

# WHY “OR” REALLY MEANS “OR”: IN DEFENSE OF THE PLAIN MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT’S SAFE HARBOR PROVISION

**Abstract:** Structural features of the class action securities litigation system have allowed plaintiffs’ attorneys to extort settlements from risk-averse corporations. The Private Securities Litigation Reform Act (“PSLRA”) of 1995 attempted to address these structural failings by implementing wide-ranging reforms. Perhaps most significantly, the PSLRA created a safe harbor provision to immunize the type of statements typically used as ammunition in these frivolous litigations—forward-looking statements. The plain language of the safe harbor provision renders inactionable statements that are not made with actual knowledge of their falsity, or are accompanied by meaningful cautionary language. Although many courts have read this provision literally and thus determined that a forward-looking statement is immunized if it meets either of these two prongs, a minority of courts have looked beyond the plain language and determined that a statement is only immunized if it meets both prongs of the provision. This Note argues that the text, legislative history, and conceptual framework of the safe harbor provision necessitate a literal reading of its text: “or” means “or.” Additionally, it counters the chief criticism of such an approach, specifically that a literal reading produces absurd or internally inconsistent results.

## INTRODUCTION

Class action securities litigation has engendered much controversy.<sup>1</sup> On the one hand, the fact that plaintiffs’ attorneys initiate lawsuits on behalf of figurehead clients with little at stake has raised the ire of many critics.<sup>2</sup> These critics argue that class action securities litiga-

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<sup>1</sup> Eliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2054 (1995).

<sup>2</sup> See H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730 (acknowledging, based on evidence presented to Congress, widespread abuses in private securities litigations); S. Rep. No. 104-98, at 4 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683 (same); Weiss & Beckerman, *supra* note 1, at 2054. The negative implications of this dynamic are best embodied by the unfortunate story of William Lerach. See William P. Barrett, *I Have No Clients*, *Forbes*, Oct. 11, 1993, at 52. Lerach, a well-regarded plaintiffs’ lawyer, earned his living by bringing fraud actions against companies when their stock prices col-

tions are mostly “strike suits”<sup>3</sup> (typically alleging fraud) that plaintiffs’ lawyers file to coerce settlements out of innocent defendants who are unwilling to incur the substantial costs of litigation.<sup>4</sup> Moreover, critics argue that class actions initiated and directed by plaintiffs’ lawyers who are largely unaccountable to their clients produce an intractable agency problem.<sup>5</sup> They assert that this dynamic encourages plaintiffs’ attorneys to pursue settlements, even though the interests of plaintiffs (who, as members of a large class, often stand to gain only a fraction of any settlement) may dictate a different strategy.<sup>6</sup>

On the other hand, plaintiffs’ attorneys argue that they both perform a vital public service and protect blameless investors.<sup>7</sup> They assert that the filing of securities class actions compliments the Security and Exchange Commission’s (“SEC”) efforts to discourage securities fraud and represents the only feasible means of redress for investors injured by such behavior.<sup>8</sup> Moreover, even if the occasional plaintiffs’ attorney does abuse the system by pursuing self-interested ends, they argue that

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lapsed. *Id.* Although he supposedly represented named plaintiffs, Lerach largely operated independent of his clients. *Id.* And, because even weak lawsuits could cost corporations upwards of \$5 million, the majority of these cases settled and Lerach, who on average collected a third of these settlements, developed a prosperous practice. *Id.* Indeed, as Lerach infamously boasted at a meeting of corporate directors, “I have the greatest practice of law in the world. I have no clients.” *Id.*

In October of 2008, however, Lerach pleaded guilty to one count of conspiracy to obstruct justice and make false statements. *Lawyer Sentenced to 2 Years in Class-Action Kickback Scheme*, CHI. TRIB., Feb. 12, 2008, § 3, at 3. Authorities said that Lerach’s firm “made an estimated \$250 million in two decades by filing legal actions on behalf of professional plaintiffs who received kickbacks.” *Id.* During this time period, Lerach’s firm “paid \$11.3 million in kickbacks to people who became plaintiffs in lawsuits targeting companies such as AT&T, Lucent, WorldCom, Microsoft and Prudential Insurance . . .” *Id.* By allowing Lerach’s firm to be among the first to file a fraud action when a corporation’s stock price collapsed, these kickbacks secured for the firm the lucrative role of lead plaintiffs’ counsel. *Id.* As a result of his role in this scheme, Lerach was sentenced to two years in federal prison, two years of probation, fined \$250,000, and ordered to complete 1000 hours of community service. *Id.*

<sup>3</sup> A “strike” suit is a frivolous lawsuit alleging violations of the federal securities laws that is filed by a plaintiff, often a repeat, professional plaintiff, in the hope that the corporate defendant will offer a substantial settlement to avoid the expense of a protracted litigation. S. Rep. No. 104-98, at 4.

<sup>4</sup> See H.R. Rep. No. 104-369, at 31 (asserting that class action securities litigations are often brought to extort settlements from faultless defendants); S. Rep. No. 104-98, at 11 (same); Weiss & Beckerman, *supra* note 1, at 2054.

<sup>5</sup> See H.R. Rep. No. 104-369, at 31 (asserting that class action lawyers often pursue self-interested ends rather than representing their purported clients); S. Rep. No. 104-98, at 4 (same); Weiss & Beckerman, *supra* note 1, at 2054–56.

<sup>6</sup> See Weiss & Beckerman, *supra* note 1, at 2054–56.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

Rule 23 of the Federal Rules of Civil Procedure<sup>9</sup> requires courts to approve class action settlements and awards of attorneys' fees, ensuring that the interests of the class members are scrupulously honored.<sup>10</sup>

In 1995, the 104th Congress, siding with the critics of the securities class action industry, attempted to implement reform by enacting the Private Securities Litigation Reform Act (the "PSLRA").<sup>11</sup> The PSLRA instituted, among other measures, a safe harbor for the types of statements often used by plaintiffs as ammunition in these claims, specifically forward-looking statements.<sup>12</sup> Not only was this safe harbor designed to encourage disclosure of these statements by limiting corporate liability, but, by establishing certain threshold requirements, it also aimed to provide defendants with a means of resolving meritless claims at the pleadings stage.<sup>13</sup>

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<sup>9</sup> See FED. R. CIV. P. 23. In relevant part, Rule 23 provides that a court may only approve a proposed settlement if it is "fair, reasonable, and adequate," that any member of the class "may object to the proposal," and that the power to award "reasonable attorney's fees" is held by the court. *Id.*

<sup>10</sup> Weiss & Beckerman, *supra* note 1, at 2055.

<sup>11</sup> See 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.); H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730 (asserting that structural defects in the private securities litigation system encouraged plaintiffs to file meritless claims); S. REP. NO. 104-98, at 5 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683 (same). The limited empirical data available seemingly confirm the existence of the structural defects that spurred Congress to pass the PSLRA. See H.R. REP. NO. 104-369, at 42-43; S. REP. NO. 104-98, at 5; Janet Copper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 517 (1991) (finding that settlement value does not correlate with case merit). Conducting an indirect analysis, one study found that damages, calculated as a percentage of the damages claimed by the class, remained remarkably consistent across a sample of cases; five cases settled for between 24.5% and 27.5%, and a sixth case for 20.6% (with the variance of the settlement amounts of the remaining two cases explained by factors not related to case merit). See Alexander, *supra*, at 517. As such, the limited empirical data available seemingly confirm that plaintiffs' attorneys were both filing securities actions and receiving settlement payments for reasons unrelated to the merits of the particular case. See *id.*

<sup>12</sup> See 15 U.S.C. § 78u-5(c)(1) (2006). As defined by SEC Rule 175, a forward-looking statement is:

- (1) A statement containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;
- (2) A statement of management's plans and objectives for future operations;
- (3) A statement of future economic performance contained in management's discussion and analysis of financial condition and results of operations; . . .
- (4) Disclosed statements of the assumptions underlying or relating to any of the statements described in paragraphs (c) (1), (2), or (3) of this section.

17 C.F.R. § 230.175 (2008). For the purposes of this Note, unless otherwise stated, the term "projection" will be used interchangeably with the term "forward-looking statement."

<sup>13</sup> See 15 U.S.C. § 78u-5(c)(1); H.R. REP. NO. 104-369, at 32, 44.

In particular, the safe harbor provision requires that plaintiffs establish that the challenged projection either lacked sufficient disclaimers, referred to in the provision as meaningful cautionary language, or that the plaintiff made the projection with actual knowledge of its falsity.<sup>14</sup> Read literally, as has been the practice of the majority of the courts, the safe harbor provision thus operates disjunctively, immunizing forward-looking statements if the plaintiff fails to show either a lack of cautionary language or actual knowledge.<sup>15</sup> A minority of courts, however, have seemingly disregarded the statute's plain meaning and instead read the two prongs conjunctively, requiring a showing of lack of actual knowledge under both prongs.<sup>16</sup>

By limiting the reach of the safe harbor provision to projections that are both unknowingly false and accompanied by sufficient cautionary language, a countertextual reading of the provision ostensibly undercuts the PSLRA's efforts to curtail frivolous fraud claims.<sup>17</sup> Indeed, under this approach, an issuer that makes extensive risk disclosures still must typically defend (at significant expense) against the plaintiff's

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<sup>14</sup> See 15 U.S.C. § 78u-5(c)(1).

<sup>15</sup> Richard A. Rosen, *The Statutory Safe Harbor for Forward-Looking Statements: A Scorecard in the Courts from November 2004 through November 2006*, 39 SEC. REG. & L. REP. (BNA) 54, II (2007); see, e.g., *Miller v. Champion Enters.*, 346 F.3d 651, 660, 678 (6th Cir. 2003); *Harris v. Ivax Corp.*, 182 F.3d 799, 807 n.10 (11th Cir. 1999).

