

---

---

# COMMENTS

## ADDING MEANING TO “MEANINGFUL CAUTIONARY STATEMENTS”: PROTECTING INVESTORS WITH A NARROW READING OF THE PSLRA’S SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS\*

### I. INTRODUCTION

Although injured investors typically have a private right to sue when a publicly traded company makes a fraudulent statement regarding its business, many courts and commentators find an exception to this general rule with the statutory safe harbor for forward-looking statements in the Private Securities Litigation Reform Act of 1995 (the “PSLRA”).<sup>1</sup> The PSLRA’s safe harbor provides that a qualifying public company shall not be liable for a false or misleading forward-looking statement as long as it was not made with actual knowledge of falsity, was immaterial, or was made with “meaningful” caution.<sup>2</sup> Many courts and commentators have given this last provision broad protective power.<sup>3</sup> They plainly read the PSLRA’s safe harbor to state that even if a defendant issuer<sup>4</sup> had actual knowledge that its forward-looking statement was false or misleading—thus, defrauding investors—there is no private securities fraud

---

\* Matthew Brinker, J.D. Candidate, Temple University Beasley School of Law, 2012. I cannot thank enough my wonderful wife, Tammy, and my amazing daughter, Molly, for their smiles, love and encouragement, but thank you nonetheless—you are my lucky charms. To my mother- and father-in-law, thank you for making everything we do possible. I’d also like to thank Professor Harwell Wells and my Comment Editor Emily Busch for the long hours they put in reading draft after draft of my ramblings and for their invaluable advice in helping me focus those thoughts into this Comment. Lastly, to the staff and editors of the *Temple Law Review*, my apologies for making you read this, over and over again, but my utmost gratitude for your excellent editing and polishing.

1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); see, e.g., Ann Morales Olazábal, *False Forward-Looking Statements and the PSLRA’s Safe Harbor*, 86 IND. L.J. 595, 625–26 (2011) (demonstrating how PSLRA’s safe harbor can operate to dismiss claims of securities fraud even though the defendant company actually intended to defraud investors with known false, forward-looking statements). The PSLRA amended both the Securities Act of 1933 and the Securities Exchange Act of 1934 at 15 U.S.C. § 77z-2 and 15 U.S.C. § 78u-5, respectively. Because the safe harbor provisions are identical in each, this Comment will only cite to the 1934 Act at 15 U.S.C. § 78u-5 (2006).

2. 15 U.S.C. § 78u-5(c)(1).

3. See *infra* Parts II.D.1 and III.B for discussions of court decisions and commentary giving expansive protection to defendant companies under the “meaningful” caution subprong.

4. An “issuer” is “any person who issues or proposes to issue any security.” 15 U.S.C. § 78c(a)(8). For the purposes of the PSLRA’s safe harbor and this Comment, an issuer is an issuing company subject to the reporting requirements of 15 U.S.C. § 78m(a) or § 78o(d), or someone speaking on its behalf. See 15 U.S.C. § 78u-5(a) (listing the parties to which the safe harbor applies).

action if the defendant company identified its statement as forward-looking and accompanied it with “meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.”<sup>5</sup> In evaluating “important factors” on a motion to dismiss, these courts and commentators state that a defendant’s actual knowledge of falsity is irrelevant to the analysis of whether a defendant’s caution was “meaningful,” and so a fraudulent forward-looking statement disclosing seemingly “important” risk factors is not actionable as a matter of law.<sup>6</sup> In short, if there is caution, there is never fraud.

This Comment rejects such a proposition. The majority’s interpretation of the PSLRA’s safe harbor, which deliberately ignores the investor-protecting quality of the word “meaningful” in the phrase “meaningful cautionary statements,” is not only inapposite to traditional securities regulation but is also not the only suitable reading of the statutory safe harbor.<sup>7</sup> This Comment proposes a reading of the PSLRA’s safe harbor for forward-looking statements that closes the gap where fraudulent forward-looking statements can find protection under the majority’s interpretation. Actual knowledge of falsity should always be relevant to a court’s analysis of a materially false or misleading forward-looking statement.<sup>8</sup> In line with the history and purpose of securities regulation and in light of other recent PSLRA procedural developments, this Comment presents a reading of the PSLRA’s safe harbor that allows for facts producing a strong inference of actual knowledge of falsity to be submitted to a court

---

5. 15 U.S.C. § 78u-5(c)(1).

6. *See, e.g., Harris v. Ivax Corp.*, 182 F.3d 799, 803–04 (11th Cir. 1999) (stating that the defendant’s knowledge of falsity is irrelevant to the analysis of “important” risk factors accompanying a false forward-looking statement).

7. *See infra* Part II.D.2 for a discussion of court decisions holding that the PSLRA’s safe harbor does not protect forward-looking statements made with actual knowledge of falsity. Recent student commentary has also taken this position. *See Anand Das, Comment, A License to Lie: The Private Securities Litigation Reform Act’s Safe Harbor for Forward-Looking Statements Does Not Protect False or Misleading Statements When Made with Meaningful Cautionary Language*, 60 CATH. U. L. REV. 1083 (2011) (stating a proper analysis of the PSLRA’s safe harbor should not treat its two main prongs independently but rather conjunctively based on the facts and circumstances, so as to avoid the illogical result of harboring knowingly false or misleading forward-looking statements); Cory A. Lasker, Note, *Private Securities Litigation Reform Act: Safe Harbor for the Innocent or Modern Day Port of Tortuga for the Buccaneers of Wall Street?*, 36 J. CORP. L. 653 (2011) (recommending that courts simply treat statements as not forward-looking, and thus not protected by the safe harbor, when the misleading nature of those statements is known to an issuer when it is made). This Comment generally sides with these student commentators but observes that a disjunctive interpretation of the statute does not have to result in harboring fraudulent statements as long as courts provide appropriate meaning to the word “meaningful” in the first subprong. Accordingly, to aid courts in their evaluation of a motion to dismiss, this Comment proposes, at *infra* Part III.E, a definition of “meaningful” that operates within the strong inference pleading standard for scienter enunciated by the Supreme Court in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) to prevent a known false or misleading forward-looking statement from finding protection in the meaningful caution subprong of the PSLRA’s safe harbor for forward-looking statements.

8. *See infra* Part III.A.1 for a discussion of how a defendant’s knowledge and intent to defraud factor into a “meaningful” caution analysis.

---

---

on a motion to dismiss to show that the cautionary language accompanying a fraudulent forward-looking statement should not be considered “meaningful.”<sup>9</sup>

Part II.A introduces forward-looking statements and the legal line that divides actionable fraudulent forward-looking statements from non-actionable statements that happen to turn out false. Part II.B details the development of legal protection for innocently false forward-looking statements embodied in the Securities and Exchange Commission’s (SEC) safe harbor rules and the judicially created bespeaks caution doctrine. Part II.C discusses the history and origins of private securities litigation and the movement for reform leading up to the 1995 passage of the PSLRA and its statutory safe harbor for forward-looking statements. Though it has been nearly fifteen years since Congress enacted the PSLRA, courts are still wrestling with how to apply the safe harbor. Part II.D provides an overview of the differing judicial interpretations of the PSLRA’s “meaningful” caution subprong—from an approach where cautionary language trumps evidence of actual knowledge to an approach that incorporates the qualitative aspects of knowledge into a determination of “meaningfulness.”

This Comment argues that quality of cautionary language is just as important as quantity and that Congress agreed with this principle when it passed the PSLRA. Part III.A supports an approach to the statutory safe harbor that incorporates evidence of scienter into a court’s meaningful caution analysis. Part III.A.1 discusses the importance of scienter as an element of securities fraud, and Part III.A.2 analyzes the text and legislative history of the PSLRA’s safe harbor to show that evidence of scienter can appropriately be submitted on a motion to dismiss to overcome any claims of “meaningful” caution. Part III.B critiques the majority interpretation, which stops short of a qualitative reading of the safe harbor by focusing entirely on the disjunctive nature of the statute’s text. Parts III.C and III.D, respectively, discuss the negative policy implications of the majority’s approach and how current pleading standards provide more-than-sufficient protection for issuers wishing to make forward-looking statements. This Comment concludes by proposing a reading of the PSLRA’s safe harbor that not only provides issuers with an opportunity to protect themselves with cautionary language, but also provides investors with meaningful protection from issuers who aim to use the safe harbor as a refuge from actionable securities fraud. Part III.E proposes a rule for courts evaluating a defendant’s motion to dismiss based on the PSLRA’s safe harbor: cautionary statements are meaningful (and thus preclude drawing a strong inference of scienter) only if they are substantive, firm specific, and tailored to a forward-looking statement and reasonably reveal any knowledge held by the defendant issuer that such a statement is or will be false or misleading.

---

9. See *infra* Part III.E for a proposed definition of “meaningful” that recognizes the fact that a defendant’s actual knowledge that a forward-looking statement is or will be false or misleading is an “important factor” necessary to disclose to investors.

## II. OVERVIEW

### A. *The Importance of Forward-Looking Statements and the Distinction Between False and Fraudulent Ones*

Although investors seek a variety of information before buying or selling securities, they crave information about an issuer's future—future earnings forecasts, future business plans, future market expectations, and future economic performance estimates.<sup>10</sup> This “soft information,” because of its subjective nature as opposed to the objectively verifiable nature of “hard information,” is called “forward-looking.”<sup>11</sup> When provided to the investing public by an issuing company's management or its representatives, securities law labels it a “forward-looking statement.”<sup>12</sup> Forward-looking statements offer investors the perception of insider information about the future and special insight regarding the risks and rewards of their investments.<sup>13</sup> Accordingly, investors rely on forward-looking statements when making investment decisions, even if subjective and unverifiable in nature.<sup>14</sup>

Because of this reliance, and the recognized importance of investors making “informed and intelligent investment decisions,”<sup>15</sup> courts have long applied the same securities fraud standards to forward-looking statements that they have applied to historical statements of fact.<sup>16</sup> The courts reasoned that a forward-looking statement resembles a “fact” in three respects: “(1) that the statement is genuinely believed, (2) that there is a reasonable basis for that belief, and (3) that the speaker is not aware of

---

10. Susanna Kim Ripken, *Predictions, Projections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements*, 2005 U. ILL. L. REV. 929, 931 (2005). For example, discounting future earnings is the most commonly used method for valuing stock. *How to Value Stocks: Earnings-Based Valuations*, THE MOTLEY FOOL, <http://www.fool.com/investing/beginning/how-to-value-stocks-earnings-based-valuations.aspx> (last visited Mar. 7, 2012).

11. See Carl W. Schneider, *Nits, Grits, and Soft Information in SEC Filings*, 121 U. PA. L. REV. 254, 254–55 (1972) (distinguishing hard information, that is, “facts,” from soft information, that is, “opinions, predictions, or subjective evaluations”).

12. See *id.* at 255 (explaining that forward-looking statements are soft information consisting of statements “concerning the future, such as projections, forecasts, predictions, and statements concerning plans and expectations”); see also Safe Harbor for Forward-Looking Statements, Securities Act Release No. 33-7101, 59 Fed. Reg. 52,723, 52,723 n.1 (Oct. 19, 1994) (explaining that forward-looking statements can be quantitative financial estimates, such as earnings forecasts and sales projections, or nonquantitative predictions, such as statements regarding labor relations or human resources). The PSLRA also provides an express list of what statements it regards as forward-looking. See 15 U.S.C. § 78u-5(i)(1) (2006) (listing forward-looking statements covered by statute, such as revenue, income and earnings per share projections; capital expenditure, dividend, and capital structure predictions; statements regarding management's plans and objectives for future operations; management's statements regarding future economic performance; statements of assumptions underlying any of above; outside reports assessing any of the above types of statements; or any other projection or estimate specified as forward-looking by the SEC).

13. Ripken, *supra* note 10, at 931.

14. *Id.*

15. *Id.* at 930.

16. See, e.g., *Kowal v. MCI Commc'ns Corp.*, 16 F.3d 1271, 1277 (D.C. Cir. 1994) (stating that “forward-looking statements . . . are considered ‘statements of fact’ for the purposes of the securities laws”); *Marx v. Computer Scis. Corp.*, 507 F.2d 485, 489 (9th Cir. 1974) (stating that it has been long established that securities regulations treat forecasts or predictions as “facts” for purposes of securities fraud).

any undisclosed facts tending to seriously undermine the accuracy of the statement.”<sup>17</sup> As a factual representation then, a forward-looking statement would be fraudulent if it was materially false or misleading, made with the intent to deceive, and relied upon by an investor to his detriment in the purchase or sale of a security.<sup>18</sup>

Issuers are not required to see the future, however, because some inaccurate forward-looking statements are simply part of the uncertain conditions under which future projections and predictions are made.<sup>19</sup> Therefore, securities regulation traditionally makes a distinction between the *merely false* forward-looking statement, which failed to materialize because of uncertain market forces, and the *fraudulent* forward-looking statement that was made with the intent to deceive.<sup>20</sup> *Scienter*, the “mental state embracing intent to deceive, manipulate, or defraud,”<sup>21</sup> is a crucial element of securities fraud,<sup>22</sup> and when applied to materially false or misleading forward-looking statements, it is “inextricably linked” to the determination of whether or not those false or misleading statements are even actionable in the first place.<sup>23</sup> The PSLRA maintains this traditional distinction between false and fraudulent forward-looking statements by protecting issuers that, only in hindsight, disclosed inaccurate forward-looking statements, while not protecting those issuers that had “actual knowledge” their statements were false or misleading when made.<sup>24</sup>

#### B. *The Historical Context of Protection for False Forward-Looking Statements*

In keeping the distinction between unexpectedly false forward-looking statements and fraudulent ones, the PSLRA continued the goal of securities regulation to promote more access to reliable, future-oriented information for investors by giving companies more freedom to make forward-looking statements.<sup>25</sup> The PSLRA’s safe harbor, however, was not the first time makers of false forward-looking statements received protection from securities fraud liability—the SEC and the federal judiciary offered

---

17. See, e.g., *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) (stating that forward-looking statements may be actionable if implicit factual representations are not accurate).

18. See *infra* Part II.C.1 for a discussion of securities fraud liability, which requires (1) a material misrepresentation or omission, (2) scienter, (3) a connection with the purchase or sale of security, (4) reliance, (5) economic loss, and (6) loss causation.

19. See, e.g., *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (stating that an unexpected turn of events by itself cannot serve as a basis for securities fraud; otherwise, it would be “fraud by hindsight”).

20. SEC Rule 10b–5(b), 17 C.F.R. § 240.10b–5(b) (2010) (implementing 15 U.S.C. § 78j(b) and making it unlawful to deceive securities market).

21. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

22. See *id.* at 193 (holding that the defendant cannot be liable for damages based on securities fraud without scienter).

23. *Marx v. Computer Scis. Corp.*, 507 F.2d 485, 490 (9th Cir. 1974) (stating that a forward-looking statement’s “untruthfulness vel non . . . is inextricably linked with . . . ‘scienter’”).

24. See 15 U.S.C. § 78u–5(c)(1)(B) (2006) (keeping liability for fraudulent forward-looking statements but redefining the intent required for liability to actual knowledge that the false forward-looking statement was false or misleading when made). To the extent that courts have interpreted the PSLRA’s safe harbor to protect fraudulent forward-looking statements, this Comment argues that their interpretations are wrong.

