionally supplied this definition as a contrast to

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Further, in discussing the bespeaks caution doctrine at length, the *Trump* panel referred to such bespeaks caution precedents as *I. Meyer Pincus*, 936 F.2d 759 (2d Cir. 1991), and *Romani v. Shearson Lehman Hutton*, 929 F.2d 875 (1st Cir. 1991), as having been materiality-based, 7 F.3d at 371, when those opinions might be more aptly described as focusing on the misleading nature of the statements the plaintiffs there challenged. *See Beck*, *supra* note 7, at 179–82. And, the *Trump* court’s explicit holding based on the bespeaks caution doctrine reflects the unavoidably intertwined nature of the materiality and misleading elements:

[W]e think it clear that the accompanying warnings and cautionary language served to negate any potentially misleading effect that the prospectus’ [challenged statement] would have on a reasonable investor. The prospectus clearly and precisely cautioned [the reader about the riskiness of the investment]. Given this context, we believe that no reasonable jury could conclude that the subject projection materially influenced a reasonable investor.

7 F.3d at 373.

184. *Rombach*, 355 F.3d at 173 (emphasis added) (quoting *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir. 2002)).

185. *See* Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83 (2002) (noting biases and bounded rationality of judges, in particular given scarce judicial resources); *see also* Grundfest & Pritchard, *supra* note 71, at 650–66 (discussing Congress’s contentment with ambiguity in the PSLRA).

186. H.R. REP. NO. 104-369, at 43 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 742; *see supra* note 73 and text accompanying notes 72–73; *cf.* *Rubinstein v. Collins*, 20 F.3d 160, 167–68 (5th Cir. 1994); *Trump*, 7 F.3d at 371–72 (giving the definition provided in leading pre-PSLRA authorities as “substantive and tailored to the specific future projections, estimates or opinions in the [disclosure document] which the plaintiffs challenge”); 17 C.F.R. § 230.175 (1997).

boilerplate,<sup>187</sup> which courts have repeatedly pointed out is insufficient to diffuse the optimistic quality of a projection.<sup>188</sup> More to the point, *See Beyond* and *Asher*'s unique focus on and interpretation of the word "meaningful" should be rejected in favor of the entire statutory term's "normal" meaning.<sup>189</sup>

"Meaningful cautionary statements" accompanying predictions and projections are those that temper the forward-looking statement with vigilance or otherwise ground its buoyant character. In light of the thrust of the PSLRA, and the position and purpose the safe harbor holds in contradistinction to its jurisprudential history, the word *meaningful* in isolation should be read to denote the subject cautionary statements' ability to neutralize any overly optimistic or misleading quality of the challenged projections.<sup>190</sup>

So what effectively neutralizes a forward-looking statement? What the PSLRA's drafters contemplated was the judiciary's educated, neutral assessment of the effect of the forward-looking statements and cautionary language on the reasonable investor. When read in context, were the projections too prominent, too confidently stated, or did they otherwise convey too much optimism, implying some sort of guarantee? Or on the other hand, have plaintiffs *ex post*—as they did in *Trump*—uncovered a buried projection that failed to materialize,<sup>191</sup> one that from a fair and neutral (albeit theoretical) *ex ante* reading of the annual report or press release at issue appeared uncertain?

As it turns out, the safe harbor and the reasonable investor standard advocated for use in this context<sup>192</sup> is nothing more than a practical, imperfect heuristic that

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187. Notably, the original House bill required only a recitation that "actual results could differ" from those predicted or projected. Rosen, *supra* note 9, at 653.

188. *E.g.*, *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010); *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 256 (3d Cir. 2009); *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 371–72 (5th Cir. 2004).

189. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 330 (2007) (noting it is the courts' job to give statutory language "its normal meaning").

190. *Cf.* *Coffee*, *supra* note 1, at 990 ("The 'bespeaks caution' prong provides protection when the cautionary statement renders the false statement (whether made knowingly or recklessly) either objectively immaterial or incapable of being reasonably relied upon, but not otherwise.").

191. 7. F.3d at 371 ("In this case the Partnership did not bury the warnings about risks amidst the bulk of the prospectus. Indeed, it was the allegedly misleading statement which was buried amidst the cautionary language.").

192. How the *reasonable investor* is defined is irrelevant in this setting. Indeed, the reasonable investor standard advocated here, requiring assessment of the cautionary statements' ability to neutralize forward-looking statements, is not at odds with literature eschewing the reasonable man standard as a measure of what is materially misleading in other contexts. *See, e.g.*, John M. Newman, Mark Herrmann & Geoffrey J. Ritts, *Basic Truths: The Implications of the Fraud-on-the-Market Theory for Evaluating the "Misleading" and "Materiality" Elements of Securities Fraud Claims*, 20 J. CORP. L. 571 (1995). Mr. Newman and his coauthors argue that the perceptions of and effect on the "prototypical" investor—the sophisticated professional investor whose conduct affects the price of a security—and not the "reasonable investor" ought to be the yardstick by which materiality and the propensity to mislead are measured in "fraud-on-the-market cases." *Id.* at 586. A major premise of their argument is that the burden is on plaintiffs to plead and prove

enables courts to do justice on an ad hoc basis by dismissing those allegations of deceptive projections that are most likely the product of hindsight.<sup>193</sup> Professor Langevoort well describes the “artificial nature of the inquiry in which courts must engage when deciding whether to dismiss” such a claim:

[I]n a class action based on securities fraud, preliminary motions usually must be decided without reference to realistic stories about the investment decision. The question of reliance—the role of the disclosure in class members’ decisions to invest . . . [i]n cases under rule 10b-5 . . . is either presumed away or deferred until much later. Thus, the judge faced with a motion to dismiss in a bespeaks caution setting must assume . . . that individual investors read and were affected by the disclosures in question. Further, the judge must ignore any factors that might have influenced the investors’ individual decisions. The action can be dismissed only upon a finding that a reasonable investor who read the document would not have been misled by the disclosure or considered it important in making his or her decision. The *Trump* case illustrates the feeling of artificiality. The court’s task was to concentrate on a single sentence buried in the midst of highly technical disclosure on the twenty-eighth page of a prospectus . . . . The likelihood that one sentence by itself influenced many decisions at all strains credulity . . . .<sup>194</sup>

While Professor Langevoort there spoke of the bespeaks caution doctrine before the enactment of the PSLRA, his observation is probably even more apt as applied to the judicial task required by Prong One.<sup>195</sup> In private securities litigation, the

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a material misrepresentation or omission, and proof of materiality is analytically and practically indistinguishable from proof of loss causation (which in practice involves assessment of what market professionals actually did in response to an issuer’s disclosures); therefore efficiency would be better achieved by utilizing a “professional investor” standard. *See id.* at 586–90. On the other end of the spectrum, Professor Margaret Sachs has advocated for the use of a “least sophisticated investor” standard in the context of inefficient markets. Margaret V. Sachs, *Materiality and Social Change: The Case for Replacing “the Reasonable Investor” with “the Least Sophisticated Investor” in Inefficient Markets*, 81 TUL. L. REV. 473, 474–81 (2006). Neither Professor Sachs nor the Newman group addresses (nor do they purport to address) disclosure of forward-looking statements or the somewhat unique procedural and analytical setting of motions to dismiss based on the statutory safe harbor.

193. *See generally* Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571 (1998) (arguing that the legal system incorporates an understanding of the profound implications of the hindsight bias).

194. Langevoort, *supra* note 1, at 492–93. Ultimately, though Professor Langevoort observes that the bespeaks caution doctrine disregards behavioral research proving that “optimism sells” and that “caution-laden estimates [might mislead] even . . . the more sophisticated and rational segment of the investor population,” he does express some confidence in its utility. *Id.* at 493–94.

195. Congress undoubtedly had the benefit of Professor Langevoort’s views, as well as the Supreme Court’s remarks in *Virginia Bankshares*, when it drafted the statutory safe harbor using the specific language it chose. Congress acknowledged Professor Langevoort’s expertise in securities fraud litigation by requesting his testimony on another aspect of the PSLRA. *See* S. REP. NO. 104-98, at 2 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 681 (acknowledging May 12, 1994 testimony of Donald C. Langevoort at hearing on the

determination of a projection's propensity to materially mislead is a hypothetical evaluation not grounded in the reality of the issuer's subjective environment nor in its scienter or lack thereof. Instead, given the fact that few, if any, investors are likely to have personally relied on or even to have read (and *a priori* not have been misled by) the projection at issue, the "meaningful cautionary language" requirement of Prong One is simply a judge's considered determination, as a matter of law, that too much hindsight is being offered as evidence of deception.<sup>196</sup> This is what Congress intended by permitting evidence of "meaningful cautionary statements" to be proffered and considered at the motion to dismiss stage, and it is a fine example of the legal system acknowledging and incorporating hindsight in a beneficial way.<sup>197</sup>

#### CONCLUSION

Issuers' voluntary disclosure of forward-looking statements accompanied by risk factors and other cautionary language is now standard. Similarly, allegations that the issuers' projections and predictions are false are now the norm in class action securities fraud suits. The statutory text and legislative history are clear that the intent of the issuer in making such forward-looking statements, as long as meaningful cautionary statements attend them, is irrelevant. Even so, a minority of courts have expressed a repugnance to faithful application of the PSLRA's safe harbor in this context, accepting a variety of illogical and unsound arguments that not only hinder the safe harbor's intended effect but which contribute to a patchwork of irrational jurisprudence.

While perhaps understandable, this circumvention of the safe harbor is nonetheless misguided. The safe harbor's arena is outside the comfort of the bespeaks caution doctrine and Rule 3(b)(6), where an issuer's good faith and a reasonable factual basis are required when making forward-looking statements. Use of these standards for assessment of claims of false projections and predictions, while more familiar and seemingly just, is prohibited by the PSLRA.

To give full effect to the statutory safe harbor, courts faced with allegations of fraudulent forward-looking statements must carefully parse mixed statements so as to avoid protecting false statements of existing fact. On a more holistic level, they must also consider the overall effect of the disclosed risk factors together with the forward-looking statements to ascertain whether a reasonable investor would have been materially deceived, or whether the complaint is at bottom what Congress sought to eliminate with the PSLRA—baseless suits that allege fraud by hindsight. In this manner, any predisposition of the statutory safe harbor to create a license to lie can be minimized and its salutary effects on corporate disclosure maximized.

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Supreme Court's *Central Bank* decision).

196. A number of courts have met this standard without classifying it as such. *E.g.*, *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 242 (3d Cir. 2004) ("Any reasonable reading of this statement, would make one skeptical about the recovery of the full \$235 million."); *Asher v. Baxter Int'l Inc.*, No. 02 C 5608, 2003 U.S. Dist. LEXIS 12905, at \*43 (N.D. Ill. July 24, 2003) (holding that *Baxter's* cautionary language was sufficient "to give a reasonable investor notice of the risks of investing in Baxter and to undertake further investigation into *Baxter* before investing in its stock" (emphasis added)).

197. See generally *Rachlinski*, *supra* note 193.