<sup>16</sup> See, e.g., *Freeland v. Iridium World Commc'ns, Ltd.*, 545 F. Supp. 2d 59, 72 (D.C. Cir. 2008) (holding that the two prongs must be read conjunctively); Rosen, *supra* note 15, at II (noting that several courts have ignored the literal language of the statute by applying the statute conjunctively).

<sup>17</sup> See TODD FOSTER ET AL., RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: FILINGS PLUMMET, SETTLEMENTS SOAR 2 (2007), available at [http://www.mmc.com/knowledgecenter/BRO\\_Recent\\_Trends\\_SEC1288-final.pdf](http://www.mmc.com/knowledgecenter/BRO_Recent_Trends_SEC1288-final.pdf). By adding a knowledge element to the cautionary language prong, the minority courts not only diminish the protection offered by the safe harbor but also effectively prevent claims from being resolved at the pleadings stage, thereby undermining one of the PSLRA's primary means of deterring frivolous claims. See 15 U.S.C. § 78u-5(c)(1); see also Alexander, *supra* note 11, at 524 (asserting that claims containing scienter elements are ill-suited for dismissal at the pleadings stage). Indeed, the empirical data (although an admittedly imperfect measure of the effectiveness of the PSLRA) suggest that filings have actually risen since the enactment of the safe harbor provision. See FOSTER ET AL., *supra*, at 2. From 1991 through 1995, the federal courts received an average of around 200 filings per year. See *id.* From 1996 through 2006, the yearly average of filings jumped to nearly 216. See *id.* This number would likely have been even higher if not for the significant drop-off in filings in 1996, as plaintiffs preemptively attempted to circumvent the PSLRA by filing in state courts (this loophole was quickly closed by an amendment to the PSLRA). See Securities Litigation Uniform Standard Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended at 15 U.S.C. § 77p(b) (2006)) (extending the PSLRA to the states); FOSTER ET AL., *supra*, at 1. Regardless of the precise number of filings, an upward trend is apparent and has occurred despite the curtailment efforts of the PSLRA. See FOSTER ET AL., *supra*, at 1.

knowledge claim, allowing plaintiffs to maintain the leverage that makes strike suits possible and, in turn, undermining Congress's attempt to fix the class action securities litigation system.<sup>18</sup>

This Note argues that the provision's text, its legislative history, and the conceptual framework in which it operates preclude the reading embraced by the minority courts.<sup>19</sup> Part I analyzes the early development of the limited liability regime for false or misleading forward-looking statements.<sup>20</sup> This Part examines the development of the common law precursor to the safe harbor provision, the "bespeaks caution" doctrine, as well as the enactment of the provision itself.<sup>21</sup> Part II then provides an overview of the jurisprudence of the safe harbor provision.<sup>22</sup> In particular, this Part examines both disjunctive and conjunctive treatments of the statute.<sup>23</sup> Finally, Part III argues that the text, legislative history, and conceptual framework of the provision necessitate a literal, disjunctive reading.<sup>24</sup> Additionally, it counters the chief criticism of such an approach, namely that a literal reading produces absurd or internally inconsistent results.<sup>25</sup> This Note thus concludes that the minority approach is misguided because the safe harbor provision, properly read, protects forward-looking statements when the plaintiff fails to establish either a lack of cautionary language or the presence of actual knowledge.<sup>26</sup>

## I. THE DEVELOPMENT OF A LIMITED LIABILITY REGIME FOR FALSE OR MISLEADING FORWARD-LOOKING STATEMENTS

A forward-looking statement is, as the name suggests, any statement that contains projections, plans, objectives, or forecasts of any kind.<sup>27</sup> Until early 1973, the Securities and Exchange Commission prohibited corporations from including forward-looking statements in any prospec-

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<sup>18</sup> See Alexander, *supra* note 11, at 524 (asserting that claims containing scienter elements are ill-suited for resolution at the pleadings stage); Rosen, *supra* note 15, at II ("The safe harbor would be illusory if issuers, notwithstanding scrupulous and detailed risk disclosures, still had to worry that any material divergence from projected results could nevertheless draw a fraud lawsuit, since even a patently meritless case can be expensive to defend").

<sup>19</sup> See *infra* notes 195–287 and accompanying text.

<sup>20</sup> See *infra* notes 27–119 and accompanying text.

<sup>21</sup> See *infra* notes 27–119 and accompanying text.

<sup>22</sup> See *infra* notes 120–194 and accompanying text.

<sup>23</sup> See *infra* notes 120–194 and accompanying text.

<sup>24</sup> See *infra* notes 195–287 and accompanying text.

<sup>25</sup> See *infra* notes 195–287 and accompanying text.

<sup>26</sup> See *infra* notes 195–287 and accompanying text.

<sup>27</sup> See 17 C.F.R. § 230.175 (2008); *supra* note 12 and accompanying text.

tus or report.<sup>28</sup> It maintained that these projections were inherently untrustworthy, that unsophisticated investors needed protection, and that sophisticated investors could make their own projections.<sup>29</sup> In 1973, however, acknowledging that projections were already widespread in the securities markets and were essential to the decision making of investors who must plan with an eye toward the future, the SEC reversed its long-standing policy and publically endorsed the disclosure of forward-looking statements.<sup>30</sup> In light of the federal securities laws' existing liability standards for fraudulent statements, however, increased disclosure still represented an unappealing option for most entities.<sup>31</sup> Indeed, because the SEC provides redress for materially false or misleading statements, making an inherently inaccurate projection substantially increases a corporation's exposure to liability.<sup>32</sup> To address this tension,

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<sup>28</sup> See Disclosures of Projections of Future Economic Performance, Securities Act Release No. 5362, Exchange Act Release No. 9984, 1 SEC Docket 11 (Feb. 2, 1973) [hereinafter Commission on Projections]. The SEC asserted that it has been its "long standing policy generally not to permit projections to be included in prospectuses and reports filed with the Commission." *Id.* The SEC concluded, however, that "changes in its present policies with regard to use of projections would assist in the protection of investors and would be in the public interest." *Id.*

<sup>29</sup> See Veronica H. Montagna, Comment, *The First Prong of the Safe Harbor Provision of the Private Securities Litigation Reform Act: Can It Still Provide Shelter from the Storm in the Wake of Asher v. Baxter International, Inc.?*, 58 RUTGERS L. REV. 511, 518 n.43 (2006). See generally William K. Sjoström, *Carving a New Path to Equity Capital and Share Liquidity*, 50 B.C. L. REV. 639 (2009) (discussing the SEC's treatment of sophisticated investors).

<sup>30</sup> See Commission on Projections, *supra* note 28, at 2.

<sup>31</sup> See 17 C.F.R. § 240.10b-5 (2010). SEC Rule 10b-5, the principle means of redress for false or misleading statements, states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

*Id.* In addition to Rule 10b-5, federal law provides other avenues for challenging an allegedly false or misleading statement, most notably SEC Rule 14a-9, which operates similarly to Rule 10b-5 when the misleading statement appears in a proxy statement. See 17 C.F.R. § 240.14a-9 (2010) (prohibiting false or misleading statements or omissions in proxy solicitations).

<sup>32</sup> See Safe Harbor Rule for Projections, Securities Act Release No. 6084, Exchange Act Release No. 15944, 44 Fed. Reg. 38,810 (July 2, 1979) (recognizing the need for a safe harbor provision to shield the disclosure of forward-looking information from the applicable liability provisions of the federal securities laws).

the SEC in 1979 adopted Rule 175, which, in certain circumstances, immunizes projections from the applicable liability provisions of federal securities laws.<sup>33</sup> This was the first of many changes; the liability regime for forward-looking statements underwent significant additional modifications, first with the courts' creation of the "bespeaks caution" doctrine, and, more recently, with Congress's enactment of a statutory safe harbor for certain forward-looking statements.<sup>34</sup>

This Part discusses the emergence of the limited liability regime for inaccurate forward-looking statements, which effectively originated with courts' articulation of the "bespeaks caution" doctrine.<sup>35</sup> This Part then considers courts' elucidation of the doctrine as a means of rendering a misleading forward-looking statement immaterial.<sup>36</sup> Finally, this Part examines the PSLRA's creation of a safe harbor provision for certain forward-looking statements, a development that substantially modified and obfuscated the existing limited liability regime.<sup>37</sup>

### A. *The Evolution of the "Bespeaks Caution" Doctrine*

#### 1. The Uncertain Role of Cautionary Language

The phrase "bespeaks caution" was first articulated in *Polin v. Conductron Corp.*, a 1977 decision of the U.S. Court of Appeals for the Eighth Circuit.<sup>38</sup> In *Polin*, a shareholder brought a 10b-5 action, alleging that Conductron's 1967 Annual Report constituted fraud.<sup>39</sup> The company had stated that it "expected" to show improvement and saw the "possibility" of breaking even, but ultimately failed to meet these

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<sup>33</sup> See 17 C.F.R. § 230.175 (2008). Rule 175, promulgated by the SEC in 1979, provided safe harbor for certain forward-looking statements made with a "reasonable basis" and in "good faith." *Id.* Because Rule 175's "safe harbor has not provided companies meaningful protection from litigation" and has been rendered largely moot by subsequent efforts to limit corporate liability, this Note does not conduct a detailed examination of the rule. See S. REP. NO. 104-98, at 16 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683 (discussing the shortcomings of Rule 175).

<sup>34</sup> See Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 753 (codified as amended at 15 U.S.C. § 78u-5(c)(1) (2006)) (creating the statutory safe harbor); see also, e.g., *Polin v. Conductron Corp.*, 552 F.2d 797, 806 n.28 (8th Cir. 1977) (articulating the "bespeaks caution" doctrine, a judicially created safe harbor).