25. Ripken, *supra* note 10, at 932.

their own types of protection before the enactment of the PSLRA.<sup>26</sup> Aspects of the SEC's safe harbor rules and the judicially created bespeaks caution doctrine served as a basis for the PSLRA's safe harbor.<sup>27</sup>

### 1. The SEC's Safe Harbor Rules

Prior to the 1970s, the SEC believed that forward-looking information should not be disclosed because of its inherent unreliability and the concern that "unsophisticated investors would place undue emphasis on the information."<sup>28</sup> Thus, for decades after the passage of the Securities Exchange Act of 1934, disclosure of forward-looking statements was prohibited.<sup>29</sup> Later, upon the urging of securities analysts, the SEC undertook an investigation into whether controlled disclosure of future projections might be feasible and published its report in 1969.<sup>30</sup> Although the recommendations of the first investigating committee still favored prohibition, the Commission found that most investment decisions were made on estimates of future earnings.<sup>31</sup> The significance of this finding led the SEC to further investigate lifting the ban on forward-looking statements, and, in 1977, the SEC's Advisory Committee on Corporate Disclosure recommended that the SEC adopt a safe harbor for forward-looking statements to encourage, though not entirely mandate, their disclosure.<sup>32</sup> As a result, two years later, the SEC passed the safe harbor provisions of Rule 175 and Rule 3b-6 (the "SEC's safe harbor rules").<sup>33</sup>

The SEC's safe harbor rules protect issuers from civil liability in lawsuits based on their making of forward-looking statements in quarterly filings with the SEC or in their annual reports.<sup>34</sup> Specifically, the safe harbor rules provide that a forward-looking statement "shall be deemed not to be a fraudulent statement . . . unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith."<sup>35</sup> Other conditions, such as continued compliance with SEC

---

26. See *id.* at 937 (stating that the SEC, Congress, and courts all had their own approach to false forward-looking statements—SEC Rules 175 and 3b-6, the PSLRA safe harbor, and the bespeaks caution doctrine, respectively—but viewed the costs and benefits of forward-looking information differently).

27. H.R. REP. NO. 104-369, at 43 (1995) (Conf. Rep.). See *infra* Part II.B.1 for a discussion of the SEC's safe harbor rules and Part II.B.2 for a discussion of the bespeaks caution doctrine.

28. Safe Harbor for Forward-Looking Statements, Securities Act Release No. 33-7101, 59 Fed. Reg. 52,723, 52,723-24 (Oct. 19, 1994).

29. *Id.*

30. *Id.* at 52,724.

31. *Id.*

32. *Id.* at 52,725. The Advisory Committee believed that market forces would effectively operate to encourage issuers to make disclosures of their future projections. *Id.* at 52,724.

33. *Id.* at 52,726.

34. SEC Rule 175(b)(1), 17 C.F.R. § 230.175(b)(1) (2010); SEC Rule 3b-6(b)(1), 17 C.F.R. § 240.3b-6(b)(1).

35. SEC Rule 175(b)(1), 17 C.F.R. § 230.175(b)(1); SEC Rule 3b-6(b)(1), 17 C.F.R. § 240.3b-6(b)(1). The rules also state in subsection (d):

For the purpose of this rule the term fraudulent statement shall mean a statement which is an untrue statement of a material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or which constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme,

reporting or registration requirements, apply as well.<sup>36</sup> Although the safe harbors do not explicitly require the disclosure of the assumptions that underlie forward-looking statements, the SEC stated that “their disclosure may be necessary in order for such statements to meet the reasonable basis and good faith standards embodied in the rule.”<sup>37</sup> Additionally, per SEC regulation, the Management’s Discussion and Analysis (“MD&A”) in regular SEC filings must disclose “material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.”<sup>38</sup> Thus, to meet the safe harbor eligibility requirements of good faith and reasonableness, the SEC requires issuers to disclose all material risks they knowingly faced when making the forward-looking statement.<sup>39</sup> Nevertheless, the SEC stated that, if disclosed, these known risks and assumptions underlying forward-looking statements would also fall within the scope of the safe harbors’ protection.<sup>40</sup>

Despite the presence of the SEC’s safe harbors and evidence of a corresponding impact on the quality of forward-looking information available,<sup>41</sup> the SEC found in 1994 that most issuers did not regularly make use of them in court.<sup>42</sup> There were several reasons for this lack of reliance, which centered mainly on fear of mass shareholder litigation.<sup>43</sup> The SEC’s safe harbor rules only protected disclosures made to the SEC, so there was concern that much of the real demand for this information in the public would not be covered.<sup>44</sup> Also, there was confusion as to whether an issuer had a duty to update its submissions in the event that subsequent events changed the nature of

---

transaction, act, practice, course of business, or an artifice to defraud, as those terms are used in the Securities Act of 1933 or the rules or regulations promulgated thereunder.

SEC Rule 175(d), 17 C.F.R. § 230.175(b)(1); SEC Rule 3b–6(d), 17 C.F.R. § 240.3b–6(b)(1).

36. SEC Rule 175(b)(1), 17 C.F.R. § 230.175(b)(1); SEC Rule 3b–6(b)(1), 17 C.F.R. § 240.3b–6(b)(1). Guidelines for reporting and registration requirements are outlined in 15 U.S.C. §§ 78m, 78o (2006).

37. Safe Harbor for Forward-Looking Statements, 59 Fed. Reg. at 52,726.

38. SEC Reg. S-K, Item 303, 17 C.F.R. § 229.303 (2010).

39. Safe Harbor for Forward-Looking Statements, 59 Fed. Reg. at 52,726. The SEC Release clarified: Required disclosure is based on currently known trends, events, and uncertainties that are reasonably expected to have material effects, such as: a reduction in the [issuer’s] product prices; erosion in the [issuer’s] market share; changes in insurance coverage; or the likely non-renewal of a material contract. In contrast, optional forward-looking disclosure involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty.

*Id.*

40. *Id.*; see also *Slayton v. Am. Express Co.*, 604 F.3d 758, 767 (2d Cir. 2010) (holding that forward-looking information disclosed in an issuer’s MD&A can also fall within the PSLRA’s safe harbor).

41. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 672 (3d ed. 2003). Although the SEC made some technical modifications to the rules over the years, the essential elements of the safe harbors remained intact by the time the PSLRA was passed. Safe Harbor for Forward-Looking Statements, 59 Fed. Reg. at 52,726.

42. Safe Harbor for Forward-Looking Statements, 59 Fed. Reg. at 52,728.

43. *Id.* (stating that surveys showed that the threat of shareholder class actions, even if only perceived, chilled the dissemination of forward-looking information).

44. *Id.*; see *id.* at 52,727 (suggesting that issuers’ fear of greater litigation risk from making forward-looking statements overcame the growing interest of the market in accessing qualitative performance information).

its disclosures.<sup>45</sup> Lastly, the requirements of reasonableness and good faith often precluded defendant issuers from raising the safe harbor as a defense because doing so would prevent an early dismissal at summary judgment of a frivolous claim by presenting a fact issue for the court.<sup>46</sup> Due to these reactions to the SEC's safe harbor rules, very few litigants utilized them and instead turned more often to the judicially created bespeaks caution doctrine.<sup>47</sup>

## 2. The Bespeaks Caution Doctrine

Apart from the efforts of the SEC, federal courts recognized the importance of forward-looking information and developed their own safe harbor.<sup>48</sup> The bespeaks caution doctrine arose from the equitable notion that courts should not "impose liability on the basis of statements that clearly 'bespeak caution.'"<sup>49</sup> In general, courts use the doctrine as a mechanism to rule as a matter of law that an inaccurate forward-looking statement is not actionable securities fraud because it was accompanied by "sufficient" cautionary statements warning against guaranteed results.<sup>50</sup> Though it has been stated that "the bespeaks caution doctrine is more a collection of cases linked by a common phrase or quotation than a set of analytically homogenous holdings,"<sup>51</sup> there are at least three cognizable strains of rationale for the doctrine.<sup>52</sup>

First, the early bespeaks caution cases focused on the false or misleading element of the securities fraud cause of action.<sup>53</sup> For example, in *Sinay v. Lamson & Sessions Co.*,<sup>54</sup> the Sixth Circuit held that, because the defendant had phrased its forward-looking statements in "sufficient cautionary language," it had negated the false or misleading nature of those statements as a matter of law.<sup>55</sup> In *Sinay*, the defendant issuer had affirmed analysts' earnings guidance in a news report and claimed its new product lines would offset the effects of a weak market, even though it recognized that demand was down due to rising interest rates.<sup>56</sup> After the earnings failed to materialize,

---

45. *Id.* at 52,729.

46. *Id.* at 52,728.

47. Ann Morales Olazábal, *Safe Harbor for Forward-Looking Statements Under the Private Securities Litigation Reform Act of 1995: What's Safe and What's Not?*, 105 DICK. L. REV. 1, 10–11 (2000).

48. See generally Donald C. Langevoort, *Disclosures that "Bespeak Caution"*, 49 BUS. LAW. 481 (1994).

49. *Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986) (quoting *Polin v. Conductron Corp.*, 552 F.2d 797, 806 n.28 (8th Cir. 1977) ("[T]erms . . . [bespeaking] caution in outlook . . . fall far short of the assurances required for a finding of falsity and fraud."); see also *Goldman v. Belden*, 754 F.2d 1059, 1068 (2d Cir. 1985) (stating that "liability probably should not be imposed on the basis of words that 'bespeak caution'" (quoting *Polin*, 552 F.2d at 806 n.28)).

50. Jennifer O'Hare, *Good Faith and the Bespeaks Caution Doctrine: It's Not Just a State of Mind*, 58 U. PITT. L. REV. 619, 628–29 (1997) (quoting *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3d Cir. 1993)).

51. Langevoort, *supra* note 48, at 483.

52. See O'Hare, *supra* note 50, at 630 (categorizing bespeaks caution jurisprudence into three types: falsity approach, materiality approach, or reliance approach).

53. *Id.*

54. 948 F.2d 1037 (6th Cir. 1991).

55. *Sinay*, 948 F.2d at 1040–41.

56. *Id.* at 1039–40.

however, because of higher-than-expected interest rates and labor problems the defendant allegedly knew about but did not disclose, investors sued for securities fraud.<sup>57</sup> Noting that “[e]conomic projections are not actionable if they bespeak caution,” the Sixth Circuit denied the investors’ claim.<sup>58</sup> The court stated that it “must scrutinize the nature of the statement to determine whether the statement was false when made,” and, in so doing, it should emphasize “whether the [forward-looking statement] suggested reliability, bespoke caution, was made in good faith, or had a sound factual or historical basis.”<sup>59</sup> Because the record showed that the defendant in *Sinay* could not have predicted a labor strike and that there was no evidence that its beliefs regarding the impact of higher interest rates “were anything other than honestly held convictions,” the Sixth Circuit concluded that the defendant’s cautionary language was sufficient evidence that its forward-looking statements were not false or misleading when made, and, thus, not actionable as a matter of law.<sup>60</sup>

Second, later courts turned away from a pure falsity approach and focused alternatively on a materiality analysis.<sup>61</sup> The Third Circuit developed such an analysis in *In re Donald J. Trump Casino Securities Litigation*,<sup>62</sup> holding that sufficient cautionary language renders false or misleading forward-looking statements immaterial and non-actionable as a matter of law.<sup>63</sup> In that case, the Trump defendants had issued bonds via a structured deal where they lent the proceeds of the bond issue to another organization, which they had formed as a partnership, with the anticipation that the servicing of that loan would provide the funds to pay back the bondholders.<sup>64</sup> In the prospectus to the bond issue, it read: “The Partnership believes that funds generated from the operation of the Taj Mahal will be sufficient to cover all of its debt service (interest and principal).”<sup>65</sup> This plan did not pan out, however.<sup>66</sup> When the bondholders heard that the Trump defendants were filing for bankruptcy and would not be able to generate the funds necessary to repay them, they sued for securities fraud.<sup>67</sup> The bondholders alleged that the Trump defendants had made material misrepresentations and omissions in the bond prospectus because the defendants “possessed neither a genuine nor a reasonable belief in its truth.”<sup>68</sup>

---

57. *Id.* at 1039.

58. *Id.* at 1040–41.

59. *Id.* at 1040 (quoting *Isquith v. Middle S. Utils., Inc.*, 847 F.2d 186, 204 (5th Cir. 1988)) (internal quotation mark omitted).

60. *Id.*

61. O’Hare, *supra* note 50, at 633. As noted earlier in this Comment, a “material misrepresentation or omission” is the first element of a securities fraud cause of action. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008). See *infra* Part II.C.1 for a discussion of the elements of securities fraud.

62. 7 F.3d 357 (3d Cir. 1993).

63. *Trump*, 7 F.3d at 371.

64. *Id.* at 364–65.

65. *Id.* at 365.

66. *Id.*

67. *Id.*

68. *Id.*

The Third Circuit rejected this claim.<sup>69</sup> It held that, even if the Trump defendants were wrong in their beliefs, the plaintiffs did not “sufficiently allege that the defendants made a *material* misrepresentation,” and thus, their claim was not actionable.<sup>70</sup> The court relied on the definition of “material” from the Supreme Court’s holding in *TSC Industries, Inc. v. Northway, Inc.*<sup>71</sup> In *TSC Industries*, the Court held that a misrepresentation or omission is material “if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [act]”;<sup>72</sup> it must “significantly alter[] the ‘total mix’ of information made available.”<sup>73</sup> Consequently, considering this definition and the prospectus’ long list of risks, warnings, and other obstacles facing the partnership in a deal of “unprecedented size and scale,” the Third Circuit in *Trump* held that the prospectus’ cautionary statements rendered the partnership’s false statements about the success of their venture immaterial as a matter of law.<sup>74</sup> The court reasoned that the partnership’s representations of success, though false, did not alter the total mix of information available to the reasonable investor.<sup>75</sup> In fact, the prospectus explicitly stated that there can be “no assurance . . . that, once opened, the Taj Mahal will be profitable or that it will generate cash flow sufficient to provide for the payment of the debt service.”<sup>76</sup> Because the risks, warnings, and obstacles outlined in the prospectus were sufficiently substantive and tailored to offset any false assurances of success, the reasonable investor would not have considered such assurances material to their investing decision.<sup>77</sup> Effectively, the court held that a

---

69. *Id.* at 369.

70. *Id.* (emphasis in original).

71. 426 U.S. 438 (1976). Although this case dealt with § 14(a) of the 1934 Act, the Supreme Court had extended its application to § 10(b) actions in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

72. *TSC Industries*, 426 U.S. at 449.

73. *Id.*

74. *Trump*, 7 F.3d at 370–72. The *Trump* court explained that “[t]o suffice, the cautionary statements must be substantive and tailored to the specific future projections, estimates or opinions in the prospectus which the plaintiffs challenge.” *Id.* at 371–72.

75. *Id.* at 371.

76. *Id.* at 370.