<sup>35</sup> See *infra* notes 38–66 and accompanying text.

<sup>36</sup> See *infra* notes 67–89 and accompanying text.

<sup>37</sup> See *infra* notes 90–119 and accompanying text.

<sup>38</sup> 552 F.2d at 806 n.28.

<sup>39</sup> *Id.* at 806. A Rule 10b-5 action is the principle means of redress for false or misleading statements in the securities context. 17 C.F.R. § 240.10b-5 (2010). For the full text of Rule 10b-5, see *supra* note 31.

projections.<sup>40</sup> The court held, however, that “[t]he terms thus employed bespeak caution in outlook and fall far short of the assurances required for a finding of falsity and fraud.”<sup>41</sup> The court noted that “[l]anguage of expectation, of anticipation, and of possibilities recognizes the imponderable influences of complex variables in a fast-changing field.”<sup>42</sup> Because the cautionary language was sufficient to prevent reasonable investors from relying on the projections, the court determined that the disclaimers were sufficient to render the projections inactionable.<sup>43</sup>

Subsequent to *Polin*, the federal courts did not again employ the “bespeaks caution” doctrine until the case of *Luce v. Edelstein*, decided in 1986 by the U.S. Court of Appeals for the Second Circuit.<sup>44</sup> In *Luce*, the court used the language coined in *Polin* to reject the plaintiffs’ claims under Rule 10b-5.<sup>45</sup> The plaintiffs in *Luce* alleged that the Offering Memorandum of the partnership, which had been created to construct and sell condominium units, contained false statements about the partnership’s potential cash flow and tax benefits.<sup>46</sup> The court determined, however, that the Offering Memorandum properly disclaimed “that its

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<sup>40</sup> *Polin*, 552 F.2d at 806 n.28.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *See id.* Although integral to a proper understanding of the liability regime for forward-looking statements, the effect of cautionary language on a projection has received only cursory and often inconsistent treatment by the courts. *Compare In re Donald J. Trump Sec. Litig.-Taj Mahal Litig.*, 7 F.3d 357, 371–72 (3d Cir. 1993) (stating that cautionary language renders false projections immaterial), *with I. Meyer Pincus & Assocs. v. Oppenheimer & Co.*, 936 F.2d 759, 762–63 (2d Cir. 1991) (stating that cautionary language prevents false projections from misleading investors). Some courts have asserted that cautionary language renders false projections immaterial by encouraging investors to shape their actions based on the contingencies described in the cautionary language (the materiality-driven approach). *See Trump*, 7 F.3d at 371–72. Under this approach, cautionary language is only sufficient if it is substantive and tailored to the specific projection challenged by the plaintiff. *See id.* at 372. Other courts have reasoned that cautionary language renders false projections “not misleading” by preventing investors from drawing any incorrect inference from the projection (the falsity-driven approach). *See Oppenheimer*, 936 F.2d at 762–63. Under this approach, cautionary language is sufficient if it prevents the reasonable investor from drawing any incorrect inference. *See id.*; Hugh C. Beck, *The Substantive Limits of Liability for Inaccurate Predictions*, 44 AM. BUS. L.J. 161, 201 (2007).

In *Polin*, the court implicitly adopted a materiality-driven approach. *See* 552 F.2d at 806 n.28. Courts that subsequently applied the doctrine articulated in *Polin* would, for the most part, adopt a similar implicit treatment of cautionary language, with some courts seemingly favoring materiality and others falsity. *See Oppenheimer*, 936 F.2d at 762–63 (falsity); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 879 (1st Cir. 1991) (materiality).

<sup>44</sup> *See* 802 F.2d 49, 56 (2d Cir. 1986).

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 52–53.

projections of potential cash and tax benefits were necessarily speculative in nature and that no assurance could be given that these projections would be realized.”<sup>47</sup> Moreover, it “warned prospective investors that actual results may vary from the predictions and these variations may be material.”<sup>48</sup> On these facts, the court asserted that it was not inclined to impose liability for statements that clearly bespoke caution.<sup>49</sup> As in *Polin*, the “bespeaks caution” doctrine articulated in *Luce* thus stood for the proposition that cautionary language is sufficient when it prevents reasonable investors from relying on an inaccurate projection.<sup>50</sup>

After *Luce*, the “bespeaks caution” doctrine was not employed again until 1991 when several circuit courts relied on either *Polin* or *Luce* or both in holding that false or misleading projections did not necessarily result in liability.<sup>51</sup> In 1991, the U.S. Court of Appeals for the First Circuit employed the “bespeaks caution” doctrine in *Romani v. Shearson Lehman Hutton*, a case in which the plaintiff alleged that a limited partnership formed for horse breeding investments committed fraud in violation of Rule 10b-5 by inducing investments through false statements about the partnership’s financial potential.<sup>52</sup> The plaintiffs in *Romani* alleged that the statements were not assurances of guaranteed results, but, instead, implicit (and misleading) representations that the operating conditions on which the partnership’s past performance occurred would continue.<sup>53</sup> The court determined, however, that the partnership’s offering materials contained numerous statements disclosing the unpredictability of the horse breeding business and stating that the partnership’s investment objectives could not be guaranteed.<sup>54</sup> Because “the documents unquestionably warned potential investors in a meaningful way that economic conditions in the horsebreeding industry were uncertain,” the court held that the statements “clearly bespoke caution.”<sup>55</sup> Thus, as in *Polin* and *Luce*, the court determined that the cautionary language, by warning investors not to rely on the projec-

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<sup>47</sup> *Id.* at 56 (internal quotation marks and alterations omitted).

<sup>48</sup> *Id.* (internal quotation marks and alterations omitted).

<sup>49</sup> *Id.* (citing *Polin*, 552 F.2d at 806 n.28).

<sup>50</sup> See *Luce*, 802 F.2d at 56; *Polin*, 552 F.2d at 806 n.28.

<sup>51</sup> Beck, *supra* note 43, at 178.

<sup>52</sup> 929 F.2d at 876.

<sup>53</sup> See *id.* at 879.

<sup>54</sup> *Id.*

<sup>55</sup> See *id.* (internal quotation marks omitted).

tions, was sufficient to render the allegedly misleading projections inactionable.<sup>56</sup>

In another 1991 decision, *I. Meyer Pincus & Associates v. Oppenheimer & Co.*, the Second Circuit undertook a similar analysis.<sup>57</sup> In *Oppenheimer*, the plaintiffs, investors in a closed-end investment company, brought a Rule 10b-5 action against the fund for alleged misrepresentations in the fund's prospectus.<sup>58</sup> Contrary to the implicit reasoning of the earlier doctrine cases, the *Oppenheimer* court reasoned that actionability depends on whether the defendants' projections, in light of the cautionary language accompanying them, would have misled the reasonable investor.<sup>59</sup> The court determined that, given the ample disclosures about the possibility of fund shares trading at a discount, no reasonable investor would have been misled into believing that the prospectus predicted the success of its shares in the secondary market.<sup>60</sup> The court thus concluded that "[t]he statements contained within the prospectus clearly bespeak caution" because they prevented the projections from misleading the reasonable investor.<sup>61</sup>

The emergent case law thus evinced a subtle split between the courts as to the proper role of cautionary language in the "bespeaks caution" doctrine.<sup>62</sup> Because the fraud provisions of the federal securities laws, contained in Rule 10b-5, require both a showing of materiality and a showing of falsity, cautionary language, to be sufficient, must negate one of those elements.<sup>63</sup> The early doctrine cases, however, to the

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<sup>56</sup> *See id.*

<sup>57</sup> *See* 936 F.2d at 762–63.

<sup>58</sup> *Id.* at 760.

<sup>59</sup> *See id.* at 761.

<sup>60</sup> *See id.* at 763.

<sup>61</sup> *Id.* (quoting language from *Luce*, 802 F.2d at 56, and *Polin*, 52 F.2d at 806 n.28).

<sup>62</sup> *Compare Oppenheimer*, 936 F.2d at 761 (holding that cautionary language prevents false projections from misleading reasonable investors), *with Polin*, 52 F.2d at 806 n.28 (implicitly reasoning that cautionary language renders inaccurate projections immaterial by preventing investors from considering the projection important in making a decision).

<sup>63</sup> *See* 17 C.F.R. § 240.10b-5 (2010). Because both materiality and falsity are required to establish a claim under any of the fraud provisions of the federal securities laws, the two approaches to cautionary language, materiality-driven and falsity-driven, only differ in the priority accorded these elements. *See Beck*, *supra* note 43, at 182. Under a materiality-driven approach, the materiality inquiry precedes the falsity inquiry. *See id.* Only if investors demonstrate that cautionary language was insufficient to prevent them from relying on a projection will a court consider whether the projection was false. *See id.* In contrast, under a falsity-driven approach, the falsity inquiry precedes the materiality inquiry. *See id.* Only if investors demonstrate that cautionary language was insufficient to prevent them from drawing an incorrect inference from a projection will the court consider whether the investors actually relied on the projection. *See id.*

extent that they considered the mechanics of cautionary language, reached contradictory conclusions.<sup>64</sup> Although many cases, such as *Polin*, implicitly held that cautionary language rendered inaccurate projections immaterial, other cases, such as *Oppenheimer*, reasoned that cautionary language effectively prevented these projections from being false.<sup>65</sup> Thus, as the “bespeaks caution” doctrine approached the fifteenth anniversary of its creation, the question as to whether the doctrine reflected a materiality or falsity framework remained open.<sup>66</sup>

## 2. The Explication of a Materiality Framework

The U.S. Supreme Court’s 1976 decision in *TSC Industries v. Northway, Inc.* did not specifically address securities fraud but nonetheless represented the Court’s first attempt to establish a uniform standard of materiality for securities litigation.<sup>67</sup> Guided by a desire to promote fairness and encourage disclosures, the Court held that a fact is material if there is a substantial possibility that a reasonable shareholder would consider the fact important in deciding how to vote.<sup>68</sup> Subsequently, in *Basic Inc. v. Levinson*, decided in 1988, the Court explicitly adopted the *TSC* materiality standard in securities fraud actions.<sup>69</sup>

Although *TSC* and *Basic* articulated a materiality standard for securities litigation, including fraud actions, neither case specifically discussed the proper materiality standard for forward-looking statements.<sup>70</sup> *Virginia Bankshares, Inc. v. Sandberg*, decided by the Court in 1991, closed the gap.<sup>71</sup> In *Virginia Bankshares*, the Court asserted that cautionary lan-

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<sup>64</sup> See *Oppenheimer*, 936 F.2d at 761; *Polin*, 552 F.2d at 806 n.28.

<sup>65</sup> See *Oppenheimer*, 936 F.2d at 761; *Polin*, 552 F.2d at 806 n.28.

<sup>66</sup> See *Oppenheimer*, 936 F.2d at 761; *Romani*, 929 F.2d at 879; *Luce*, 802 F.2d at 56; *Polin*, 552 F.2d at 806 n.28. Operating within a materiality framework, cautionary statements render a projection inactionable (immaterial) when they are substantive and tailored to the specific projection challenged by the plaintiff. See *Trump*, 7 F.3d at 371–72. In contrast, operating within a falsity framework, cautionary statements render projections inactionable (not false) when plaintiffs fail to show “that a reasonable investor would have drawn important incorrect inferences from the publication of the prediction despite the disclosures in the accompanying statements.” Beck, *supra* note 43, at 200.

<sup>67</sup> See 426 U.S. 438, 449 (1976). *TSC* involved the use of an allegedly misleading proxy statement in violation of the SEC’s proxy rules. *Id.* at 441.

<sup>68</sup> See *id.* at 448–49.

<sup>69</sup> 485 U.S. 224, 232 (1988) (“We now expressly adopt the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b-5 context.”) (footnote omitted).

<sup>70</sup> See *id.* at 228; *TSC*, 426 U.S. at 441–42.

<sup>71</sup> See 501 U.S. 1083, 1094, 1097–98 (1991). Although the Court did not expressly identify the challenged statements as projections, it recognized that the statements were at least partially forward-looking. *Id.* at 1094 (“In this case, whether \$42 was ‘high,’ and the proposal ‘fair’ to the minority shareholders, depended on whether provable facts about the

guage renders an allegedly false or misleading projection immaterial when it prevents the projection from influencing the reasonable investor.<sup>72</sup> There, the directors of a bank had solicited proxies for approval of the bank's planned merger.<sup>73</sup> Subsequently, a minority shareholder brought suit alleging that the proxy statement's assertion that the directors had approved the merger plan because it provided "high" value and "fair" terms was materially misleading.<sup>74</sup> The Court determined, however, that misleading statements accompanied by truthful cautionary language are rendered immaterial when the inconsistency between the deceptive statement and the accurate complimentary language would exhaust the misleading conclusion's capacity to influence the reasonable shareholder.<sup>75</sup> Thus, a forward-looking statement is considered immaterial when its accompanying language prevents the reasonable investor from relying on the allegedly misleading statement.<sup>76</sup>

Working from this understanding of materiality, the U.S. Court of Appeals for the Third Circuit, in a seminal decision in 1993, *In re Donald J. Trump Securities Litigation—Taj Mahal Litigation*, addressed whether the "bespeaks caution" doctrine reflected a materiality or falsity framework by expressly articulating the implicit materiality analysis that undergirded the early "bespeaks caution" cases.<sup>77</sup> In *Trump*, bondholders in a casino acquisition and construction project sued the partnership that issued the bonds, alleging that the representations in the prospectus on the partnership's ability to repay the bonds amounted to fraud.<sup>78</sup> Citing *Polin* and *Romani*, the Third Circuit noted that a number of federal appeals courts had determined that cautionary language renders alleged misrepresentations or omissions immaterial.<sup>79</sup> To be sufficient,

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Bank's assets, and about actual and *potential* levels of operation, substantiated a value that was above, below, or more or less at the \$42 figure . . . ." (emphasis added).

<sup>72</sup> *Id.* at 1097–98.

<sup>73</sup> *Id.* at 1088.

<sup>74</sup> *Id.*

<sup>75</sup> *See id.* at 1097–98.

<sup>76</sup> *See id.*

<sup>77</sup> *See* 7 F.3d 357 at 371. As referenced below in Part II.B, commentator Hugh Beck asserts that *Trump* represents a "heretofore unacknowledged, doctrinal shift . . . [by holding] that accompanying statements appropriately tailored to a prediction render the prediction immaterial." Beck, *supra* note 43, at 163. This assertion, however, rests on the disputable assumption that all pre-1993 "bespeaks caution" case law implicitly rejected such an approach. *See id.* In part, this Note disputes the assertion that *Trump* represented such a doctrinal shift. *See infra* notes 232–240 and accompanying text.

<sup>78</sup> *Trump*, 7 F.3d at 364–65.

<sup>79</sup> *Id.* at 371. In supporting this assertion, the court also cited *Oppenheimer*; because *Oppenheimer* clearly adopted a falsity-based approach, however, this reliance is likely mis-

the court held, cautionary language must be more than mere boilerplate; the language must be both “substantive and tailored” to the specific projections challenged.<sup>80</sup> Because the cautionary language in the prospectus not only conveyed the riskiness of the investment but also directly addressed the statements challenged, the court held that the projections at issue were immaterial and thus inactionable.<sup>81</sup>

The *Trump* court thus indicated that earlier “bespeaks caution” decisions were conducting an implicit materiality analysis by finding inaccurate forward-looking statements inactionable under the fraud provisions of the federal securities laws.<sup>82</sup> In explicating this underlying materiality framework, *Trump* relied on the U.S. Supreme Court’s articulation of a materiality standard for securities fraud cases.<sup>83</sup> Although the Supreme Court’s materiality standard largely postdated the early “bespeaks caution” cases, it arose from the same conventional test of materiality that previously informed the emergent “bespeaks caution” doctrine.<sup>84</sup> As a result, the materiality standard that *Trump* saw to be underlying the early “bespeaks caution” cases and the standard articulated by the Supreme Court required the same basic inquiry: whether a false or misleading projection had the ability to impact the decision-making process of the reasonable investor.<sup>85</sup> By expressly incorporating the Court’s materiality analysis into the “bespeaks caution” doctrine, the *Trump* decision held that cautionary language prevents the reasonable investor from relying on false or misleading projections and thus renders those projections immaterial.<sup>86</sup>

Although one commentator has asserted that the *Trump* court misread precedent in articulating a materiality framework, most courts to employ the “bespeaks caution” doctrine after *Trump* have adopted this

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guided. *See id.*; *Oppenheimer*, 936 F.2d at 761 (following a falsity-based approach that proves incompatible with the *Trump* court’s materiality-based interpretation).

<sup>80</sup> *Trump*, 7 F.3d at 371–72.

<sup>81</sup> *See id.* at 373.

<sup>82</sup> *See id.* at 371.

<sup>83</sup> *Id.* at 369 (citing *TSC*, 426 U.S. at 448–50).

<sup>84</sup> *See TSC*, 426 U.S. at 445 & n.8 (adopting the conventional tort test of materiality—whether a reasonable person would attach importance to the misrepresented fact in determining a course of action—that had been widely recited in various areas of the securities laws); *Trump*, 7 F.3d at 371 (stating that the early “bespeaks caution” cases implicitly adopted a materiality-based approach).

<sup>85</sup> *See TSC*, 426 U.S. at 449; *Trump*, 7 F.3d at 371.

<sup>86</sup> *See Trump*, 7 F.3d at 369, 371.

understanding.<sup>87</sup> Thus, even if the early “bespeaks caution” decisions did not reflect an implicit materiality analysis, the *Trump* court succeeded in establishing a lasting precedent that firmly implanted this analysis in the doctrine.<sup>88</sup> As such, post-1993, the “bespeaks caution” doctrine stood for the proposition that cautionary language renders inaccurate projections inactionable by negating the materiality (not the falsity) of a false or misleading projection.<sup>89</sup>

### B. A Statutory Limit to Liability: The PSLRA’s Safe Harbor Provision

In 1995, the 104th session of Congress determined that legislation was necessary to further insulate defendants from unwarranted liability.<sup>90</sup> After hearing substantial testimony, Congress concluded that class action securities litigations were often filed by plaintiffs’ attorneys for manipulative and extortionate purposes.<sup>91</sup> Particularly, Congress found that many of these litigations constituted strike suits that were filed after a collapse in a company’s stock price by plaintiffs’ attorneys aiming to extract settlements from risk-averse defendants.<sup>92</sup> Indeed, the evidence reviewed by Congress established that certain attorneys targeted deep-pocketed defendants without consideration of actual culpability.<sup>93</sup> These plaintiffs’ lawyers not only used the discovery process to leverage settlements out of faultless defendants, but also regularly manipulated their clients to secure lucrative fee payments.<sup>94</sup> Despite the egregiousness of this behavior, Congress observed that, absent truly outrageous conduct, federal judges were largely unwilling to utilize Rule 11 of the Federal Rules of Civil Procedure to sanction offending plaintiffs.<sup>95</sup>

Congress thus concluded that the unchecked filing of frivolous securities suits significantly and detrimentally impacted not only the nation’s capital markets and corporations, but the investing public as

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<sup>87</sup> See Beck, *supra* note 43, at 163; see also, e.g., Saltzberg v. TM Sterling/Austin Assocs., 45 F.3d 399, 400 (11th Cir. 1995) (stating that cautionary language renders predictive statements immaterial); Rubenstein v. Collins, 20 F.3d 160, 167 & n.24 (5th Cir. 1994) (same).