77. *Id.* at 371–72. Additionally, the *Trump* court noted that, although the Supreme Court had not ruled on the bespeaks caution doctrine, it believed the Court impliedly accepted the focus on materiality when it stated that “[w]hile a misleading statement will not always lose its deceptive edge simply by joinder with others that are true, the true statements may discredit the other one so obviously that the risk of real deception drops to nil.” *Id.* at 372 (quoting *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991)). The *Trump* court believed that its materiality approach to the bespeaks caution doctrine subsumed the falsity approach. *Id.* at 371. Later commentary argues, however, that the *Trump* court misread the Supreme Court’s *Virginia Bankshares* holding and improperly shifted the approach of the bespeaks caution doctrine from falsity to materiality alone. See generally Hugh C. Beck, *The Substantive Limits of Liability for Inaccurate Predictions*, 44 AM. BUS. L.J. 161, 182–96 (2007). The misreading occurred because the *Trump* court failed to consider the Supreme Court’s clarification of the above statement in *Virginia Bankshares*: “But not every mixture with the true will neutralize the deceptive. . . . Only when the inconsistency would exhaust the misleading conclusion’s capacity to influence the reasonable shareholder would [the] action fail on the element of materiality.” *Va. Bankshares*, 501 U.S. at 1097–98. Thus, the misleading or false nature of a statement would still be relevant to the materiality analysis.

misrepresentation must be “material” to be actionable under the bespeaks caution doctrine.<sup>78</sup>

Third, other courts focused on reliance.<sup>79</sup> Under this last rationale for the bespeaks caution doctrine, courts ruled as a matter of law that not only can cautionary statements render inaccurate forward-looking statements immaterial but they can also effectively prevent an investor from reasonably relying on false projections made in context with countervailing risks.<sup>80</sup> Accordingly, where there was sufficient cautionary language accompanying false forward-looking statements, an investor could not sustain a claim for securities fraud if he was unreasonable in relying on those false statements.<sup>81</sup> The Ninth Circuit articulated this rationale in *In re Worlds of Wonder Securities Litigation*.<sup>82</sup> The court stated that, although the contextual nature of the bespeaks caution doctrine typically raises a question of fact, the context of a forward-looking statement can also inform a decision of law by the court.<sup>83</sup> Essentially, the court can reject a securities fraud claim as a matter of law when the allegedly fraudulent forward-looking document “contains adequate cautionary language disclosing specific risks, [so that] no reasonable inference can be drawn that a statement regarding those risks was misleading.”<sup>84</sup> The court explained that this expression of the bespeaks caution doctrine comported with the doctrine’s intent “to address situations in which optimistic projections are coupled with cautionary language—in particular, relevant specific facts or assumptions—affecting the reasonableness of reliance on and the materiality of those projections.”<sup>85</sup>

### C. *The Private Securities Litigation Reform Act of 1995*

#### 1. Purpose and Origins of Private Securities Litigation

Federal securities laws aim to ensure honest securities markets that foster investor confidence.<sup>86</sup> In passing the Securities Exchange Act of 1934 (the “1934 Act”), Congress sought “to achieve a high standard of business ethics in the securities industry” by replacing *caveat emptor* with “a philosophy of full disclosure.”<sup>87</sup> Congress recognized that “[j]ust as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the

---

78. *Trump*, 7 F.3d at 373 (stating that “a misrepresentation or omission *is* actionable when materially misleading” (emphasis in original)).

79. O’Hare, *supra* note 50, at 636.

80. *Id.* at 636–37.

81. *Id.* at 637.

82. 35 F.3d 1407 (9th Cir. 1994).

83. *See In re Worlds of Wonder*, 35 F.3d at 1413–14 (stating that bespeaks caution doctrine stands for the “unremarkable proposition that statements must be analyzed in context” (quoting *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994))).

84. *Id.* at 1413 (quoting *In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850, 859 (N.D. Cal. 1993)).

85. *Id.* at 1414 (quoting *Rubinstein*, 20 F.3d at 167).

86. *SEC v. Zandford*, 535 U.S. 813, 819 (2002).

87. *Id.* (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972)) (internal quotation marks omitted).

operation of the markets as indices of real value. There cannot be honest markets without honest publicity.”<sup>88</sup> To achieve honesty and transparency, section 10(b) of the 1934 Act broadly bans manipulation and deception of the securities markets.<sup>89</sup> SEC Rule 10b–5 likewise implements section 10(b) by making it illegal to disclose “any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements . . . not misleading.”<sup>90</sup> Thus, section 10(b) and Rule 10b–5 together seek to protect investors from issuers who manipulate or deceive the market by making false or misleading statements that are material to securities transactions.<sup>91</sup>

To enforce these provisions, the Department of Justice can initiate a criminal action, the SEC can initiate a civil one, or injured investors can sue on their own.<sup>92</sup> Private civil actions are an “essential supplement” to government policing of market honesty and integrity.<sup>93</sup> Accordingly, courts have implied from section 10(b) and Rule 10b–5 “a private damages action, which resembles, but is not identical to, common-law tort actions for deceit and misrepresentation.”<sup>94</sup> Unlike common-law fraud actions, which require direct reliance,<sup>95</sup> securities fraud claims exist even for secondary-market purchasers because of the widely accepted fraud-on-the-market theory.<sup>96</sup> Due to the assumed informational efficiency of actively-traded securities markets,<sup>97</sup> investors do not always rely directly on an issuer’s statements when valuing the purchase or sale of

---

88. H.R. REP. NO. 73-1383, at 11 (1934).

89. 15 U.S.C. § 78j(b) (2006). The 1934 Act § 10(b) reads: “It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of [SEC] rules and regulations.” *Id.*

90. SEC Rule 10b–5(b), 17 C.F.R. § 240.10b–5(b) (2010).

91. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b–5(b); *see also* H.R. REP. NO. 73-1383, at 10 (declaring all manipulative devices banned for the sake of investors and fair, honest securities markets).

92. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007).

93. *Tellabs*, 551 U.S. at 313; *see also* *Basic Inc. v. Levinson*, 485 U.S. 224, 230–31 (1988) (explaining that a private cause of action exists in § 10(b) and Rule 10b–5 because courts have implied its existence, the legislature has acquiesced, and time has passed, thus confirming its existence in law and its function as an essential tool for enforcing 1934 Act’s requirements).

94. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005). *Compare* RESTATEMENT (SECOND) OF TORTS § 525 (1977) (“One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.”), *with* *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008) (explaining that a § 10(b) private action for securities fraud requires: (1) material misrepresentation or omission; (2) scienter; (3) connection with purchase or sale of security; (4) reliance; (5) economic loss; and (6) loss causation).

95. *See* RESTATEMENT (SECOND) TORTS § 525.

96. *See Basic*, 485 U.S. at 241–47 (“The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants’ fraud and the plaintiffs’ purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.” (omissions in original) (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986))).

97. *See* JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 104–07 (6th ed. 2009) (discussing three levels of efficient capital markets—weak, semi-strong, and strong—and indicating the semi-strong form, in which market prices quickly reflect all publicly-released information, is the prevailing view).

a security; rather, they rely on market integrity for their price.<sup>98</sup> Thus, the fraud-on-the-market theory holds that “[b]ecause most publicly available information is reflected in market price, an investor’s reliance on any public material misrepresentations . . . may be presumed for purposes of a Rule 10b-5 action.”<sup>99</sup> This theory correlates with the semi-strong form of the efficient market hypothesis, which states that “security prices reflect all publicly available information.”<sup>100</sup> As a result of courts accepting the fraud-on-the-market theory, section 10(b) and Rule 10b-5 actions are the lawsuits of choice for most private securities fraud class actions and now play a prominent role in federal securities regulation.<sup>101</sup> This prevalence of securities class actions underscores the intentions of securities laws to not only compensate injured investors for their economic loss but also to deter fraud and “maintain public confidence in the marketplace.”<sup>102</sup>

## 2. Reforming Private Securities Class Actions

The virtues of private securities class actions, however, came under attack in the early 1990s due to apparent abuses.<sup>103</sup> Several members of Congress perceived significant problems with the state of private securities litigation.<sup>104</sup> First, despite empirical evidence that showed capital markets were growing substantially,<sup>105</sup>

---

98. *Basic*, 485 U.S. at 241–42; *see also id.* at 246–47 n.24 (indicating that the Court need not rule on economic theory to affirm the presumption of reliance under a fraud-on-the-market theory; rather, it “need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices”).

99. *Id.* at 247; *see also Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975) (explaining that an investor generally relies “on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price—whether he is aware of it or not, the price he pays reflects material misrepresentations”).

100. *COX ET AL.*, *supra* note 97, at 105. Likewise, the obverse of the fraud-on-the-market theory is the truth-on-the-market defense, which asserts that a false or misleading statement is not actionable if the efficient market knows the statement is false or misleading. *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989).

101. 2 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES LAW HANDBOOK* § 27:1 (2011 ed.); *see also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 165 (2008) (explaining that the implied private right of action under § 10(b) “is now a prominent feature of federal securities regulation”).

102. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345 (2005).

103. *See generally Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., and Urban Affairs*, 103d Cong. (1993) [hereinafter *Hearings*] (discussing the need to reform securities class action litigation because of frivolous lawsuits controlled by plaintiffs’ attorneys who were not looking out for investors’ best interests but merely seeking coerced settlement payments).

104. *See SELIGMAN*, *supra* note 41, at 660–61 (detailing four arguments posited by proponents of private securities litigation reform); John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 337–38 (1996) (outlining the three most prominent arguments for reform). Although the empirical evidence regarding these problems was inconclusive, the anecdotal evidence presented to Congress helped form the perception of a “securities litigation crisis.” Avery, *supra*, at 339–40. “[N]o matter what the degree of actual dysfunction,” one witness testified, “[the] fear of dysfunctional litigation is adversely affecting capital marketplace decisions.” *Securities Litigation Reform: Hearings Before the Subcomm. on Telecomm. and Fin. of the H. Comm. on Energy and Commerce*, 103d Cong. 120 (1994) (testimony of Professor Donald C. Langevoort).

105. *SELIGMAN*, *supra* note 41, at 661 (citing 1992 SEC ANN. REP. 52).

proponents of reform became concerned that private securities litigation was “out of hand” and destroying the ability of issuers to reach the capital markets for their financing needs.<sup>106</sup> Likewise, proponents were concerned that the current system of securities class actions unnecessarily encouraged “strike suits”<sup>107</sup> filed immediately after large drops in share prices for the sole purpose of eliciting a settlement payment for undeserving investors and fees for plaintiffs’ attorneys.<sup>108</sup> These proponents argued that, due to the high costs of litigation and the threat of vengeful juries, defendant companies often felt “coerced” into settlement when faced with a strike suit.<sup>109</sup> Even though data presented to congressional subcommittees at the time showed that of 17,400 registered companies only an average of 124 were sued for securities fraud each year, and that most of those suits were dismissed early for failing to meet the pleading requirements of Federal Rule of Civil Procedure 9(b),<sup>110</sup> proponents of reform argued that more judicial devices were necessary to discourage “frivolous litigation.”<sup>111</sup> Thirdly, the proponents argued, the traditional rule of joint and several liability fell disproportionately on accountants and other professional advisers, who at the time could be held liable for aiding and abetting securities fraud.<sup>112</sup> Lastly, those favoring reform were concerned that securities class actions overall did not “fairly represent the best interests of . . . investor[s].”<sup>113</sup> Specifically, in regards to this last concern, they believed the threat of frivolous litigation had a chilling effect on beneficial corporate practices—particularly, the disclosure of forward-looking information.<sup>114</sup>

The PSLRA was the proposed solution to these perceived problems. Passed by a Republican-controlled Congress in December 1995, and over a veto from President

---

106. *Hearings, supra* note 103, at 2 (statement of Sen. Dodd). Proponents argued that the costs of litigation and the need to settle even meritless claims increased the costs of raising funds through the capital markets. S. REP. NO. 104-98, at 4 (1995).

107. A strike suit is “often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement.” *Black’s Law Dictionary* 1475 (9th ed. 2009).

108. Avery, *supra* note 104, at 337. This argument rested on the practice of plaintiffs’ attorneys—representing “professional plaintiffs” who owned shares in a corporation only for the purposes of litigation—filing securities fraud class actions within days of a suddenly large drop in a defendant company’s share price. S. REP. NO. 104-98, at 4 (internal quotation mark omitted). To avoid the high costs of discovery and trial, a defendant company would then settle these claims for millions of dollars. *Id.*

109. Avery, *supra* note 104, at 339. Additionally, commentators argued that the settlements of these claims were also meritless because they were typically uniform in amount and did not vary case by case, as would be expected if the merits were actually considered in determining settlement payments. *See generally* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991).

110. SELIGMAN, *supra* note 41, at 661–63.

111. *Id.* at 661.

112. Avery, *supra* note 104, at 338. In 1994, however, prior to the PSLRA’s passage, the Supreme Court overruled this form of liability. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994) (holding that a judicially implied private cause of action under § 10(b) and Rule 10b–5 does not extend to aiding and abetting § 10(b) violations).

113. Avery, *supra* note 104, at 338. Proponents argued that not only was there a conflict of interest with plaintiffs’ attorneys controlling securities litigation because they were interested only in obtaining a settlement payment but also that innocent investors bore all the costs of such litigation as shareholders of the defendant companies. *Id.* at 338–39.

114. *Id.* at 339.

Clinton,<sup>115</sup> the PSLRA aimed to “protect investors, issuers, and all [those] associated with our capital markets from abusive securities litigation.”<sup>116</sup> The goal was to weed out meritless claims, preserve meritorious ones, and strike a balance between the costs of unnecessary class actions and the benefits of private enforcement of securities fraud.<sup>117</sup> To achieve this goal, the legislation implemented procedural and substantive reforms.<sup>118</sup> Procedurally, for example, the PSLRA required a heightened pleading standard for scienter,<sup>119</sup> created a mandatory stay of discovery during a pending motion to dismiss,<sup>120</sup> changed certain settlement rules,<sup>121</sup> and mandated that each securities fraud class action be controlled by a lead plaintiff.<sup>122</sup> Substantively, it established a system of proportionate liability<sup>123</sup> and, most notably, created a statutory safe harbor for forward-looking statements.<sup>124</sup>

*a. Heightened Pleading Standard for Scienter*

The PSLRA’s heightened pleading standard for scienter, coupled with the stay of discovery on a motion to dismiss, greatly reformed private securities litigation.<sup>125</sup> Essentially, after passage of the PSLRA, not only must all private plaintiffs alleging securities fraud “state with particularity all facts on which [their claim] is formed,”<sup>126</sup> but also, if they are seeking monetary damages based on a culpable state of mind (i.e., scienter) they must “state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind.”<sup>127</sup> Additionally, because of the PSLRA’s new discovery rules, these facts must be obtained before a plaintiff even files a complaint, as their access to discovery is temporarily blocked as soon as a defendant

---

115. See SELIGMAN, *supra* note 41, at 663–69 (detailing the legislative process leading up to passage). In vetoing the bill, President Clinton stated that he was not only concerned with the heightened pleading standards of the PSLRA but also that he suspected the language of the Conference Report would weaken the requirements for the statutory safe harbor. PRESIDENT WILLIAM CLINTON, MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING HIS VETO OF H.R. 1058, A BILL TO REFORM FEDERAL SECURITIES LITIGATION, H.R. DOC. NO. 104-150, at 1–2 (1995), *reprinted in* 3 WILLIAM H. MANZ, PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995: A LEGISLATIVE HISTORY OF PUB. L. NO. 104-67 AND SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998: PUB. L. NO. 105-353, at iii (2000). As discussed *infra* Part II.D.1, his suspicions were accurate.

116. H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.).

117. *Id.* at 31.

118. See *id.* at 32 (highlighting the statute’s procedural protections and limits to liability).

119. See 15 U.S.C. § 78u-4(b)(2) (2006).

120. See *id.* § 78u-4(b)(3).

121. See *id.* § 78u-4(a)(4)–(9).

122. See *id.* § 78u-4(a)(3).

123. See *id.* § 78u-4(f).

124. See *id.* § 78u-5.

125. See SELIGMAN, *supra* note 41, at 671 (remarking that the PSLRA’s heightened pleading standard for scienter effectively marked the end of uniform pleading requirements for federal claims and shifted the focus of securities fraud cases from trials on their merits to adjudications on pretrial motions).

126. 15 U.S.C. § 78u-4(b)(1).