<sup>88</sup> See Saltzberg, 45 F.3d at 400; Rubenstein, 20 F.3d at 167 & n.24; Trump, 7 F.3d at 371.

<sup>89</sup> See, e.g., Saltzberg, 45 F.3d at 400; Rubenstein, 20 F.3d at 167 & n.24; Trump, 7 F.3d at 371.

<sup>90</sup> See H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730; S. REP. NO. 104-98, at 4 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 683.

<sup>91</sup> See H.R. REP. NO. 104-369, at 31; S. REP. NO. 104-98, at 4.

<sup>92</sup> H.R. REP. NO. 104-369, at 31; S. REP. NO. 104-98, at 4.

<sup>93</sup> H.R. REP. NO. 104-369, at 31.

<sup>94</sup> *Id.*

<sup>95</sup> FED. R. CIV. P. 11; H.R. REP. NO. 104-369, at 31.

well.<sup>96</sup> The negative economic impact of these suits was most glaring.<sup>97</sup> By imposing unnecessary litigation and, often times, settlement expenses on faultless parties, these suits increased the cost of raising capital.<sup>98</sup> Moreover, by threatening to expose the defendant company and its directors to substantial (and often unwarranted) liability, these suits also deterred the most qualified candidates from serving on corporate boards and effectively chilled disclosures of predictive information.<sup>99</sup> Indeed, when frivolous litigation compels companies or their insurers to pay attorneys' fees, incur settlement expenses, and generally waste management resources, investors are ultimately the ones forced to suffer the decrease in economic efficiency.<sup>100</sup>

Accordingly, Congress determined that procedural protections were needed to safeguard against the threat of such litigation.<sup>101</sup> The Private Securities Litigation Reform Act was thus enacted on December 22, 1995.<sup>102</sup> The purpose of the legislation was threefold: "(1) to encourage the voluntary disclosure of information by corporate issuers; (2) to empower investors so that they—not their lawyers—exercise primary control over private securities litigation; and (3) to encourage plaintiffs' lawyers to pursue valid claims and defendants to fight abusive claims."<sup>103</sup> To encourage disclosure, the PSLRA instituted a safe-harbor provision that immunizes, in certain circumstances, false or misleading forward-looking statements.<sup>104</sup> To empower investors, the PSLRA cre-

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<sup>96</sup> See H.R. REP. NO. 104-369, at 32; S. REP. NO. 104-98, at 4.

<sup>97</sup> See H.R. REP. NO. 104-369, at 31-32; S. REP. NO. 104-98, at 4.

<sup>98</sup> See S. REP. NO. 104-98, at 4.

<sup>99</sup> See H.R. REP. NO. 104-369, at 31-32, 38.

<sup>100</sup> *Id.* at 32.

<sup>101</sup> *Id.*

<sup>102</sup> 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.). Following debate on the floor, the Senate passed the bill 65 votes to 30; the House, with 320 representatives voting for and 102 voting against, subsequently passed the bill with a veto-proof majority. 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, 1917-18 (2006). The bill was then sent to President Clinton, who, on December 19, with less than an hour to go before the bill automatically became law, exercised his veto power. *Id.* at 1917. The President's veto, however, was promptly overridden with the House and Senate voting to override, 319 to 100 and 68 to 30, respectively. *Id.* at 1918. The PSLRA thus became law on December 22, 1995. *Id.*

<sup>103</sup> See S. REP. NO. 104-98, at 4.

<sup>104</sup> See 15 U.S.C. § 78u-5(c)(1) (2006); S. REP. NO. 104-98, at 5. As enacted, the safe harbor provides that a defendant shall not be liable with respect to any forward-looking statement to the extent that:

(A) The forward-looking statement is—(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identify-

ated a presumption that investors with the largest financial interest would serve as the lead plaintiff, required more transparency in settlement agreements, and precluded certain abusive practices (such as plaintiffs receiving bounty payments for participation in the suit).<sup>105</sup> Finally, to encourage valid claims and deter abusive ones, the PSLRA also adopted a modified proportionate liability standard for less culpable defendants, heightened the pleading standard for bringing a securities fraud claim, and required courts to make findings regarding the compliance of all participating attorneys with Rule 11 of the Federal Rules of Civil Procedure.<sup>106</sup>

Amidst these sweeping reforms, the safe harbor provision stood out as the cornerstone of the PSLRA.<sup>107</sup> It provides three avenues through which a defendant can immunize an allegedly false or misleading projection.<sup>108</sup> First, under subsection (A), the safe harbor inoculates all projections that are identified as forward-looking and accompanied by meaningful cautionary statements that identify important factors that could cause actual results to differ materially from those projected.<sup>109</sup> This same subsection also removes from the purview of the federal securities laws any forward-looking statements deemed immaterial.<sup>110</sup> In addition, under subsection (B), the safe harbor provi-

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ing 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.

15 U.S.C. § 78u-5(c)(1) (footnote omitted).

<sup>105</sup> See S. REP. NO. 104-98, at 6.

<sup>106</sup> See *id.* at 7; see also FED. R. CIV. P. 11.

<sup>107</sup> See 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, 4 (2000) (noting that the safe harbor is the PSLRA's "most significant substantive component").

<sup>108</sup> See 15 U.S.C. § 78u-5(c)(1). For the full text of PSLRA's safe harbor provision, see *supra* note 104.

<sup>109</sup> 15 U.S.C. § 78u-5(c)(1)(A).

<sup>110</sup> *Id.* § 78u-5(c)(1)(A)(ii). This provision primarily encompasses statements that constitute puffery, which has been defined by the courts as "vague and general statements of optimism." See *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1428 n.14 (3d Cir. 1997). Because statements of puffery are understood by reasonable investors as such, investors do not rely on them and they are therefore immaterial. See *id.* Although determinations of materiality are typically left to the trier of fact, securities fraud claims often contain misrepresentations that are so obviously unimportant that courts can rule them immaterial

sion inoculates any forward-looking statements that the plaintiff fails to prove were made by the issuer with actual knowledge of their falsity.<sup>111</sup> Thus, a literal reading of the safe harbor provision immunizes defendants if, under the first prong, they accompany the forward-looking language with “meaningful cautionary statements” or if, under the third prong, they make the statements without “actual knowledge” of their falsity.<sup>112</sup>

The congressional record indicates that the safe harbor provision of the PSLRA was built on the foundations of the two earlier attempts to limit liability for inaccurate projections, namely the courts’ “bespeaks caution” doctrine and the SEC’s Rule 175.<sup>113</sup> Although Congress found that the “bespeaks caution” doctrine and Rule 175 did not adequately deter frivolous litigation, it nevertheless incorporated elements of both these earlier approaches in drafting the PSLRA.<sup>114</sup> Although Congress utilized only Rule 175’s definition of forward-looking statements, the “bespeaks caution” doctrine played a much more substantive role in Congress’s construction of the new statutory safe harbor.<sup>115</sup> The Senate Report’s articulation of the “bespeaks caution” doctrine extensively quoted language from the Third Circuit’s materiality-driven decision in *Trump*.<sup>116</sup> Indeed, in quoting from *Trump*, the Report focused on language that formally explicated a materiality-driven approach to the “be-

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as a matter of law at the pleading stage (thus furthering the PSLRA’s policy of forestalling manipulative fraud litigations). See *Payne v. DeLuca*, 433 F. Supp. 2d 547, 561 (W.D. Pa. 2006).

<sup>111</sup> 15 U.S.C. § 78u-5(c)(1)(B). Although the provision contains only two main subsections, (A) and (B), a statement receives the protection of the safe harbor in three different situations: when the statement is identified as forward-looking and accompanied with meaningful cautionary language, when the statement is immaterial, and when the defendant makes the statement without knowledge of its falsity. *Id.* § 78u-5(c)(1). Accordingly, in referencing the meaningful cautionary language and actual knowledge prongs of the provision, this Note will refer to the former as the first prong and the latter as the third prong. See *id.* The second prong, (A)(ii), is beyond the scope of this Note as the materiality-framework implicated in this Note focuses on the impact of cautionary language on the materiality of a projection, not on the facial materiality of a projection. See *id.* § 78u-5(c)(1)(A)(ii).

<sup>112</sup> See *id.* § 78u-5(c)(1). As this Note discusses in Part II, there is considerable disagreement as to whether the courts should read the safe harbor literally and thus apply the provision disjunctively or, instead, adopt a conjunctive understanding of the statute. See *infra* notes 120–194 and accompanying text.

<sup>113</sup> See H.R. REP. NO. 104–369, at 43 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730; S. REP. NO. 104–98, at 16–17 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 683.

<sup>114</sup> See H.R. REP. NO. 104–369, at 43.

<sup>115</sup> See S. REP. NO. 104–98, at 17; 17 C.F.R. § 230.175(c) (2008).

<sup>116</sup> S. REP. NO. 104–98, at 16–17.

speaks caution” doctrine.<sup>117</sup> As this reliance on *Trump* indicates, Congress, in constructing the safe harbor, envisioned cautionary language as capable of rendering inaccurate projections immaterial.<sup>118</sup> Although the PSLRA’s safe harbor provision evinces neither an adoption nor a complete supplanting of the “bespeaks caution” doctrine, the congressional record makes clear that this materiality-based conception of cautionary language was one of the elements of the doctrine that was incorporated into the statutory safe harbor.<sup>119</sup>

## II. JUDICIAL INTERPRETATIONS OF THE PSLRA’S SAFE HARBOR PROVISION

When Congress passed the PSLRA on December 22, 1995, the meaning and impact of the safe harbor provision were largely unclear.<sup>120</sup> As one commentator observed, “Congress [had] simply left too many ambiguous gaps and statutory hiatuses for the Reform Act’s impact to be reliably assessed . . . .”<sup>121</sup> Chief among these uncertainties was the interpretation of the statute’s safe harbor provision—specifically, the proper definition of meaningful cautionary language.<sup>122</sup> A clear split subsequently emerged between the federal circuit courts of appeals over precisely this issue.<sup>123</sup> The majority of circuit courts, reading the cautionary language prong as sufficient to immunize any projection accompanied by adequate disclaimers, have interpreted the safe harbor to protect statements when either the first or third prongs are satisfied (re-

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<sup>117</sup> See *id.* (“In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.”).

<sup>118</sup> See *id.*

<sup>119</sup> See *id.* Although the congressional record suggests that that safe harbor provision was not intended to be coterminous with the “bespeaks caution” doctrine, several courts have determined that the former codified the latter. See, e.g., *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1213 n.23 (1st Cir. 1996) (stating that the “bespeaks caution” doctrine was codified in the PSLRA’s safe harbor provision); *In re Copper Mountain Sec. Litig.*, 311 F. Supp. 2d 857, 881–82 (N.D. Cal. 2004) (same).

<sup>120</sup> John C. Coffee, *The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Yet Sung*, 51 BUS. LAW. 975, 975 (1996) (asserting that the PSLRA is not a fait accompli, but that it “is more like wet clay that has been shaped into an approximation of a human form by an apprentice craftsmen and has now been turned over to the master sculptor for the details that will spell the difference between high art and merely competent mediocrity”).

<sup>121</sup> *Id.*

<sup>122</sup> See *id.* at 989–90.

<sup>123</sup> See *Freeland v. Iridium World Commc’ns, Ltd.*, 545 F. Supp. 2d 59, 72 (D.D.C. 2008) (acknowledging that the circuits had split on the proper definition of meaningful cautionary language).

ferred to hereinafter as a “disjunctive reading”).<sup>124</sup> At the same time, however, a significant number of circuits have reasoned that cautionary language attached to a knowingly false projection is typically not meaningful, and have thus held that a projection must satisfy both the first and third prongs of the safe harbor provision to receive its protection (a “conjunctive reading”).<sup>125</sup> With these divergent interpretations arising from courts’ (often implicit) utilization of distinct conceptual frameworks, the circuit split arises from a fundamental disagreement as to the proper conceptual home for cautionary language.<sup>126</sup>

This Part reviews the jurisprudence relating to the PSLRA’s safe harbor provision.<sup>127</sup> Section A examines a number of decisions that have interpreted the provision disjunctively.<sup>128</sup> Section B then analyzes several conjunctive interpretations of the provision.<sup>129</sup>

### A. *Disjunctive Interpretations of the PSLRA’s Safe Harbor Provision*

A literal reading of the PSLRA’s safe harbor provision suggests a disjunctive interpretation, as the statute ostensibly immunizes a defendant’s forward-looking statements if they meet either the first prong’s meaningful cautionary statement requirement *or* the third prong’s actual knowledge requirement.<sup>130</sup> As such, a disjunctive reading suggests that the defendant’s state of mind is not relevant to a first prong analysis.<sup>131</sup> This interpretation, which conceptualizes cautionary language as a means of notifying investors of the risks attendant to the projection, is firmly rooted in the materiality framework.<sup>132</sup> The majority of the fed-

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<sup>124</sup> See, e.g., *Miller v. Champion Enters.*, 346 F.3d 651, 660, 678 (6th Cir. 2003); *Harris v. Ivax Corp.*, 182 F.3d 799, 807 n.10 (11th Cir. 1999).

<sup>125</sup> See, e.g., *Baron v. Smith*, 380 F.3d 49, 55 n.3 (1st Cir. 2004); *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 936 (9th Cir. 2003).

<sup>126</sup> See *Harris*, 182 F.3d at 807 n.10 (adopting a materiality-based approach and a disjunctive reading); *Freeland*, 545 F. Supp. 2d at 74 (adopting a falsity-based approach and a conjunctive reading).

<sup>127</sup> See *infra* notes 130–194 and accompanying text.

<sup>128</sup> See *infra* notes 130–155 and accompanying text.

<sup>129</sup> See *infra* notes 156–194 and accompanying text.

<sup>130</sup> See 15 U.S.C. § 78u-5(c)(1) (2006); Steven J. Spencer, Comment, *Has Congress Learned Its Lesson? A Plain Meaning Analysis of the Private Securities Litigation Reform Act of 1995*, 71 ST. JOHN’S L. REV. 99, 118 (1997) (noting that, under a plain meaning approach, “[e]ven deliberate omission of one or more important factors appears not to subject the issuer to private liability, since some important factors would still be identified, just not all of them”).

<sup>131</sup> See 15 U.S.C. § 78u-5(c)(1); Spencer, *supra* note 130, at 118.

<sup>132</sup> See *Harris*, 182 F.3d at 807 (stating that cautionary language is sufficient when an investor is “warned of risks of a significance similar to that actually realized, [so that] she is sufficiently on notice of the danger of the investment to make an intelligent decision

eral circuits to consider this issue have elected to adopt this literal reading and have thus determined that either a presence of cautionary language or a lack of actual knowledge immunizes a false or misleading projection.<sup>133</sup>

In July of 1999, *Harris v. Ivax Corp.*, decided by the U.S. Court of Appeals for the Eleventh Circuit, was the first circuit court-level opinion to squarely address the first prong of the PSLRA's safe harbor provision.<sup>134</sup> In *Harris*, investors filed a Rule 10b-5 fraud action against Ivax and a number of its officers.<sup>135</sup> The plaintiffs alleged that certain press releases failed to mention the possibility of a goodwill write-down that would result in a \$104 million loss in the third quarter of 1996.<sup>136</sup> The plaintiffs contended that the optimistic outlook in Ivax's press releases concealed its intention to write down goodwill and that the lists of potential risk factors contained within the releases failed to include the possibility of such a write-down.<sup>137</sup>

The court first examined the statements in the press releases and determined that each statement fell squarely within one of the defined categories of forward-looking statements.<sup>138</sup> The court thus concluded that the statements potentially qualified for safe harbor protection.<sup>139</sup> The court then considered the cautionary language that accompanied the forward-looking statements and determined that it was indeed sufficient to grant the statements the protection of the safe harbor.<sup>140</sup>

In reaching this conclusion, the court rejected the plaintiffs' contention that the language was merely boilerplate.<sup>141</sup> The court instead reasoned that the warning that Ivax appended to the press releases was detailed and informative: it told the investor what kind of hardships

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about it according to her own preferences for risk and reward."); *In re XM Satellite Radio Holdings Sec. Litig.*, 479 F. Supp. 2d 165, 185, 186 n.14 (D.D.C. 2007) (holding, in language mirroring the materiality standard articulated in *In re Trump Securities Litigation-Taj Mahal Litigation*, 7 F.3d 357 (1993), that cautionary language is sufficient when it provides "substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statement").

<sup>133</sup> See Rosen, *supra* note 15, at II.

<sup>134</sup> See 182 F.3d at 807.

<sup>135</sup> *Id.* at 802.

<sup>136</sup> *Id.* Goodwill refers to "[a] business's reputation, patronage, and other intangible assets that are considered when appraising the business, [especially] for purchase; the ability to earn income in excess of the income that would be expected from the business viewed as a mere collection of assets." BLACK'S LAW DICTIONARY 763 (9th ed. 2009).

<sup>137</sup> See *Harris*, 182 F.3d at 804.

<sup>138</sup> See *id.* at 804-07.

<sup>139</sup> *Id.* at 807.

<sup>140</sup> *Id.* at 803.

<sup>141</sup> *Id.* at 807.

could befall the company and what their effect could be.<sup>142</sup> Further, the court determined that the absence of the factor that ultimately made the forward-looking statement inaccurate—the failure to disclose the possibility of a goodwill write-down—was not dispositive of the sufficiency of the cautionary language.<sup>143</sup> The court held that, to put an investor on notice of the risk of an investment, the statute only required the warning to mention important factors that could cause actual results to differ from those predicted, not to list all such factors.<sup>144</sup> Thus, in articulating its understanding of cautionary language, the court recognized that the purpose of such language is to render false or misleading projections immaterial (as opposed to not misleading).<sup>145</sup>

The plaintiffs argued, however, that the defendants' knowledge of the need to write down goodwill stripped the projections of their forward-looking status.<sup>146</sup> The court rejected this argument as entirely unpersuasive; it reasoned that a defendant's state of mind is only relevant to liability, and then only when the cautionary language is insufficient.<sup>147</sup> Indeed, the court reasoned that when a forward-looking statement is accompanied by sufficient cautionary language, a defendant's knowledge of a projection's false or misleading nature is irrelevant to the court's safe harbor analysis.<sup>148</sup> In sum, the court determined that when investors have been warned of risks similar to those actually realized, they are sufficiently on notice of the danger of the investment to make an informed decision in accordance with their own preferences for risk.<sup>149</sup> Thus, according to the court, when cautionary language is sufficient to render a projection immaterial, the defendant's state of mind is irrelevant.<sup>150</sup>

A majority of the federal circuits have either explicitly or implicitly adopted the *Harris* court's literal reading and, in turn, its disjunctive interpretation of the PSLRA's safe harbor provision.<sup>151</sup> For instance, in

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<sup>142</sup> *Id.*

<sup>143</sup> *See Harris*, 182 F.3d at 807.