127. *Id.* § 78u-4(b)(2)(A) (emphasis added).

files a motion to dismiss.<sup>128</sup> Thus, the heightened pleading standard and discovery stay substantially shifted the importance of the fact-intensive inquiry of scienter from trial to the forefront of the litigation process with motions to dismiss.<sup>129</sup>

Despite this significant transformation in securities litigation, the PSLRA provided no guidance as to what would be sufficient in establishing such a “strong inference” of scienter necessary to overcome the stay of discovery.<sup>130</sup> Congress left that job to the courts (likely in an attempt to ensure the passage of the PSLRA).<sup>131</sup> Unlike the safe harbor provision, however, the Supreme Court has spoken on the heightened pleading standard for scienter.<sup>132</sup> When determining if a plaintiff has sufficiently pleaded a strong inference of scienter on a motion to dismiss, a court must complete a comparative analysis: “[t]o qualify as ‘strong’ within the intendment of [the PSLRA], . . . an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.”<sup>133</sup>

*b. Safe Harbor for Forward-Looking Statements*

More controversial than the heightened pleading standard, the PSLRA’s safe harbor for forward-looking statements was one of the most hotly debated reforms implemented.<sup>134</sup> Congress generally agreed upon the value of forward-looking information to the investing public.<sup>135</sup> It noted in its Conference Report to the PSLRA that “[u]nderstanding 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.”<sup>136</sup> Thus, Congress intended for the PSLRA’s safe harbor to “enhance market efficiency by encouraging companies to disclose forward-looking information.”<sup>137</sup> However, along with the debate over whether or not corporate managers were actually “muzzled” by current private securities litigation practices,<sup>138</sup> there was considerable debate over how a safe harbor provision should protect false or

---

128. See *id.* § 78u-4(b)(3)(B) (mandating stay of discovery while pretrial motions are under adjudication).

129. SELIGMAN, *supra* note 41, at 671.

130. See 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, 654 (2002) (explaining that, although the Senate passed an explanatory provision for “strong inference,” the Conference Committee reconciling Senate- and House-passed bills deleted that explanation, leaving no guidance in the final bill).

131. *Id.* at 650 (arguing that but for ambiguity in the text of the heightened pleading provision the PSLRA would not have passed).

132. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007).

133. *Id.*

134. See SELIGMAN, *supra* note 41, at 671 (indicating the PSLRA’s safe harbor was the “most hotly contested provision”).

135. H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.).

136. *Id.* at 43 (quoting congressional testimony of former SEC chairman Richard C. Breeden).

137. *Id.*

138. See SELIGMAN, *supra* note 41, at 671–72 (stating that the reform proponents’ claim of a chilling effect on corporate disclosures was unproven) (quoting H.R. REP. NO. 104-369, at 43).

misleading forward-looking statements.<sup>139</sup> After both House and Senate formulations were compromised by the Conference Committee, the end result was a bifurcated safe harbor based on the SEC’s safe harbor rules and the bespeaks caution doctrine.<sup>140</sup>

The exact text of the PSLRA’s safe harbor for forward-looking statements reads as follows:

(c) Safe harbor

(1) In general

Except as provided in subsection (b) of this section, in any private action arising under this chapter that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a [qualifying 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—

(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

(ii) if made by a business entity; was—

(I) made by or with the approval of an executive officer of that entity; and

(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.<sup>141</sup>

The statute divides the first main prong into two subprongs: the meaningful caution subprong<sup>142</sup> and the immateriality subprong.<sup>143</sup> Thus, under the first prong, the

139. See *id.* at 664–67 (detailing the PSLRA legislative history and listing alternate solutions proposed by a member of Congress, such as SEC control or expressly requiring proof of reliance).

140. H.R. REP. NO. 104-369, at 43. See also *supra* Parts II.B.1 and II.B.2 for a discussion of the SEC’s safe harbor rules and the bespeaks caution doctrine, respectively.

141. 15 U.S.C. § 78u-5(c)(1) (2006). As the structure of the statute is significant to the interpretation proposed in this Comment, see *infra* Part III.A.2, the text has been presented as it appears in the Code. Additionally, this section of the safe harbor pertains only to written forward-looking statements; oral forward-looking statements may also be protected by the meaningful caution subprong if the speaker references a readily available written document that provides the requisite meaningful caution regarding an oral forward-looking statement. See 15 U.S.C. § 78u-5(c)(2) (outlining the conditions required for an oral forward-looking statement to qualify for the safe harbor).

142. See 15 U.S.C. § 78u-5(c)(1)(A)(i) (immunizing issuers that provide “meaningful cautionary statements” along with false or misleading forward-looking statements). The meaningful caution subprong

maker of a false or misleading forward-looking statement is immune from liability if either the statement is “immaterial” *or* he identified the statement as forward-looking and accompanied it with “meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.”<sup>144</sup> Although it is safe to assume that “immaterial” means “not material” as already defined by the Supreme Court,<sup>145</sup> Congress again left to the courts the role of defining “meaningful” and provided only nominal clarification as to what constitutes “important factors” sufficient for safe harbor protection.<sup>146</sup> According to the Conference Committee’s Report,<sup>147</sup> although the exact factor that ultimately causes the forward-looking statement to be false should not be required, the “important factors” provided should be substantive, relevant to the forward-looking statement, and able to materially affect the realization of the forward-looking statement.<sup>148</sup> Consequently, boilerplate warnings and cautionary statements that misstate historical facts would not be protected.<sup>149</sup> Additionally, the Conference Report suggested that, where appropriate, courts evaluating meaningfulness on a motion to dismiss may need to look at only the cautionary language and not at the maker’s state of mind regarding the forward-looking statement in order to provide immunity.<sup>150</sup>

---

borrowed “cautionary statements” from the bespeaks caution doctrine. See *supra* Part II.B.2 for a discussion of the bespeaks caution doctrine. Congress was sure to state in the Conference Report, however, that the PSLRA’s safe harbor would not supersede the bespeaks caution doctrine. H.R. REP. NO. 104-369, at 46. Thus, defendants not eligible for the statutory safe harbor can still avail themselves of the bespeaks caution doctrine.

143. See 15 U.S.C. § 78u-5(c)(1)(A)(ii) (immunizing issuers that make false or misleading forward-looking statements that are immaterial as a matter of law).

144. *Id.* § 78u-5(c)(1)(A)(i)-(ii).

145. See *supra* notes 71-73 and accompanying text for a discussion of materiality. *But see* 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, 991 (1996) (arguing that “immaterial” did not refer to the bespeaks caution doctrine).

146. See H.R. REP. NO. 104-369, at 43-44 (discussing the terminology of the meaningful caution subprong).

147. Although the Supreme Court does consider the Conference Report as the authoritative source for legislative intent, *Garcia v. United States*, 469 U.S. 70, 76 (1984), statements within it must be “anchored in the text of the statute.” *Shannon v. United States*, 512 U.S. 573, 583 (1994). Also, it should be noted that “[l]obbyists and lawyers maneuver endlessly to persuade staff members (who write the committee reports) and/or their legislative bosses to throw in helpful language in the reports when insertion of similar language would be inappropriate or infeasible for the statute itself.” WILLIAM N. ESKRIDGE, JR. & PHILIP P. FRICKEY, *CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 710 (1988).

148. H.R. REP. NO. 104-369, at 43-44.

149. *Id.* For mixed statements with present and future attributes, the part referring to the present may or may not be protected by the safe harbor. See *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 255 (3d Cir. 2009) (holding the present element is not protected); *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 705 (7th Cir. 2008) (same); *In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 213 (1st Cir. 2005) (same). *But see Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999) (permitting a mixed present/future statement to receive safe harbor protection).

150. H.R. REP. NO. 104-369, at 44.

The statute’s second main prong, the scienter prong,<sup>151</sup> establishes a stricter state of mind requirement for fraudulent forward-looking statements—“actual knowledge . . . that the statement was false or misleading.”<sup>152</sup> Hence, recklessness was clearly rejected as sufficient proof of scienter.<sup>153</sup> Explaining the actual knowledge standard of proof, the Conference Committee stated: “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.”<sup>154</sup> As opposed to the meaningful caution and immateriality subprongs, the scienter prong focuses only on proving the state of mind of the person who made the forward-looking statement.<sup>155</sup>

In addition to the above conditions, the safe harbor is applicable to only certain issuers and their representatives who are regulated by the SEC<sup>156</sup> and does not cover issuers who have violated securities laws within the prior three years of making a challenged forward-looking statement.<sup>157</sup> Also, forward-looking statements made in regards to certain transactions, such as blank checks, penny stocks, rollups, going private, tender offers, and initial public offerings, are excluded.<sup>158</sup>

#### D. Differing Judicial Interpretations and Applications of the PSLRA’s Safe Harbor

Since the passage of the PSLRA, courts interpreting the statutory safe harbor for forward-looking statements and applying it to plaintiffs’ complaints on motions to dismiss have largely fallen into two widely divergent camps.<sup>159</sup> Some courts treat allegations of actual knowledge as irrelevant to their analysis of the meaningful caution subprong.<sup>160</sup> Conversely, other courts accept sufficient allegations of actual knowledge

---

151. 15 U.S.C. § 78u-5(c)(1)(B) (2006). The statute also divides this second main prong into two subprongs based on who made the forward-looking statement: a natural person or a business entity. *Id.* § 78u-5(c)(1)(B)(i)-(ii). Because both of these subprongs require actual knowledge of falsity for culpability, however, this Comment will refer to them collectively as the scienter prong.

152. *Id.* § 78u-5(c)(1)(B).

153. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 n.3 (2007) (referring to the fact that all circuits that have considered the issue accept recklessness as scienter for traditional securities fraud liability, though the Supreme Court did not rule on the issue).

154. H.R. REP. NO. 104-369, at 44 (emphasis added).

155. *Id.* at 44, 47.

156. *See* 15 U.S.C. § 78u-5(a) (indicating the safe harbor is applicable to issuers subject to the reporting requirement of § 78m(a) or § 78o(d) and those working on their behalf).

157. *Id.* § 78u-5(b).

158. *Id.*

159. *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 IOWA J. CORP. L. 519, 539 (2010) (stating that judicial interpretations of the statutory safe harbor vary widely, but fall either on the side of accepting actual knowledge as relevant to the meaningful cautionary language inquiry or rejecting it). Professor Horwich also notes a third camp that treats alleging actual knowledge as a means to preclude a meaningful cautionary language defense entirely; but, for the sake of simplicity, this Comment will include that camp within the camp that sides with accepting actual knowledge as relevant to the meaningful cautionary language inquiry. *Id.*

160. *Id.*; *see also* 15 U.S.C. § 78u-5(c)(1)(A) (providing that a person making an untrue forward-looking statement shall not be liable if the forward-looking statement is “accompanied by meaningful cautionary statements” or immaterial). *See infra* Part II.D.1 for a discussion of this interpretation of the PSLRA’s safe

of falsity even if the meaningful caution subprong appears to be met, and may deny a motion to dismiss as a result.<sup>161</sup>

### 1. Courts Holding Actual Knowledge Irrelevant to Meaningful Caution Analysis

The seminal case holding that actual knowledge of falsity is irrelevant to a statutory safe harbor analysis under the meaningful caution subprong is the Eleventh Circuit's *Harris v. Ivax Corp.*<sup>162</sup> In *Harris*, a generic drug manufacturer, the Ivax Corporation, made press releases at the middle and end of the third quarter of 1996 stating that it was optimistic about its future drug sales even though it was undertaking a large business restructuring plan that would result in third-quarter losses of approximately \$43 million.<sup>163</sup> When actual third-quarter losses were reported in the fourth quarter of 1996, the damage was much worse—a loss of \$179 million due to a \$104 million goodwill write-down that had not been mentioned in the third-quarter press releases.<sup>164</sup> As a result, the stock plummeted and Ivax securities purchasers sued for fraud.<sup>165</sup>

In rejecting the plaintiffs' claims and accepting defendant Ivax Corporation's assertion of the PSLRA's safe harbor, the court held that Ivax Corporation was not liable for its false forward-looking statements because they were accompanied by "meaningful cautionary language."<sup>166</sup> The court reasoned that the safe harbor applied because the third-quarter press releases were mostly forward-looking<sup>167</sup> and accompanied by an appended "laundry list" of important factors that would potentially affect the amount of losses sustained, such as high inventory levels, low orders, declining prices, and a large customer's bankruptcy.<sup>168</sup> Though Ivax Corporation failed to warn investors of the substantial goodwill write-down, the court reasoned that this was not required by the PSLRA's safe harbor: "[W]hen an 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>169</sup> Thus, because there was meaningful

---

harbor, which the Sixth, Ninth, and Eleventh Circuits have expressly accepted, and which the Fourth Circuit appears to accept implicitly.

161. Horwich, *supra* note 159, at 539. See also *infra* Part II.D.2 for a discussion of this interpretation of the PSLRA's safe harbor, which only the Fifth and Seventh Circuit have expressly accepted. Circuit court dicta and district court cases in the D.C., First, Second, Eighth, and Tenth Circuits, however, appear to align with this camp. The Third Circuit has avoided the issue all together. See *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 259 (3d Cir. 2009) (avoiding the issue because failure to plead actual knowledge was dispositive).

162. 182 F.3d 799 (11th Cir. 1999).

163. *Harris*, 182 F.3d at 802.

164. *Id.*

165. *Id.*

166. *Id.* at 803.

167. The *Harris* court also held 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." *Id.* at 807.

168. *Id.* at 805–07.

169. *Id.* at 807.

cautionary language, the court held that it did not need to “enter the thicket of the PSLRA’s new pleading requirements for scienter.”<sup>170</sup> The court stated simply, “if a statement is accompanied by meaningful cautionary language, the defendants’ state of mind is irrelevant.”<sup>171</sup>

The Sixth Circuit, and more recently, the Ninth Circuit in *In re Cutera Securities Litigation*<sup>172</sup> have followed the Eleventh Circuit and stated the same.<sup>173</sup> The Ninth Circuit made its determination despite several district court cases concluding that actual knowledge of falsity negates a meaningful caution analysis.<sup>174</sup> Although the Ninth Circuit rested its conclusion on the disjunctive structure of the PSLRA’s safe harbor,<sup>175</sup> overruling the district courts who held otherwise,<sup>176</sup> it explicitly failed to reconcile the district court case *In re SeeBeyond Technologies Corp. Securities Litigation*.<sup>177</sup> The court in *In re SeeBeyond* agreed with a disjunctive construction but stated further that “[w]hether cautionary language is meaningful, in that it identifies important factors, can only be understood with reference to the defendant’s knowledge of relevant factors.”<sup>178</sup> It continued:

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.<sup>179</sup>

The Ninth Circuit in *In re Cutera* did not have this issue with actual knowledge, however, because defendant, Cutera, Inc., had publicly disclosed its knowledge of a weak sales force, which was the material factor plaintiffs alleged it had concealed to defraud them in the first place.<sup>180</sup>

---

170. *Id.* at 803.

171. *Id.* (internal quotation marks omitted).

172. 610 F.3d 1103 (9th Cir. 2010).

173. See *In re Cutera*, 610 F.3d at 1112–13 (holding that state of mind is not to be considered in the meaningful caution inquiry because the statute is written in the disjunctive form); *Miller v. Champion Enters., Inc.*, 346 F.3d 660, 672 (6th Cir. 2003) (holding that state of mind is irrelevant under the meaningful caution subprong). The Fourth Circuit has not directly addressed the conflict between actual knowledge of falsity and meaningful caution, but its unpublished decision in *Marsh Group v. Prime Retail, Inc.* appears to imply that it would side with the above courts of appeals. See 46 F. App’x 140, 145 (4th Cir. 2002) (reaffirming pre-PSLRA holding that forward-looking statements cannot be actionable unless they amount to a guarantee).

174. See, e.g., *No. 84 Emp’r-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 936 (9th Cir. 2003) (indicating the issuer may be liable, despite meaningful caution, if forward-looking statement was made with actual knowledge that it was false or misleading).

175. *In re Cutera*, 610 F.3d at 1113. The court reasoned that because “or” appeared between all three prongs of the statutory safe harbor, each prong served as an alternate and exclusive basis for issuer immunity. *Id.*

176. *Id.* at 1113 & n.5 (overruling courts that used a conjunctive interpretation of the PSLRA’s safe harbor to deny a motion to dismiss because of the “strong inference of actual knowledge” reference made in *Am. W. Holding*, 320 F.3d at 937 n.15).