<sup>144</sup> *Id.*

<sup>145</sup> *See id.* ("In short, when 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>146</sup> *Id.* at 808 n.10.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* at 803.

<sup>149</sup> *See Harris*, 182 F.3d at 807.

<sup>150</sup> *Id.* at 803.

<sup>151</sup> *See Rosen*, *supra* note 15, at II. U.S. district courts within the Fifth, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits have read the safe harbor provision literally, extend-

2003, the U.S. Court of Appeals for the Sixth Circuit in *Miller v. Champion Enterprises* expressly cited *Harris* in determining that the projections at issue, which were accompanied by sufficient cautionary language, qualified for safe harbor protection under the PSLRA.<sup>152</sup> In articulating its understanding of cautionary language, the court asserted that issuers must only disclose the general nature of the risk and need not “detail every facet or extent of that risk,” recognizing, as did the court in *Harris*, that cautionary language serves to render projections immaterial.<sup>153</sup> Because the court determined that the contested forward-looking statements contained such cautionary language, it concluded that “[n]o investigation of defendant’s state of mind [was] required.”<sup>154</sup> The *Miller* court’s reliance on the *Harris* precedent represents the typical treatment of the safe harbor provision by federal courts.<sup>155</sup>

### B. *Conjunctive Interpretations of the PSLRA’s Safe Harbor Provision*

Although a majority of the circuits have adopted a literal interpretation of the safe harbor and have accordingly read the statute disjunctively, a substantial minority of circuits have read the first prong’s meaningful cautionary language requirement and the third prong’s actual knowledge requirement conjunctively.<sup>156</sup> Proponents of such an approach generally assert that a defendant’s actual knowledge of the false or misleading nature of a forward-looking statement prevents that de-

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ing protection to statements that either contain cautionary language or lack evidence of knowing falsity. *Id.*

<sup>152</sup> *Miller*, 346 F.3d at 678.

<sup>153</sup> *See id.* Indeed, this language effectively precludes a falsity-driven approach to cautionary language because, to be sufficient under such an approach, cautionary language must prevent the reasonable investor from drawing important incorrect inferences. *See Beck*, *supra* note 43, at 200.

<sup>154</sup> *Miller*, 346 F.3d at 678.

<sup>155</sup> *See, e.g.,* *Southland Sec. Corp. v. Inspire Ins. Solutions, Inc.*, 365 F.3d 353, 371 (5th Cir. 2004) (“The safe harbor has two independent prongs: one focusing on the defendant’s cautionary statements and the other on the defendant’s state of mind.”); *XM Satellite Radio*, 479 F. Supp. 2d at 186 n.14 (“The provision is worded disjunctively: the forward-looking statement must either be accompanied by meaningful cautionary language, or plaintiffs must fail to prove that it was made with actual knowledge of its falsity.”); *In re Splash Tech. Holdings, Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1071 (N.D. Cal. 2001) (“[T]he court already has ruled, that the two prongs of the safe harbor are ‘alternative means by which forward-looking statements may qualify for the safe harbor . . . .’”).

<sup>156</sup> *See Freeland*, 545 F. Supp. 2d at 72 (holding that the two prongs must be read conjunctively); *Rosen*, *supra* note 15, at II (noting that several courts have ignored the literal language of the statute by applying the statute conjunctively).

fendant from satisfying the first prong of the safe harbor.<sup>157</sup> That is, courts adopting a conjunctive reading argue that cautionary language cannot be meaningful if the actual factor that the defendant knew would cause the projection to be false or misleading was not explicitly included in the cautionary language.<sup>158</sup> This interpretation, which asserts that cautionary language is insufficient if it fails to prevent an investor from drawing an incorrect inference, is firmly rooted in the falsity framework.<sup>159</sup> A significant number of courts in various districts have adopted this reading and have thus held that the safe harbor provision only immunizes a defendant if the defendant accompanies a projection with sufficient cautionary language and does not make the projection with actual knowledge of its false or misleading nature.<sup>160</sup>

For instance, in 2003, the U.S. Court of Appeals for the Ninth Circuit in *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.* reasoned that a defendant may be found liable, despite the presence of cautionary language, if the plaintiff establishes that the defendant had actual knowledge of the falsity of the projection.<sup>161</sup> Although the court's determination that the challenged statements did not qualify as forward-looking suggests that this pronouncement amounts to dicta, this fact does not detract from the court's reasoning.<sup>162</sup>

Indeed, a number of district courts have independently reached similar conclusions.<sup>163</sup> In *In re Nash Finch Co. Securities Litigation*, for instance, the U.S. District Court for the District of Minnesota found that

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<sup>157</sup> See, e.g., *Baron*, 380 F.3d at 55 n.3; *America West*, 320 F.3d at 937 n.15; Schaffer v. Evolving Sys., Inc., 29 F. Supp. 2d 1213, 1224 (D. Colo. 1998).

<sup>158</sup> See *Baron*, 380 F.3d at 55 n.3; *America West*, 320 F.3d at 937 n.15; *Schaffer*, 29 F. Supp. 2d at 1224.

<sup>159</sup> See *Freeland*, 545 F. Supp. 2d at 73 (quoting Beck, *supra* note 43, at 200) (“Under this interpretation, to demonstrate that a prediction falls outside the protection of the meaningful cautionary statements safe harbor provision a plaintiff must show that a reasonable investor would have drawn important incorrect inferences from the publication of the prediction despite the disclosures in the accompanying statements.”). The courts typically neglect to explain why they have chosen to adopt a seemingly countertextual reading. See *America West*, 320 F.3d at 937 n.15 (holding without further explanation that, although the statements were not forward-looking, even if they were, “it is arguable that a strong inference of actual knowledge has been raised, thus, excepting these statements from the safe harbor rule altogether”); *Schaffer*, 29 F. Supp. 2d at 1224 (holding, without citing any support, that “Plaintiffs correctly argue that the safe harbor provision provides no refuge for Defendants who make statements with ‘actual knowledge’ of their falsity”).

<sup>160</sup> See *Baron*, 380 F.3d at 55 n.3; *America West*, 320 F.3d at 937 n.15; *Schaffer*, 29 F. Supp. 2d at 1224.

<sup>161</sup> 320 F.3d at 936.

<sup>162</sup> See *id.* at 936–37 (citing only the PSLRA).

<sup>163</sup> See, e.g., *In re Nash Finch Co. Sec. Litig.*, 502 F. Supp. 2d 861, 873 (D. Minn. 2007); *Schaffer*, 29 F. Supp. 2d at 1224.

the contested statements were both forward-looking and accompanied by sufficient cautionary language.<sup>164</sup> Nevertheless, the court held that the projections were not immunized by the PSLRA's safe harbor, as "cautionary language can not be 'meaningful' when defendants know that the potential risks they have identified have in fact already occurred, and that the positive statements they are making are false."<sup>165</sup>

In contrast to these cursory treatments of the issue, *Freeland v. Iridium World Communications*, decided in 2008 by the U.S. District Court for the District of Columbia, provided perhaps the most nuanced and comprehensive articulation of a conjunctive approach to the safe harbor provision.<sup>166</sup> In *Freeland*, plaintiffs, holders of various securities of the corporate defendant, alleged that a number of statements made by the defendant during the class period violated the federal securities laws, particularly SEC Rule 10b-5.<sup>167</sup> Plaintiffs claimed that defendant's projections were not only false, but were made with actual knowledge of their falsity.<sup>168</sup> The defendant moved for summary judgment, arguing that the safe harbor's "use of the disjunctive 'or' between subsections (A)(i), (A)(ii) and (B)(i) means that 'actual knowledge' of a statement's falsity is immaterial as long as that statement is identified as 'forward looking'" and accompanied by meaningful cautionary language.<sup>169</sup> The defendant supported this conclusion by highlighting the fact that a majority of the circuits had determined that a defendant's state of mind is irrelevant to a determination of the meaningfulness of cautionary language.<sup>170</sup>

Although conceding that some courts, including another court in the same federal district, had articulated a disjunctive understanding of the statute, the court noted that neither the U.S. Court of Appeals for the D.C. Circuit nor the U.S. Supreme Court had directly ruled on the issue.<sup>171</sup> Absent such precedent, the court concluded that the safe harbor provision did not necessarily protect statements that were knowingly false at the time they were made.<sup>172</sup>

Drawing from an article written by Hugh C. Beck, the court suggested that a proper interpretation of the safe harbor should meet

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<sup>164</sup> *Nash*, 502 F. Supp. 2d at 873.

<sup>165</sup> *Id.*

<sup>166</sup> *See* 545 F. Supp. 2d at 71–74.

<sup>167</sup> *Id.* at 63–65.

<sup>168</sup> *See id.* at 67–68.

<sup>169</sup> *Id.* at 71.

<sup>170</sup> *See id.* at 72.