177. 266 F. Supp. 2d 1150, 1166 (C.D. Cal. 2003).

178. *In re SeeBeyond*, 266 F. Supp. 2d at 1166 n.8.

179. *Id.* at 1165.

180. *In re Cutera*, 610 F.3d at 1110.

## 2. Courts Holding Actual Knowledge Relevant to Meaningful Caution Analysis

Alternatively, each using different rationales, the Fifth and Seventh Circuits have held that actual knowledge is relevant to the meaningful caution inquiry.<sup>181</sup> The Second Circuit, seemingly on the fence, appears to accept an interpretation that would consider allegations of actual knowledge of falsity a relevant inquiry on a motion to dismiss.<sup>182</sup>

The Fifth Circuit in *Lormand v. US Unwired, Inc.*<sup>183</sup> held that defendants who allegedly have actual knowledge that their forward-looking statements are false or misleading when made can never avail themselves of the safe harbor.<sup>184</sup> *Lormand* involved the tense relationship between Sprint Corporation, a nationwide telecommunications company, and one of its regional affiliates, US Unwired, Inc.<sup>185</sup> Essentially, Sprint forced US Unwired to do two things it did not want to do: stop requiring deposits from subprime credit customers, and change its affiliate relationship with Sprint so that Sprint would have control of certain internal operations such as customer care, billing, and cash flow.<sup>186</sup> US Unwired, who was issuing stock to fund its growth plans during this time, knew both these changes would be disastrous to the success of its expansion, which relied on controlling internal operations and customer payments.<sup>187</sup> Nevertheless, despite knowledge of and concern over the risks it faced, US Unwired did not publicly disclose the magnitude it attributed to these risks; instead, it released statements indicating confidence in the integration plan with Sprint and stated that it thought “these [no-deposit] customers are necessary to reach our full market penetration potential and . . . do it profitably.”<sup>188</sup> When news of long-term

---

181. See *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 244 (5th Cir. 2009) (holding that allegations of actual knowledge avoid the PSLRA’s safe harbor entirely); *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 734–35 (7th Cir. 2004) (holding that actual knowledge may preclude meaningful caution analysis but the court requires additional information into important risk factors apparent at the time of the forward-looking statement), *cert denied*, *Baxter Int’l Inc. v. Asher*, 544 U.S. 920 (2005). The First Circuit would appear to side with this camp because of its statement in *Baron v. Smith* that forward-looking statements accompanied by meaningful caution “are protected by the statutory safe harbor unless the person making the forward-looking statements . . . had actual knowledge they were false or misleading.” 380 F.3d 49, 55 n.3 (1st Cir. 2004). *But see In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 212 (1st Cir. 2005) (conceding that the PSLRA’s safe harbor seems to provide a “surprising rule” where fraudulent forward-looking statements can escape liability). Although the D.C., Third, Fourth, Eighth, and Tenth Circuits have not spoken on this issue, there are district court cases within the D.C., Eighth, and Tenth Circuits that consider actual knowledge of falsity relevant to the meaningful caution analysis. See, e.g., *Freeland v. Iridium World Commc’ns, Ltd.*, 545 F. Supp. 2d 59, 72–73 (D.D.C. 2008) (holding that safe harbor does not necessarily protect forward-looking statements that were knowingly false when made); *In re Nash Finch Co. Sec. Litig.*, 502 F. Supp. 2d 861, 873 (D. Minn. 2007) (same); *Schaffer v. Evolving Sys., Inc.*, 29 F. Supp. 2d 1213, 1224 (D. Colo. 1998) (stating that defendants who make forward-looking statements with actual knowledge cannot find refuge in safe harbor).

182. See *Slayton v. Am. Exp. Co.*, 604 F.3d 758, 771–72 (2d Cir. 2010) (implying that some inquiry into the speaker’s knowledge at the time of the false forward-looking statement is warranted, even if the statute is clearly written in the disjunctive form creating alternate means of protection).

183. 565 F.3d 228 (5th Cir. 2009).

184. *Lormand*, 565 F.3d at 244.

185. *Id.* at 232–33.

186. *Id.* at 234–35.

187. *Id.*

188. *Id.* at 235–36 (alteration in original).

challenges with Sprint eventually leaked, US Unwired’s stock crashed, inciting a suit for securities fraud.<sup>189</sup>

Although the district court granted protection to US Unwired under the PSLRA’s safe harbor for some of its forward-looking statements, the Fifth Circuit reversed.<sup>190</sup> It stated that “[b]ecause the plaintiff adequately allege[d] that the defendants actually knew that their statements were misleading at the time they were made, the safe harbor provision is inapplicable to all alleged misrepresentations.”<sup>191</sup> The court relied on its conclusion in *Southland Securities Corp. v. INSpire Insurance Solutions Inc.*<sup>192</sup> that the safe harbor has two independent prongs, one for the defendant’s cautionary statements and another for the defendant’s state of mind.<sup>193</sup> Thus, because the defendants in *Lormand* allegedly had the requisite state of mind for liability under the scienter prong, the Fifth Circuit found that the district court committed error when it afforded US Unwired protection under the meaningful caution subprong.<sup>194</sup>

The Seventh Circuit in *Asher v. Baxter International Inc.*<sup>195</sup> took a slightly different approach. It held that plaintiffs’ allegations of actual knowledge of falsity preclude dismissal when those allegations sufficiently cast doubt on the importance of the defendant’s meaningful cautionary statements.<sup>196</sup> The plaintiffs in *Asher* brought a fraud-on-the-market class action against Baxter International, a medical products manufacturer, alleging that Baxter fraudulently inflated its share price by making public “commitments” as to its future earnings, which, according to plaintiffs, Baxter knew it would not meet.<sup>197</sup> Though it did “commit” publicly that its earnings would be lower than in previous years, and cautioned of risks facing certain business units, Baxter did not disclose specific internal problems along with its forward-looking statements, such as a product development failure and other on-going problems with meeting internal budgets and projections.<sup>198</sup> In fact, as these problems were developing, the cautions Baxter provided remained constant.<sup>199</sup> Plaintiffs claimed that omission of these problems was material, and thus, Baxter’s long list of company-specific risks that

---

189. *Id.* at 236–37.

190. *Id.* at 244.

191. *Id.*

192. 365 F.3d 353 (5th Cir. 2004).

193. *Southland Sec.*, 365 F.3d at 371–72 (denying safe harbor because the statement was not forward-looking but also explaining that “[t]o avoid the safe harbor, plaintiffs must plead facts demonstrating that the statement was made with actual knowledge of its falsity”).

194. *Lormand*, 565 F.3d at 244 (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007)) (instructing the district court that it must “accept as true the well-pleaded factual allegations in the complaint during the pleadings stage”). The *Lormand* court alternatively held that, even if actual knowledge was not sufficiently alleged, US Unwired’s cautionary statements were mere boilerplate and would not fall within the PSLRA’s safe harbor. *Id.*

195. 377 F.3d 727 (7th Cir. 2004), *cert denied*, *Baxter Int’l Inc. v. Asher*, 544 U.S. 920 (2005). Judge Frank Easterbrook, a renowned law and economics scholar, authored the opinion.

196. *Asher*, 377 F.3d at 734.

197. *Id.* at 728. In characterizing the plaintiffs’ allegations, Judge Easterbrook noted: “[Plaintiffs charge] the defendants with stupidity as much as with knavery, for the truth was bound to come out quickly, but the securities laws forbid foolish frauds along with clever ones.” *Id.*

198. *Id.* at 728–29.

199. *Id.* at 734–35.

it attached to its public statements were not “meaningful cautionary statements.”<sup>200</sup> Arguing that the statements were made with meaningful caution, Baxter moved for dismissal under the PSLRA’s safe harbor.<sup>201</sup>

The Seventh Circuit said this was precisely the issue the court must tackle: Were the cautionary statements that Baxter made “meaningful” in light of the information that Baxter may have known but did not disclose?<sup>202</sup> The court noted that resolving this issue is not as simple as looking to the statute for instruction: “The fundamental problem is that the statutory requirement of ‘meaningful cautionary statements’ is not itself meaningful.”<sup>203</sup> After concluding that Baxter’s cautions were neither boilerplate nor adequately cautionary because they did not change as internal problems developed, the court turned its focus to what cautionary information investors would ultimately want to have;<sup>204</sup> that is, “full disclosure of the assumptions and calculations *behind* the [forward-looking statements].”<sup>205</sup> The court noted, however, that actually reaching this end might not always be sensible because of competitive risk, and in the court’s opinion, the PSLRA did not require such full disclosure.<sup>206</sup> Thus, the court concluded:

The PSLRA does not require the *most* helpful caution . . . . [I]t is enough to point to the principal contingencies that could cause actual results to depart from the projection. . . .

. . . [Yet, t]here 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 that at the time were the (or any of the) “important” sources of variance. . . . For all we can tell, the major risks Baxter *objectively faced* when it made its forecasts were exactly those that, according to the complaint, came to pass, yet the cautionary statement mentioned none of them.<sup>207</sup>

---

200. *Id.* at 729–30.

201. *Id.* at 728.

202. *Id.* at 729. Also, as a preliminary matter, the court explained that, because the fraud-on-the-market theory is premised on efficient market theory and substituted reliance, the alleged fraudulently inflated stock price must be viewed as incorporating all publicly-available information on Baxter, optimistic and cautionary. *Id.* at 731–32 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 241–47 (1988)). However, the court stated this still leaves the issue of “[w]hether all firm-specific non-disclosures add up to a material non-disclosure.” *Id.* at 729.

203. *Id.* at 729. The court characterized the meaningful caution subprong as the result of a compromise made by legislators to get a bill passed—a compromise between legislators who did not want a safe harbor and those who wanted a safe harbor that did not require cautionary language at all, much like the SEC safe harbor rules that required only a rational basis for making a forward-looking statement. *Id.* at 732–33. The court stated that although “[c]ompromises of this kind lack spirit. . . . the language was enacted, and [the court] must make something of it.” *Id.* at 733.

204. *Id.* at 733.

205. *Id.* (emphasis in original).

206. *Id.* at 733–34. Additionally, the court explained that sometimes “[i]ncomplete information . . . is better than none, because market professionals know other tidbits that put the news in context.” *Id.* at 734.

207. *Id.* (second emphasis added).

Due to this doubt about what Baxter “objectively faced” when it made its future projections, the court held that, at this stage, the safe harbor did not apply and the complaint could not be dismissed.<sup>208</sup>

The Second Circuit has not reached a conclusion on how to apply the meaningful caution subprong when actual knowledge of falsity is alleged; recently in *Slayton v. American Express Co.*,<sup>209</sup> however, it echoed the Seventh Circuit’s sentiment that the PSLRA’s safe harbor was difficult to apply.<sup>210</sup> Aptly characterizing the nature of the problem dividing courts on this issue, the Second Circuit acknowledged the disjunctive construction of the PSLRA’s safe harbor and stated:

On the one hand, the Conference Report makes quite plain that it does not want courts to inquire into a defendant’s state of mind, i.e., a defendant’s knowledge of the risks at the time he made the statements. At the same time, however, the Conference Report requires cautionary statements to convey substantive information about factors that realistically could cause results to differ materially from projections. In order to assess whether an issuer has identified the factors that realistically could cause results to differ, we must have some reference by which to judge what the realistic factors were at the time the statement was made. We think that the most sensible reference is the major factors that the defendants faced at the time the statement was made. But this requires an inquiry into what the defendants knew because in order to determine what risks the defendants faced, we must ask of what risks were they aware.<sup>211</sup>

Yet, because *Slayton* involved vague cautionary language that was clearly not meaningful,<sup>212</sup> the court did not have to decide this “thorny issue.”<sup>213</sup>

What the *Slayton* court did address, however, was the pleading requirements for actual knowledge under the PSLRA’s safe harbor (as opposed to pleading scienter elsewhere under the Act).<sup>214</sup> The Second Circuit held that, when evaluating the sufficiency of pleading actual knowledge of falsity on a motion to dismiss, a court must look at the complaint and the defendant’s statements and determine if the complaint establishes a strong inference that the defendants “(1) did not genuinely believe the . . . statement, (2) actually knew that they had no reasonable basis for making [it], or (3) were aware of undisclosed facts tending to seriously undermine [its] accuracy.”<sup>215</sup>

---

208. *Id.* at 734–35. The court did continue, however: “[W]e cannot exclude the possibility that if after discovery Baxter establishes that the cautions did reveal what were, *ex ante*, the major risks, the safe harbor may yet carry the day.” *Id.* at 735.

209. 604 F.3d 758 (2d Cir. 2010).

210. *Slayton*, 604 F.3d at 771.

211. *Id.* at 771 (footnote omitted).

212. *Id.* at 772. The court considered defendant American Express’s cautions basically boilerplate, amounting to a warning that “if our portfolio deteriorates, then there will be losses in our portfolio.” *Id.*

213. *Id.* at 772.

214. *Id.* at 775. Outside of the safe harbor, recklessness suffices for scienter. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (referring to the fact that all circuits accept recklessness as scienter for traditional securities fraud liability).

215. *Slayton*, 604 F.3d at 775. Also, to be “strong” per *Tellabs*, the inference must be “cogent and at least as compelling as any opposing inference.” *Id.* (quoting *Tellabs*, 551 U.S. at 314).

## III. DISCUSSION

Because a statutory scheme that intends to regulate the honesty and transparency of the securities markets should not permit dishonest and opaque practices,<sup>216</sup> this Comment proposes a new meaning for the phrase “meaningful cautionary statements” under the PSLRA’s safe harbor for forward-looking statements.<sup>217</sup> This Comment argues that cautionary statements accompanying false or misleading forward-looking statements are sufficiently “meaningful” for the meaningful caution subprong *only if*: (1) they contain substantive, issuer-specific, and material risk factors tailored to the forward-looking statements, *and* (2) they reasonably reveal to investors any knowledge held by the issuer that the forward-looking statements are or will be false or misleading.<sup>218</sup>

Currently, a majority of courts and commentators reject such a qualitative definition, which incorporates the integral element of scienter,<sup>219</sup> because they assert that the meaningful caution subprong operates without considering the state of mind of the issuer.<sup>220</sup> As a result, their interpretation of the PSLRA’s safe harbor provides “a surprising rule that the maker of knowingly false and wilfully fraudulent forward-looking statements, designed to deceive investors, escapes liability for the fraud if the statement is . . . accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially.”<sup>221</sup> This Comment aims to put an end to this “surprising rule.”

To ensure that the PSLRA’s safe harbor does not protect fraudulent forward-looking statements,<sup>222</sup> this Comment argues that courts, evaluating a motion to dismiss

---

216. See H.R. REP. NO. 73-1383, pt. 2, at 11 (1934) (stating that honest markets for investors require honest publicity by issuers).

217. 15 U.S.C. § 78u-5(c)(1)(A)(i) (2006).

218. See *infra* Part III.E for a discussion of this definition of “meaningful” and how it operates within the PSLRA’s safe harbor. As a side note, if the issuer currently knows for a fact that the forward-looking statement he is making will never be true, the statement is arguably not “forward-looking” and thus the PSLRA’s safe harbor would not apply. See, e.g., *In re Splash Tech. Holdings, Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1067–68 (N.D. Cal. 2001) (stating that forward-looking statements are not current facts but those for which “the truth or falsity . . . cannot be discerned until some point in time after the statement is made”).

219. See *supra* notes 21–24 and accompanying text for a discussion of scienter.

220. See *supra* Part II.D.1 for a discussion of courts ruling that allegations of scienter are irrelevant to a meaningful caution analysis. See also Olazábal, *supra* note 1, at 615–25 (arguing that legislative history points to ignoring scienter in meaningful caution analysis and so courts that do incorporate scienter have wrongly decided cases); Richard F. Conklin, Note, *Why “Or” Really Means “Or”: In Defense of the Plain Meaning of the Private Securities Litigation Reform Act’s Safe Harbor Provision*, 51 B.C. L. REV. 1209, 1227 (2010) (arguing that disjunctive construction of the statute implies irrelevance of scienter under the first prong of the safe harbor); Alfred Wang, Comment, *The Problem of Meaningful Cautionary Language: Safe Harbor Protection in Securities Class Action Suits After Asher v. Baxter*, 100 NW. U. L. REV. 1907, 1908–10 (2006) (opposing the Seventh Circuit’s position on false forward-looking statements and arguing that plain reading and legislative history preclude considerations of knowledge under the meaningful caution subprong).

221. *In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 212 (1st Cir. 2005); see, e.g., *Harris v. Ivax Corp.*, 182 F.3d 799, 806–07 (11th Cir. 1999) (avoiding the question of whether the defendant issuer had concealed actual knowledge that it would soon take a \$104 million write-down at the time it made optimistic forward-looking statements because the issuer had provided a long list of other risks, which the court thought were “meaningful”).

222. See *supra* Part II.A for a discussion of what constitutes a fraudulent forward-looking statement.

under the PSLRA’s meaningful caution subprong, should apply the above definition of “meaningful” and consider, alongside a defendant’s cautionary statements, a plaintiff’s alleged facts producing a strong inference of actual knowledge that a forward-looking statement was false or misleading when made.<sup>223</sup> If this comparative analysis reveals that investors were reasonably informed of the issuer’s actual knowledge of falsity, the PSLRA’s safe harbor should protect the issuer because the cautions were “meaningful.”<sup>224</sup> If the comparison does not show that the issuer revealed such knowledge of falsity because it was concealed, then the PSLRA’s safe harbor should not protect the issuer that fraudulently misled investors.<sup>225</sup>

Part III.A.1 highlights the importance of scienter in securities fraud actions, which Part III.A.2 tracks in the text and legislative history of the PSLRA. Part III.B critiques the majority interpretation that ignores scienter on a motion to dismiss based on the meaningful caution subprong. Parts III.C and III.D, respectively, demonstrate that overbroad protection of issuers frustrate the disclosure rationales of securities law and is hardly necessary in light of the PSLRA’s high pleading standards for scienter. Lastly, Part III.E proposes a new reading of the PSLRA’s safe harbor that incorporates the qualitative aspects of scienter into a meaningful caution analysis.

#### A. *Support for Incorporating Scienter into Definition of “Meaningful”*

The majority opinion that actual knowledge of falsity is irrelevant to a meaningful caution analysis understates the significance of scienter<sup>226</sup> as an element of securities fraud and draws the unnecessary conclusion that it should not be considered on a motion to dismiss under the meaningful caution subprong.<sup>227</sup> Conversely, scienter plays an important role in securities fraud,<sup>228</sup> and according to the origins of fraudulent forward-looking statements, the PSLRA’s text, and its legislative history, scienter should also play an important role in a meaningful caution analysis.

---

223. See *infra* Part III.E for a discussion of how the definition proposed here operates within the PSLRA’s safe harbor. To be sure, this Comment does not argue that allegations of scienter can overcome a PSLRA safe harbor defense asserted under the immateriality subprong. As with any statement subject to a 10b-5 private action, a false or misleading forward-looking statement is not actionable if not material. See *supra* Part II.C.1 for a discussion of actionable securities fraud. In addition, it is beyond the scope of this Comment to address the deficiencies of the strong inference standard itself, which effectively protects issuers who committed fraud by making it harder for injured investors to marshal the facts necessary to establish a viable claim in court.

224. See *infra* Part III.E for a discussion of when the meaningful caution subprong applies under the interpretation argued in this Comment.

225. See *infra* Part III.E for a discussion of when the meaningful caution subprong does not apply under the interpretation argued in this Comment.

226. Scienter is the “mental state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

227. See *supra* Part II.D.1 for a discussion of the majority opinion and cases supporting it. See *infra* Part III.B for a critique of that opinion and those cases.

228. See *supra* notes 21–24 and accompanying text for cases and discussion highlighting the importance of scienter.

### 1. Scierter Distinguishes False from Fraudulent Forward-Looking Statements

As an integral element of securities fraud, scierter, or the “intent to deceive, manipulate, or defraud,”<sup>229</sup> distinguishes the merely false forward-looking statement from the fraudulent one.<sup>230</sup> Issuers do not have to see the future when making forward-looking statements; the forward-looking statement that turns out to be untrue or misleading is not per se fraudulent.<sup>231</sup> Therefore, something other than falsity must cause a false or misleading forward-looking statement to rise to the level of actionable securities fraud—this threshold requirement is scierter.<sup>232</sup> Courts have long applied the traditional elements of securities fraud to forward-looking statements,<sup>233</sup> and the basis for so doing was the fact that an issuer making a forward-looking statement also makes implicit representations about the truth or falsity of its statement.<sup>234</sup> These implicit representations are: “(1) that the statement is genuinely believed, (2) that there is a reasonable basis for that belief, and (3) that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement.”<sup>235</sup> If any of these implicit representations are lacking, courts consider the forward-looking statement an untrue statement of fact that implicates scierter.<sup>236</sup> Accordingly, under the PSLRA, plaintiffs must sufficiently plead that an issuer either did not genuinely believe its statement, did not have a reasonable basis for making it, or otherwise failed to disclose facts seriously undermining it, in order to produce a strong inference of actual knowledge, the level of scierter required by the PSLRA’s safe harbor.<sup>237</sup>

Because scierter is an essential requirement for investors to recover on a suit alleging a fraudulent forward-looking statement,<sup>238</sup> cautionary statements, which fail to reveal the inaccuracy of the above implicit representations, should not negate sufficient allegations of scierter on a motion to dismiss.<sup>239</sup> A court’s interpretation of what

---

229. *Hochfelder*, 425 U.S. at 194 n.12.

230. See *supra* Part II.A for a discussion of false versus fraudulent forward-looking statements.

231. See, e.g., *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (stating that an unexpected turn of events by itself cannot serve as a basis for securities fraud; otherwise, it would be “fraud by hindsight”).

232. See *Hochfelder*, 425 U.S. at 193 (holding that the defendant cannot be liable for damages based on securities fraud without scierter).

233. See *Marx v. Computer Scis. Corp.*, 507 F.2d 485, 489 (9th Cir. 1974) (stating it has been established that securities regulations treat forecasts or predictions as “facts” for purposes of securities fraud).

234. See *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) (explaining that forward-looking statements receive securities fraud treatment because of implicit factual representations).

235. *Id.*

236. See *Marx*, 507 F.2d at 490 (explaining that forward-looking statements made without a reasonable basis are untrue statements of fact and this “untruthfulness vel non . . . is inextricably linked with . . . ‘scierter’”).

237. *Slayton v. Am. Express Co.*, 604 F.3d 758, 775 (2d Cir. 2010).

238. See *supra* Part II.A for a discussion of false versus fraudulent forward-looking statements.

239. Immateriality of a false or misleading forward-looking statement, on the other hand, can effectively negate scierter because securities fraud always requires materiality. See SEC Rule 10b-5(b), 17 C.F.R. § 240.10b-5(b) (2010) (requiring “material fact”). The meaningful caution subprong, however, stands on different footing because it assumes the materiality of the forward-looking statement under controversy. See 15 U.S.C. § 78u-5(c)(1) (2006) (reiterating the threshold requirement of “material fact” for the applicability of safe harbor). Although an issuer would technically not need the protection of the PSLRA’s safe harbor if its false forward-looking statement was not material to the reasonable investor, see *Basic Inc. v. Levinson*, 485

constitutes “meaningful” caution against a false or misleading forward-looking statement should also address the reasons why such a statement could be fraudulent despite the presence of caution. The majority’s interpretation, which ignores any evidence of a defendant issuer’s state of mind in a “meaningful” caution analysis, entirely overlooks this.<sup>240</sup> For this reason, this Comment proposes a meaning for “meaningful cautionary statements” that requires an issuer’s cautions to reasonably reveal to investors any knowledge held by the issuer that the forward-looking statement is or will be false or misleading.

## 2. PSLRA’s Text and Legislative History Can Be Validly Read to Incorporate Scier into the Meaningful Caution Analysis

Though the majority of courts and commentators use the disjunctive construction of the PSLRA’s bifurcated safe harbor to draw their conclusion that scier is irrelevant to a meaningful caution analysis,<sup>241</sup> this is not a necessary conclusion.<sup>242</sup> The PSLRA’s safe harbor consists of two dominant prongs separated by “or.”<sup>243</sup> The first dominant prong is further subdivided into two substantive subprongs also separated by “or”—the meaningful caution subprong and the immateriality subprong.<sup>244</sup> On their face, these subprongs respectively signal to issuers that if they “meaningfully” caution against the certainty of forward-looking statements, or if they make forward-looking statements that do not substantially influence the decision-making process of or total mix of information available to the reasonable investor, they cannot be liable for securities fraud.<sup>245</sup> The second dominant prong—the scier prong—establishes the standard of proof for plaintiffs suing issuers that made false or misleading forward-looking statements.<sup>246</sup> This prong signals to investors that no longer is recklessness sufficient to find an issuer liable for securities fraud when making a forward-looking statement; a plaintiff must now “*prove* that the forward-looking statement . . . was made with actual knowledge . . . that the statement was false or misleading.”<sup>247</sup>

Looking only at the text of the statute, these declarations of immunity and a higher standard of proof do not themselves preclude consideration of actual knowledge

---

U.S. 224, 224 (1988) (requiring materiality in 10b–5 actions), the PSLRA’s safe harbor explicitly provides protection for immaterial statements anyway. 15 U.S.C. § 78u–5(c)(1)(A)(ii) (the immateriality subprong). As a result, this Comment argues that only the immateriality subprong should trump scier; the meaningful caution subprong should not.

240. See *supra* Part II.D.1 for this majority interpretation and notes 1 and 220 for scholarly commentary arguing the same.

241. See *supra* Part II.D.1 for a discussion of courts ruling this way and notes 1 and 220 for citations to commentary concluding the same. See *infra* Part III.B for a critique of this reasoning.

242. See, e.g., *In re SeeBeyond Techs. Corp.*, 266 F. Supp. 2d 1150, 1164–66 (C.D. Cal. 2003) (upholding the disjunctive construction but allowing allegations of actual knowledge of falsity to trump the meaningful caution subprong).

243. See *supra* Part II.C.2.b for the text of the PSLRA’s safe harbor.

244. *In re SeeBeyond*, 266 F. Supp. 2d at 1164.

245. *Id.* at 1163. The use of the word “immaterial” triggers established judicial tests for materiality. See *supra* notes 71–73 and accompanying text for a definition of materiality.

246. See *supra* Part II.C.2.b for the text of the PSLRA’s safe harbor.

247. 15 U.S.C. § 78u–5(c)(1)(B) (2006) (emphasis added); see also *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (discussing recklessness as otherwise sufficient for scier).

of falsity in a meaningful caution analysis.<sup>248</sup> Although the presence of “or” between all prongs plainly creates independent and alternative paths to protection under the safe harbor,<sup>249</sup> the text of the statute neither prohibits the development of a meaning for “meaningful cautionary statements” that would mandate reasonable disclosure of actual knowledge of falsity nor bars courts from considering such knowledge as relevant to a meaningful caution analysis on a motion to dismiss.<sup>250</sup> In fact, the text of the statute qualifies “meaningful cautionary statements” with only the requirement that they “identify[] important factors that could cause actual results to differ materially from those in the forward-looking statement.”<sup>251</sup> Without any further qualification, concealed knowledge of a material factor that causes or foreseeably will cause a forward-looking statement to be false or misleading would appear to be an “important factor” necessary to identify for investors.<sup>252</sup> Therefore, requiring disclosure of such knowledge in order for cautionary language to be “meaningful,” as this Comment proposes, does not conflict with a plain reading of the statute.

The PSLRA’s Conference Report creates complications for such a reading, however, because it recommends courts only look at cautionary statements and not a defendant’s state of mind on a motion to dismiss under the meaningful caution prong.<sup>253</sup> Although Conference Reports are considered the authoritative source for legislative intent,<sup>254</sup> the instructive statements within them must be “anchored in the text of the statute.”<sup>255</sup> The majority interpretation argues that their anchor in the PSLRA’s safe harbor is the “or” separating the three substantive prongs of the safe harbor.<sup>256</sup> Yet, this argument simply relies on the disjunctive construction of the statute, which is not necessarily inconsistent with the meaningful caution analysis proposed in this Comment.<sup>257</sup> Thus, a closer parsing of the Conference Report is in order.

For example, the majority’s argument refers to the following paragraph from the PSLRA’s Statement of Managers:

---

248. See *In re SeeBeyond*, 266 F. Supp. 2d at 1165–66 (explaining that allegations of actual knowledge of falsity should inform the meaningful caution subprong).

249. *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 371–72 (5th Cir. 2004).

250. See *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 729 (7th Cir. 2004) (explaining that the statute provides no meaning for meaningful cautionary statements).

251. See *supra* Part II.C.2.b for the text of the PSLRA’s safe harbor.

252. See *In re SeeBeyond*, 266 F. Supp. 2d at 1166 n.8 (stating that the PSLRA’s “important factors” include the speaker’s belief that the forward-looking statement is false or misleading and reasons why it is false or misleading).

253. H.R. REP. NO. 104-369, at 47 (1995) (Conf. Rep.).

254. See *Garcia v. United States*, 469 U.S. 70, 76 (1984).

255. *Shannon v. United States*, 512 U.S. 573, 583 (1994). Realistically, one should also consider the lobbying involved in writing Conference Reports, which seeks to insert language that would be “inappropriate or infeasible for the statute itself.” ESKRIDGE & FRICKEY, *supra* note 147, at 710; see also *Asher*, 377 F.3d at 732–33 (characterizing the PSLRA’s compromised statutory text, the result of polarizing debate, as lacking in the spirit of the law).

256. Conklin, *supra* note 220, at 1238; see also Olazábal, *supra* note 1, at 616–17 (asserting that the legislative history of the PSLRA “reinforces the disjunctive quality of the safe harbor’s . . . prongs”).

257. See *supra* notes 241–52 and accompanying text for a synthesis of the disjunctive construction with the use of scierter in the meaningful caution prong.

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>258</sup>

After reading this paragraph, the majority view took the following order from Congress: on a motion to dismiss under the meaningful caution subprong, never consider scienter.<sup>259</sup> Although Congress recommended that courts “should not examine” a speaker’s state of mind, never considering scienter ignores the clear discretion Congress gave to courts to disregard state of mind “where appropriate.”<sup>260</sup> One would also have to assume that the words “meaningful” and “important factors” do not contain within them any reference to scienter-like requirements, which is not at all necessary.<sup>261</sup> In addition, because the Conference Committee never recommends disregarding the speaker’s “state of mind” at summary judgment, “meaningful” and “important factors” would take on new and different meanings after discovery, when undisputed facts could arise that show clear evidence of actual knowledge of falsity.<sup>262</sup> Lastly, the majority’s argument requires the assumption that the cautionary statement, which is the only thing the court should look at according to the Conference Committee, does not include false or misleading risk factors known by the issuer to be false or misleading.<sup>263</sup> Reading the above assumptions into the Conference Report is not warranted, however, because, at the very least, cautionary statements must identify “important factors” that are substantive, firm specific, and relevant to the forward-looking statement.<sup>264</sup>

Unfortunately, the Conference Report provides no further guidance on what exactly “meaningful” means.<sup>265</sup> Although Congress could have made it clear that scienter is *always* irrelevant when there is “meaningful” cautionary language, it did not do so in the statute or in the Conference Report.<sup>266</sup> Therefore, this Comment follows

---

258. H.R. REP. NO. 104-369, at 44 (emphasis added).

259. See, e.g., *Miller v. Champion Enters., Inc.*, 346 F.3d 660, 672 (6th Cir. 2003) (recognizing that state of mind is irrelevant under the meaningful caution subprong). The PLSRA’s heightened pleading standards refer to “required state of mind” for scienter, thus making it clear that the Conference Report’s “state of mind” referred to scienter, as well. See 15 U.S.C. § 78u-4(b)(2) (2006) (establishing a heightened pleading standard for “required state of mind”).

260. H.R. REP. NO. 104-369, at 44.

261. See *infra* Part III.E for a definition of “meaningful” that incorporates a scienter-like component.

262. Cf. *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 734 (7th Cir. 2004) (holding the proper definition of “meaningful” that requires looking into the principal risk factors objectively faced by the defendant at the time the false forward-looking statement was made cannot effectively operate on a motion to dismiss).

263. Otherwise, the majority interpretation would allow the absurd result where false cautionary statements would protect false forward-looking statements.

264. See *supra* Part II.C.2.b for a discussion of the Conference Report’s guidance on “important factors.”

265. *Id.*

266. See *Coffee*, *supra* note 145, at 975, 977 (“Simply stated, some of the boldest, broadest statements in the Reform Act’s legislative history have only a tenuous connection to its statutory text.”).

the suggestion of the Second Circuit in *Slayton* and argues that the most reliable source of meaningfulness is the defendant's knowledge of material risk factors faced at the time it made the forward-looking statement.<sup>267</sup> "[T]his requires an inquiry into what the defendants knew because in order to determine what risks the defendants faced, [a court] must ask of what risks were they aware."<sup>268</sup>

The Conference Report makes a significant reference that reveals legislative intent in line with the definition of "meaningful" proposed in this Comment: "The Conference Committee safe harbor, like the Senate safe harbor, is based on aspects of SEC Rule 175 and the judicial created 'bespeaks caution' doctrine."<sup>269</sup> All of these sources maintain the element of scienter when analyzing false or misleading forward-looking statements and cautionary language.<sup>270</sup> The Senate's Committee Report expressly notes that the Senate-passed version of the PSLRA's safe harbor "does not protect forward-looking statements 'knowingly made with the expectation, purpose, and actual intent of misleading investors.'"<sup>271</sup> Likewise, the SEC safe harbor rules and the bespeaks caution doctrine contemplate good faith and reasonableness standards for forward-looking statements.<sup>272</sup> As a result of these references in the Conference Report, courts interpreting and applying the PSLRA's safe harbor should make something more of the PSLRA's legislative record than what the current majority of courts have.

Lastly, although disclosure rationales drove the passage of the PSLRA's safe harbor, the PSLRA's legislative process focused on curtailing abusive securities litigation.<sup>273</sup> Many members of Congress perceived an intolerable rise in frivolous lawsuits, filed for the sole purpose of extracting settlements out of innocent issuers and padding the pockets of plaintiff-attorneys and undeserving investors.<sup>274</sup> Thus, the central purpose of the PSLRA was to enact significant procedural and substantive hurdles to discourage the filing of strike suits; it was not the purpose of the Act to prevent the filing of meritorious securities fraud claims based on fraudulent forward-looking statements. Moreover, the PSLRA's stringent procedural standards allow legitimate claims to proceed to trial while concurrently encouraging courts to dismiss non-meritorious complaints early in the litigation, thereby avoiding unwarranted settlements. As with the overarching goal of the PSLRA, courts should use the

---

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

268. *Id.*

269. H.R. REP. NO. 104-369, at 43 (1995) (Conf. Rep.).

270. The SEC's safe harbor rules require a rational basis and good faith for their protection. SEC Rule 175(a), 17 C.F.R. § 230.175(a) (2010); SEC Rule 3b-6(a), 17 C.F.R. § 240.3b-6(a) (2010). The bespeaks caution doctrine requires reasonable belief, substance and tailoring, and reliability for protection. See *supra* Part II.B.2 for a discussion of the bespeaks caution doctrine. The Senate's safe harbor would not have protected false forward-looking statements made with the intent to deceive. S. REP. NO. 104-98, at 18 (1995).

271. S. REP. NO. 104-98, at 18. The Senate Committee Report also noted, however, that "market discipline will most likely provide sufficient disincentives for using the safe harbor as a 'license to lie.'" *Id.*

272. See *supra* Part II.B.1 for a discussion of the SEC safe harbor rules and Part II.B.2 for a discussion of the bespeaks caution doctrine.

273. See H.R. REP. NO. 104-369, at 32 ("This Conference Report seeks to protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation.").

274. See *supra* Part II.C.2 for a discussion of strike suits as a reason for passing the PSLRA.

PSLRA’s safe harbor to weed out frivolous securities fraud claims, but not legitimate ones, and the reading proposed in this Comment would help them do so.

*B. Critique of Majority Interpretation of the Meaningful Caution Subprong*

The plain reading of the PSLRA’s safe harbor provision promulgated by several commentators<sup>275</sup> and the Sixth, Ninth, and Eleventh Circuits,<sup>276</sup> although appealing for its simplicity, misses the mark. At first blush, finding support for the majority’s plain reading of the statute that excludes scienter in a meaningful caution analysis on a motion to dismiss seems easy—too easy because it allows issuers to overreach in safe harbor protection.<sup>277</sup> One commentator asserts that “[u]nder a plain meaning approach, the disjunctive ‘or’ between the two [dominant prongs] suggests that the cautionary language and actual knowledge prongs operate as independent, alternative means of immunizing a misleading projection.”<sup>278</sup> Although this commentator’s assertion is not necessarily inaccurate, as previously discussed, it ignores the word “meaningful” that qualifies what types of cautionary statements are sufficient for protection under the PSLRA’s safe harbor.<sup>279</sup> By overlooking this fact, the majority’s plain reading improperly extends safe harbor protection to fraudulent forward-looking statements when an issuer has actual knowledge its statements are false or misleading but contemporaneously provides cautionary statements that only amount to more than boilerplate.<sup>280</sup> Caution that appears to be more than boilerplate should not alone constitute “meaningful” caution because such a test would almost always ignore the qualitative aspects of scienter in securities fraud.<sup>281</sup>

Even the Ninth Circuit’s ruling in *In re Cutera*, which purportedly supports the majority approach of disregarding scienter in a meaningful caution analysis, does not contradict this.<sup>282</sup> In addition to the court’s explicit decision not to reconcile the district court case *In re SeeBeyond*, which concluded that scienter informs a meaningful caution analysis, the Ninth Circuit did not have to ignore the implicit representations embodied in scienter, as the general majority approach would have it.<sup>283</sup> Because the defendant, Cutera, Inc., had publicly disclosed its knowledge of the fact that ultimately

---

275. See, e.g., Conklin, *supra* note 220, at 1238 (citing 15 U.S.C. § 78u-5(c)(1) (2006); *Harris v. Ivax Corp.*, 182 F.3d 799, 803 (11th Cir. 1999)) (arguing that “[t]he disjunctive ‘or’ that separates the two prongs of the [safe harbor] provision indicates that the cautionary language and actual knowledge prongs act as independent, alternative means of immunizing a projection”).

276. See *supra* Part II.D.1 for a discussion of these courts’ holdings.

277. See *Harris*, 182 F.3d at 803–04 (holding that because the statute establishes alternative safe harbors for issuers, the scienter prong is irrelevant to the meaningful caution subprong, and thus, the defendant’s allegedly concealed knowledge of a pending \$104 million write-down was not considered).

278. Conklin, *supra* note 220, at 1242.

279. See *supra* Part III.A.2 for an alternative plain reading of the PSLRA’s safe harbor proposed by this Comment.

280. See *supra* notes 220–21 and accompanying text for this “surprising rule.”

281. See *supra* Part III.A.1 for reasons for incorporating scienter into the definition of “meaningful cautionary statements.”

282. See *supra* notes 172–80 and accompanying text for a discussion of *In re Cutera Securities Litigation*, 610 F.3d 1103 (9th Cir. 2010).

283. *In re Cutera*, 610 F.3d at 1110.

made its forward-looking statement false or misleading when made—its failing junior sales force—the court’s ruling under the meaningful caution subprong is not inconsistent with the reading of the PSLRA’s safe harbor proposed in this Comment.<sup>284</sup> Consequently, this demonstrates that the majority’s reliance on a disjunctive construction for their interpretation should not be conclusive regarding how scienter should be treated under a meaningful caution analysis.

Similarly, the Conference Report also should not provide conclusive support for the majority approach. Though the Conference Report appears to support the majority’s interpretation,<sup>285</sup> the Conference Committee provided only a suggestion to courts that it should not consider scienter in a meaningful caution analysis.<sup>286</sup> Because Congress hedged its guidance and afforded courts discretion on how to conduct a meaningful caution analysis on a motion to dismiss,<sup>287</sup> the majority approach should not be the only approach. The fervent debate and ensuing compromise of the final version of the PSLRA support a more reasonable conclusion<sup>288</sup>—that Congress did not have one set meaning for “meaningful cautionary statements” in mind when it eventually passed the bill.<sup>289</sup> A compromise between legislators on two polar sides of a debate—those who did not want a safe harbor and those who wanted a safe harbor that did not even require cautionary language at all—arguably “lack[s] spirit,” in the words of Judge Easterbrook.<sup>290</sup>

Lastly, courts and commentators arguing that the meaningful caution subprong does not require a consideration of scienter rest their conclusion on the faulty premise that materiality is the only doctrine at work in the PSLRA safe harbor’s first prong.<sup>291</sup> This argument stems from both the existence of the immateriality subprong<sup>292</sup> and the use of the words “meaningful cautionary statements” in the Third Circuit’s bespeaks caution case *Trump*, which limited the bespeaks caution doctrine to nothing more than a materiality inquiry.<sup>293</sup> Because Congress utilized these precise words when crafting the final version of the PSLRA’s meaningful caution subprong, commentators argue the analysis in *Trump* guides the statutory safe harbor’s meaningful caution analysis.<sup>294</sup>

---

284. *Id.*

285. See H.R. REP. NO. 104-369, at 47 (1995) (Conf. Rep.) (stating that the applicability of the meaningful caution subprong “does not depend on the state of mind of the defendant”).

286. See *supra* notes 253–72 for a discussion of the PSLRA’s Conference Report.

287. See H.R. REP. NO. 104-369, at 44 (suggesting that courts, where appropriate, may choose to not look at state of mind on a motion to dismiss).

288. See Coffee, *supra* note 145, at 975, 977 (“Simply stated, some of the boldest, broadest statements in the Reform Act’s legislative history have only a tenuous connection to its statutory text.”).

289. See *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 732–33 (7th Cir. 2004) (explaining that Congress did not provide meaning for “meaningful”).

290. *Id.* at 733.

291. 15 U.S.C. § 78u-5(c)(1)(A) (2006) (first dominant prong). Compare Conklin, *supra* note 220, at 1239–40 (arguing materiality approach), with Beck, *supra* note 77, at 196–204 (detailing missteps in the reasoning of the materiality approach).

292. 15 U.S.C. § 78u-5(c)(1)(A)(ii) (immateriality prong).

293. See *supra* notes 62–78 for a discussion of *Trump*.

294. See Conklin, *supra* note 220, at 1240–41 (implying that the *Trump* reasoning mandates a materiality framework for the PSLRA’s meaningful caution subprong).

This conclusion, however, ignores the missteps the *Trump* court made in limiting the bespeaks caution doctrine to a materiality framework.<sup>295</sup> Though the Supreme Court had not ruled on the bespeaks caution doctrine, the *Trump* court believed the Court impliedly accepted the focus on materiality when it stated in *Virginia Bankshares, Inc. v. Sandberg*<sup>296</sup> that “true statements may discredit [misleading statements] so obviously that the risk of real deception drops to nil.”<sup>297</sup> This premise is faulty because it misunderstands the context of the Supreme Court’s statements, which later clarified: “But not every mixture with the true will neutralize the deceptive. . . . Only when the inconsistency would exhaust the misleading conclusion’s capacity to influence the reasonable shareholder would [the action] fail on the element of materiality.”<sup>298</sup> These Supreme Court assertions do not appear to stand for only materiality; rather, in recognition of the implicit representations made by forward-looking statements,<sup>299</sup> they appear to stand for the proposition that a false or misleading forward-looking statement is immaterial only if it no longer has the “capacity” to deceive.<sup>300</sup> Consequently, the majority’s materiality approach should be rejected because it relies on the incomplete reasoning of *Trump* and improperly disregards a false or misleading forward-looking statement’s deceptive capacity, or scienter.

### C. *Too Much Issuer Protection Frustrates Disclosure Rationales*

“Underlying the complex [PSLRA] safe harbor[] was a simple, but unproven, belief: [f]ear that inaccurate projections will trigger the filing of securities class action lawsuits has muzzled corporate management.”<sup>301</sup> Nevertheless, Congress passed the PSLRA’s safe harbor to encourage additional disclosure of forward-looking information and increase informational efficiency in the marketplace.<sup>302</sup> Securities laws are founded on the principle of disclosure,<sup>303</sup> so this goal of increasing disclosure of forward-looking information via the protective mechanisms of a safe harbor aligns with

---

295. Beck, *supra* note 77, at 196–204 (explaining the *Trump* court’s missteps).

296. 501 U.S. 1083 (1991).

297. *Va. Bankshares*, 501 U.S. at 1097; *see also In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 372 (3d Cir. 1993) (suggesting that the Supreme Court impliedly accepted the materiality approach to the bespeaks caution doctrine).

298. *Va. Bankshares*, 501 U.S. at 1097–98; *see also* Beck, *supra* note 77, at 202–03 (providing an alternate understanding of *Virginia Bankshares* assertions).

299. *See supra* Part III.A.1 for a discussion of implicit representations made by makers of forward-looking statements, which necessarily implicate a scienter inquiry.

300. *See* Beck, *supra* note 77, at 203 (explaining that a materially false forward-looking statement only becomes immaterial when cautionary statements preclude a reasonable investor from drawing incorrect inferences regarding management’s beliefs). Because an issuer’s undisclosed knowledge of the false or misleading nature of its forward-looking statement would permit investors to draw incorrect inferences regarding the issuer’s actual knowledge (and thus, be deceived), this Comment argues that only cautionary statements, which reasonably reveal to investors any knowledge held by the issuer that the forward-looking statements are or will be false or misleading, can be “meaningful.”

301. SELIGMAN, *supra* note 41, at 671–72 (internal quotation mark omitted).

302. *See* H.R. REP. NO. 104-369, at 43 (1995) (Conf. Rep.) (stating the congressional intention to “enhance market efficiency” via the PSLRA’s safe harbor protection for forward-looking statements).

303. *See supra* Part II.C.1 for a discussion of the underlying principles of securities regulation.

traditional securities regulation.<sup>304</sup> Moreover, Congress developed the 1934 Act on the premise that disclosure of accurate “hard” information was beneficial to the securities markets and its investors; thus, the PSLRA of 1995 only naturally extended that rationale to “soft” information.<sup>305</sup>

Yet, all disclosure is not the same.<sup>306</sup> There is disclosure of reasonably accurate and useful company-specific information upon which investors can make intelligent investment decisions, and there is disclosure of false or misleading information made with intent to deceive.<sup>307</sup> Whereas the former type upholds the integrity of the securities markets and promotes investor confidence, the latter type serves only to distort the true value of securities and frustrate the honest functioning of the market.<sup>308</sup> Thus, securities regulation does not contemplate disclosure for the sake of disclosure,<sup>309</sup> and there should be no exception for forward-looking statements. Neither the SEC safe harbors, the judicially created bespeaks caution doctrine, nor the text and legislative history of the PSLRA says that quantity of disclosure is better than quality.<sup>310</sup>

The majority’s reading of the meaningful caution subprong, however, does just that.<sup>311</sup> In several respects, investors rely on projections and expectations made by issuing companies about their future success.<sup>312</sup> Directly, investors perceive forward-looking statements from company insiders as specialized information on the intricacies of the risks and rewards of investing in an issuer’s securities.<sup>313</sup> If the disclosure upon which investors rely is known to be false or misleading by the issuer but investors are not cautioned about that fact—and only cautioned about other, less-threatening potential risks facing an issuing company—then there is no valuable quality in that

---

304. See *supra* notes 134–39 and accompanying text for a discussion of the legislative reasoning for enacting the PSLRA’s safe harbor provisions.

305. See *supra* Part II.A for a discussion of hard and soft information and Part II.C.2 for a discussion of the purposes behind passing the PSLRA.

306. See *supra* Parts II.A and II.C.1 for a discussion of fraudulent information, which injures investors and deceives the market.

307. SEC Rule 10b–5(b), 17 C.F.R. § 10b–5(b) (2010). See also *supra* Part II.A for a discussion of false or misleading information.

308. See *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (stating that full disclosures ensure an honest market and investor confidence).

309. The foundational securities acts of 1933 and 1934 make it unlawful to use manipulative or deceptive devices in securities transactions. 15 U.S.C. § 78j(b) (2006). Thus, disclosures that have deceptive or manipulative qualities are not only discouraged, but likely illegal.

310. The SEC safe harbors require a rational basis and good faith for their protection. SEC Rule 175(a), 17 C.F.R. § 230.175-a (2010); SEC Rule 3b–6(a), 17 C.F.R. § 240.3b–6(a) (2008). The bespeaks caution doctrine requires truth, substance and tailoring, or reliability for protection. See *supra* Part II.B.2 for a discussion of the bespeaks caution doctrine. Although the Conference Report does not define “meaningful cautionary language,” it does require it to identify “important factors,” which the Conference Report states is a qualitative term requiring, at the very least, substance, relevance and firm-specific detail. H.R. REP. NO. 104-369, at 43–44 (1995) (Conf. Rep.).

311. See, e.g., Olazábal, *supra* note 1, at 629–31 (arguing that, even if the PSLRA’s safe harbor protects some fraudulent forward-looking statements, such a result is justified as a means to increase corporate disclosure of forward-looking information).

312. See *supra* Part II.A for an explanation of the significance of forward-looking information.

313. Ripken, *supra* note 10, at 931.

disclosure and no reason for allowing investors to have access to it in the first place.<sup>314</sup> Indirectly, as well, investors rely on an accurate current value of their investment because of the presumed efficiency of the securities markets.<sup>315</sup> Efficient markets reflect in the price of securities all publicly available information—the good, the bad, historical facts, and future projections.<sup>316</sup> Efficient markets do not reflect nonpublic information,<sup>317</sup> however, so protection for fraudulently concealed forward-looking information does not follow.<sup>318</sup> Fraudulent information, which the investing public does not know to be false or misleading, but which an issuer does, cannot serve to accurately inform the market because the issuer is withholding the truth.<sup>319</sup>

The majority’s interpretation, nevertheless, would protect such fraudulent statements from discovery and liability. This occurs when an issuer makes a false or misleading forward-looking statement and, at the same time, floods the market with “meaningful” caution regarding other specific risks related to that forward-looking statement, without revealing any knowledge the issuer has that the forward-looking statement is or foreseeably will be materially false or misleading.<sup>320</sup> Because of the seemingly tailored flood of caution, a court accepting the majority view would prevent a plaintiff class from arguing that an issuer still deceived the market because it knew it was making a false prediction or concealing material information.<sup>321</sup> This application of the meaningful caution subprong does nothing to “protect investors” and “enhance market efficiency”—two paramount reasons for Congress’s enacting the PSLRA.<sup>322</sup> Thus, protecting disclosure of fraudulent forward-looking statements, which do not inform investors directly or through efficient securities markets that they are inaccurate, defeats the “philosophy of full disclosure” espoused in all securities laws.<sup>323</sup>

---

314. See *id.* at 933 (explaining that the first two prongs of the safe harbor provision protect corporations that issue forward-looking statements that are known to be false so long as those statements include meaningful cautionary language that warn investors of potential risks).

315. *Id.* at 970–71. See also *supra* notes 98–101 and accompanying text for an explanation of the efficient market theory and the prevailing view that publicly traded securities markets are efficient in the semi-strong form.

316. See Ripken, *supra* note 10, at 970–72 (explaining the prevailing view of the efficient capital market hypothesis).

317. See COX ET AL., *supra* note 97, at 105 (stating that no significant empirical evidence supports a strong efficient market in which secret information is believed to be compounded into market prices).

318. See *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 731 (7th Cir. 2004) (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 241–47 (1988)) (arguing that that fraud-on-the-market theory relies on market efficiency in reflecting all available public information in the market price of securities).

319. *Id.*

320. See, e.g., *Harris v. Ivax Corp.*, 182 F.3d 799, 803–05 (11th Cir. 1999) (dismissing claim without considering allegations of fraudulent intent because the defendant had disclosed a “laundry list” of warnings); see also Ripken, *supra* note 10, at 976 (stating that even sophisticated investors, upon which efficient markets rely, may not “appreciate the magnitude of the risks of certain investments unless the warnings are communicated in a way that is cognitively salient and penetrating”).

321. See *In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 212 (1st Cir. 2005) (explaining this absurd result under the majority approach).

322. H.R. REP. NO. 104-369, at 31, 43 (1995) (Conf. Rep.).

323. *SEC v. Zandford*, 535 U.S. 813, 819 (2002).

*D. PSLRA's Heightened Procedural and Substantive Burdens Offer Sufficient Protections for Issuers Making False Forward-Looking Statements*

As one commentator phrased it, the PSLRA's safe harbor "was not so much a safe harbor as a safe ocean."<sup>324</sup> With the procedural and substantive changes made to private securities litigation with the PSLRA,<sup>325</sup> there is already sufficient protection for issuers making forward-looking statements that courts should not have to resort to an improper interpretation of the statute. To some extent, traditional securities laws have always permitted false or misleading statements to escape securities fraud liability by not imposing a policy of strict liability.<sup>326</sup> The requirements of materiality and scienter serve this purpose.<sup>327</sup> A false or misleading statement must influence the total mix of information contemplated by the reasonable purchaser to be material,<sup>328</sup> and the maker of that statement must have intended to deceive, manipulate, or defraud the market to have scienter.<sup>329</sup> Because of these requirements for liability, there should be no reason for a court to interpret the PSLRA's safe harbor to provide further substantive protection than the materiality and scienter requirements already provide.

This becomes clearer when considering the PSLRA's safe harbor provision requiring "actual knowledge" and not recklessness<sup>330</sup> and the Supreme Court's mandate that courts evaluate competing inferences on motions to dismiss.<sup>331</sup> Coupled with the higher burden on plaintiffs to prove what an issuer actually knew, the heightened pleading standards for scienter make a plaintiff's task of overcoming a motion to dismiss now unprecedentedly high.<sup>332</sup> Plaintiffs must come to court not only with a complaint of securities fraud but also a "strong inference" of actual knowledge,<sup>333</sup> and, according to the Supreme Court, a cogent inference of actual knowledge is still not enough.<sup>334</sup> The plaintiff's alleged facts must produce an inference of actual knowledge that is "more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."<sup>335</sup> Because the PSLRA stays discovery while a motion to dismiss is pending,<sup>336</sup> plaintiffs also cannot rely on the litigation process to muster up their case and must have persuasive facts in their

---

324. SELIGMAN, *supra* note 41, at 671.

325. See *supra* Part II.C.2 for a discussion of the substantive and procedural reforms embodied in the PSLRA.

326. See *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (stating that issuers are not automatically liable for making false statements but must be sufficiently culpable).

327. See *supra* note 94 for a list of required elements for a securities fraud cause of action: materiality; scienter; connection to securities transaction; reliance; economic loss; and loss causation.

328. See *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (defining materiality).

329. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193–94 n.12 (1976) (defining scienter).

330. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (stating that all circuits accept recklessness as scienter for traditional securities fraud liability).

331. *Tellabs*, 551 U.S. at 314; 15 U.S.C. § 78u–5(c)(1)(B) (2006).

332. SELIGMAN, *supra* note 41, at 671.

333. 15 U.S.C. § 78u–4(b)(2).

334. *Tellabs*, 551 U.S. at 314.

335. *Id.*

336. 15 U.S.C. § 78u–4(b)(3)(B).

complaint from the start.<sup>337</sup> Consequently, there are sufficient issuer-protecting mechanisms currently in place to prevent plaintiffs from overreaching, and courts should not have to resort to an erroneous interpretation to provide issuers more immunity than they deserve.<sup>338</sup>

*E. A New Look at the PSLRA’s Safe Harbor for Forward-Looking Statements*

The reading of the PSLRA’s safe harbor for forward-looking statements proposed in this Comment aims to strike an appropriate balance between protecting issuers that disclose forward-looking information beneficial to the securities markets and protecting investors from issuers that manipulate and deceive the markets by concealing material information important to the validity of a forward-looking statement and its cautionary language.<sup>339</sup> With this meaning for “meaningful cautionary statements,” innocent issuers will still find abundant protection in the safe harbor and investors will not have to sacrifice honesty and transparency in the marketplace.

Accordingly, this Comment proposes the following definition of “meaningful”: Cautionary statements accompanying false or misleading forward-looking statements are sufficiently “meaningful” for the meaningful caution subprong of the PSLRA’s safe harbor *only if*: (1) they contain substantive, issuer-specific, and material risk factors tailored to the forward-looking statements, *and* (2) they reasonably reveal to investors any knowledge held by the issuer that the forward-looking statements are, or more likely than not will be, false or misleading.<sup>340</sup> If an issuer complies with both of these conditions, it will have already provided the court with sufficient evidence producing strong inferences of nonfraudulent intent as a matter of law, and these nonfraudulent inferences will necessarily overcome any competing inference of fraudulent intent presented by a plaintiff. Conversely, if the defendant issuer does not meet the above two conditions, a plaintiff is free to plead a strong inference of fraudulent intent to overcome a safe harbor defense of “meaningful” cautionary language.

---

337. See H.R. REP. NO. 104-369, at 47 (1995) (Conf. Rep.) (explaining that a court shall look at only the complaint and the defendant’s moving papers on a motion to dismiss).

338. Even if not convinced by the theoretical burdens now faced by the securities fraud class action, one need only look at the empirical evidence: securities class actions involving allegations of false forward-looking statements have significantly decreased since 2005. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION CASE FILINGS: 2010 YEAR IN REVIEW 32 (2011) (showing a twenty-six percent decline in the filing of securities class actions alleging fraudulent forward-looking statements since 2006). The interesting fact about this is that the decline began after the Seventh Circuit’s pro-plaintiff *Asher* decision in 2004 and before the Ninth Circuit’s pro-defendant *Cutera* decision in 2010.

339. Additionally, the possibility of an immateriality dismissal even if actual knowledge of falsity exists strikes an important balance, long accepted by securities laws requiring materiality for fraud, between allowing issuers breathing room to make false forward-looking statements without liability and ensuring the integrity of the securities markets.

340. Whereas all courts seem to require that cautionary language contain substantive, issuer-specific, and material risk factors tailored to the forward-looking statement, the majority approach stops there. The interpretation presented in this Comment adds an additional step to the inquiry so that cautionary language is truly meaningful for investors and does not shield issuers who have concealed their actual knowledge that a forward-looking statement is or will be false or misleading.

Whereas the immateriality subprong covers statements upon which the reasonable investor would not rely,<sup>341</sup> the meaningful caution subprong depends on what the reasonable investor would consider material<sup>342</sup> and on what the *issuer* would consider *the* substantive, firm-specific and relevant material risk factors (i.e., the “important factors,” associated with the forward-looking statement).<sup>343</sup> This “meaningfulness” rests on the implicit representation made by the issuer that what it is saying in its forward-looking statement is reasonably believed and does not conceal any information that would contradict such belief.<sup>344</sup> Thus, the “important factors” referred to in the PSLRA’s safe harbor are the risk factors known to or objectively faced by the issuer about the realistic chances of the forward-looking statement being true.<sup>345</sup> As such, actual knowledge that a forward-looking statement is or will be untrue would be a factor that must be disclosed. The circumstances under which the words “meaningful” and “important factors” really become pivotal is when the speaker of a forward-looking statement actually knows his statement is misleading investors because his cautionary language does not reveal the material risk factor that “realistically could cause results to differ materially from those projected in the forward-looking statement.”<sup>346</sup> Although an issuer does not need to reveal all risk factors relevant to the forward-looking statement,<sup>347</sup> under the definition proposed in this Comment, he cannot omit a known material risk factor, foreseeably determinative of the forward-looking statements validity, without being misleading.

Consequently, courts evaluating a motion to dismiss under the PSLRA’s meaningful caution subprong should apply the above definition of “meaningful” and consider, along with a defendant’s cautionary language, a plaintiff’s alleged facts producing a strong inference of actual knowledge that a forward-looking statement was false or misleading when made. If “no [cogent] inference can be drawn that a statement regarding those risks was misleading,”<sup>348</sup> then the cautionary language is meaningful and the claim is dismissed. If a cogent inference of scienter is drawn, however, that can be at least as compelling as the nonfraudulent inferences drawn from the material risk

---

341. See *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (defining materiality as that which would substantially influence the decision of a reasonable investor and alter the total mix of information available).

342. This is because the entry point to the PSLRA’s safe harbor is “any private action . . . that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading.” 15 U.S.C. § 78u-5(c)(1) (2006).

343. See *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010) (indicating that meaningful cautionary statements cannot be evaluated without investigating the risk factors an issuer was aware of when making forward-looking statements); H.R. REP. NO. 104-369, at 43-44 (1995) (Conf. Rep.) (providing definition for “important factors”).

344. See *supra* note 17 and accompanying text for a discussion of the implicit representations of issuers making forward-looking statements.

345. See, e.g., *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 734 (7th Cir. 2004) (stating “important factors” are those that the issuer “objectively faced” and that it considered important at the time of making the forward-looking statement).

346. H.R. REP. NO. 104-369, at 43.

347. *Id.* at 44.

348. *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413 (9th Cir. 1994); see also *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007) (replacing the word “reasonable” with “cogent”).

factors and knowledge of the issuer already revealed in the issuer’s cautionary statements, then the court should not dismiss the claim and proceed to discovery. The significance of this comparative inquiry is that the PSLRA’s safe harbor will not protect the issuer who conceals its knowledge of falsity and fraudulently misleads investors, but it will protect the issuer that shares its knowledge with investors and promotes an honest and transparent marketplace.

#### IV. CONCLUSION

The majority interpretation of the PSLRA’s safe harbor for forward-looking statements retreats from a policy of full disclosure to a policy of *caveat emptor*. Such an interpretation is improper. In line with the fundamental principles of honesty and transparency in the securities markets, courts should take a closer look at the statutory safe harbor and ascribe a higher quality definition to the word “meaningful” in the phrase “meaningful cautionary statements.” Such a definition necessarily includes the qualitative aspects of scienter, and, unless an issuer making a false forward-looking statement reveals the material knowledge it possesses regarding the likelihood of truth or falsity, a plaintiff should not be foreclosed from pleading facts showing a strong inference of fraudulent intent. Blocking such allegations not only overprotects issuers making forward-looking statements but it also does nothing to improve the quality of the information available to the securities markets. Judge Milton Pollack of the Southern District of New York said it best when he wrote that the law “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.”<sup>349</sup>

---

349. *In re Prudential Sec. Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996).