<sup>171</sup> *Id.*

<sup>172</sup> *See Freeland*, 545 F. Supp. 2d at 72.

three criteria: “(1) each provision should protect some set of forward-looking statements that the other two provisions does not . . . ; (2) the provisions should provide acceptable guidance to managers; and (3) the interpretations ought to be reasonable constructions of the statutory language.”<sup>173</sup> These criteria of construction, the court found, prevent cautionary language from immunizing all defendants who disclose knowingly false or misleading forward-looking information.<sup>174</sup>

According to the Beck article, from which the court’s decision drew heavily, the Third Circuit’s decision in *In re Donald J. Trump Securities Litigation-Taj Mahal Litigation*, discussed in Part I above, represented a significant doctrinal shift in “bespeaks caution” doctrine case law.<sup>175</sup> Beck asserted that the pre-*Trump* “bespeaks caution” case law stood for the proposition that cautionary language was meaningful if it prevented an investor from drawing important incorrect inferences from a projection.<sup>176</sup> Conversely, *Trump* and its progeny asserted that cautionary language is meaningful if it renders a projection immaterial by preventing investors from inappropriately relying on the projection.<sup>177</sup>

The D.C. district court then applied Beck’s criteria of construction to the materiality framework explicated in the *Trump* decision.<sup>178</sup> Operating within this materiality framework, the court found that the statute satisfied the first of Beck’s criteria.<sup>179</sup> It reasoned that the “meaningful cautionary statements” prong of the safe harbor would not render the “actual knowledge” prong superfluous because a materiality-based interpretation protects knowingly false projections as long as they are accompanied by appropriately tailored cautionary language.<sup>180</sup> The court found, however, that such an interpretation of the safe harbor provision would unavoidably fail the second two criteria of construction.<sup>181</sup> The materiality framework fails the guidance criterion by allowing managers to make knowingly false disclosures fearlessly as long as they provide cautionary language tailored to the subject matter of the

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<sup>173</sup> *Id.* (quoting Beck, *supra* note 43, at 199).

<sup>174</sup> *Id.* at 73.

<sup>175</sup> Beck, *supra* note 43, at 163; see *supra* notes 77–89 and accompanying text.

<sup>176</sup> Beck, *supra* note 43, at 182.

<sup>177</sup> See *Freeland*, 545 F. Supp. 2d at 73; see also Beck, *supra* note 43, at 194–95. Although Beck supports the falsity-driven approach, he recognizes the existence of the distinct materiality-based approach explicated in *Trump*. See Beck, *supra* note 43, at 194–95.

<sup>178</sup> See *Freeland*, 545 F. Supp. 2d at 73.

<sup>179</sup> See *id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

projection.<sup>182</sup> Moreover, this framework also fails the third criterion because a reasonable construction of “meaningful cautionary statements” does not allow disclosures that tailor to a specific projection but fail to disclose factors that management knows will cause that projection to prove false or misleading.<sup>183</sup> Accordingly, the court asserted that the materiality framework did not provide a satisfactory interpretation of the statutory language.<sup>184</sup>

In contrast, the court determined that the falsity framework (which it found characterized the pre-*Trump* cases) allowed for a reasonable interpretation of the statutory safe harbor.<sup>185</sup> Under this framework, cautionary language renders a projection inactionable when it prevents the reasonable investor from drawing important, incorrect inferences from its publication.<sup>186</sup> This approach satisfies the first criterion because a projection made with actual knowledge of its falsity that would not cause a reasonable investor to draw important incorrect references would be immunized by the first prong while falling outside of the purview of the third prong.<sup>187</sup> Moreover, the falsity framework avoids the incentive-to-lie problem that prevents the materiality framework from satisfying Beck’s remaining two criteria of construction.<sup>188</sup> That is, because the same evidence that demonstrates that a defendant had actual knowledge of a projection’s falsity will also likely demonstrate that the cautionary language is not meaningful, managers do not have impunity to make false projections.<sup>189</sup> A falsity-based approach thus provides managers with adequate guidance and suggests a reasonable interpretation of the statutory language.<sup>190</sup> As such, the court found that the falsity framework provided a more satisfactory interpretation of the safe harbor than did the materiality-based interpretation.<sup>191</sup>

Applying this analysis to the facts of *Freeland*, the D.C. district court declined to grant the defendant summary judgment.<sup>192</sup> The court found that the plaintiffs had provided enough evidence to allow a trier of fact to find both that the defendant made the projections with actual

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<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *See Freeland*, 545 F. Supp. 2d at 73.

<sup>185</sup> *See id.*

<sup>186</sup> *See id.*

<sup>187</sup> *See id.*

<sup>188</sup> *See id.*

<sup>189</sup> *See id.* at 73–74

<sup>190</sup> *See Freeland*, 545 F. Supp. 2d at 73.

<sup>191</sup> *See id.*

<sup>192</sup> *Id.* at 74.

knowledge of their falsity and that reasonable investors could have drawn important, incorrect inferences from the defendant's disclosures.<sup>193</sup> By recognizing that the falsity-driven approach to cautionary language demands a conjunctive reading of the safe harbor provision, the court not only found the defendants' disclosures to be inadequate, but, perhaps more importantly, it explicitly articulated a conceptual home for a conjunctive reading of the safe harbor provision.<sup>194</sup>

### III. THE CASE FOR A DISJUNCTIVE READING OF THE SAFE HARBOR PROVISION

As the case law suggests, two possible interpretations of the PSLRA's safe harbor provision exist.<sup>195</sup> Equally clear, however, is the need for a reading of this provision to adequately reflect the safe harbor's text and provide a reasonable construction of its language.<sup>196</sup> As an initial matter, the materiality framework, which, according to the congressional record, informs the safe harbor provision, comports well with the plain meaning of the provision.<sup>197</sup> It does so by allowing the two prongs of the safe harbor to act as independent, alternative means of immunizing a forward-looking statement.<sup>198</sup> The text of the safe harbor provision, as well as its legislative history, affirms this disjunctive reading.<sup>199</sup> Moreover, despite the "license to lie" that purportedly results from a materiality-driven interpretation, reading the safe harbor in this light both accords with the policies undergirding the PSLRA and effectively disincentivizes the disclosure of false or misleading projections.<sup>200</sup> Thus, taken together, these factors support the conclusion that

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<sup>193</sup> See *id.*

<sup>194</sup> See *id.* at 73–74. Because a conjunctive reading strays from a literal reading of the safe harbor provision, the reasoning in *Freeland* helps justify this countertextual approach. See *id.* For the full text of the safe harbor provision, see *supra* note 104.

<sup>195</sup> See *Freeland v. Iridium World Commc'ns, Ltd.*, 545 F. Supp. 2d 59, 74 (D.D.C. 2008) (conjunctive interpretation of the safe harbor); *Harris v. Ivax Corp.*, 182 F.3d 799, 807 & n.10 (11th Cir. 1999) (disjunctive interpretation of the safe harbor).

<sup>196</sup> See 15 U.S.C. § 78u-5(c)(1) (2006).

<sup>197</sup> See *id.* § 78u-5(c)(1) (articulating the two prongs disjunctively); *Harris*, 182 F.3d at 807–08 n.10 (adopting a materiality-based approach and a disjunctive reading); S. REP. NO. 104–98, at 16–17 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 683 (referencing *In re Donald J. Trump Securities Litigation-Taj Mahal Litigation*, 7 F.3d 357 (3d Cir. 1993), the Third Circuit's seminal materiality-driven decision, in constructing the safe harbor provision).

<sup>198</sup> See 15 U.S.C. § 78u-5(c)(1); *Harris*, 182 F.3d at 807 & n.10.

<sup>199</sup> See 15 U.S.C. § 78u-5(c)(1); H.R. REP. NO. 104–369, at 44 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730 (“The second prong of the safe harbor provides an alternative analysis.”) (emphasis added).

<sup>200</sup> See *Trump*, 7 F.3d at 371; H.R. REP. NO. 104–369, at 32. Because, under a materiality-based approach, sufficient cautionary language renders false projections immaterial by

the safe harbor provision, properly interpreted, immunizes forward-looking statements either when they are accompanied by cautionary language *or* when an issuer makes such statements without actual knowledge of their falsity.<sup>201</sup>

This Part argues that the safe harbor provision demands disjunctive treatment.<sup>202</sup> Section A begins by establishing that the safe harbor operates within a materiality framework, and that, thus viewed, its two prongs must act as alternative means of immunizing a forward-looking statement.<sup>203</sup> Section B then contends that the plain language of the provision, as well as its legislative history, supports a disjunctive reading.<sup>204</sup> Finally, Section C concludes by addressing the primary criticism of a disjunctive approach, namely that it produces absurd or internally inconsistent results.<sup>205</sup>

#### A. *The Safe Harbor Provision Operates Within a Materiality Framework*

At the outset, an inquiry into the conceptual framework of the PSLRA's safe harbor provision is necessary because the framework adopted can prove determinative of the actionability of a false or misleading projection.<sup>206</sup> Indeed, just as a materiality-based approach comports better with a disjunctive reading of the safe harbor provision, a falsity-based approach comports better with a conjunctive interpretation.<sup>207</sup>

These two mutually exclusive paths—materiality and falsity—emerge because materiality and falsity are basic elements in any affirmative fraud action in the securities context.<sup>208</sup> As such, the immunizing

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preventing the projections from affecting the “total mix” of information provided to investors, any knowingly false statement that actually does impact investors will fall outside the safe harbor. *Trump*, 7 F.3d at 371.

<sup>201</sup> See 15 U.S.C. § 78u-5(c)(1); *Harris*, 182 F.3d at 807 & n.10; H.R. REP. NO. 104-369, at 32, 44.

<sup>202</sup> See *infra* notes 206–287 and accompanying text.

<sup>203</sup> See *infra* notes 206–243 and accompanying text.

<sup>204</sup> See *infra* notes 244–271 and accompanying text.

<sup>205</sup> See *infra* notes 272–287 and accompanying text.

<sup>206</sup> See *Freeland*, 545 F. Supp. 2d at 73 (noting that the defendant's materiality-based approach would produce a different outcome than the court's falsity-based approach).

<sup>207</sup> See *Harris*, 182 F.3d at 807 & n.10 (adopting a materiality-based approach and reading the safe harbor provision disjunctively); *Freeland*, 545 F. Supp. 2d at 73 (adopting a falsity-based approach and reading the provision conjunctively).

<sup>208</sup> See 17 C.F.R. § 240.10b-5 (2010); see also Beck, *supra* note 43, at 166 n.13. Beck notes that falsity and materiality together represent the initial threshold of proof that a plaintiff must meet to recover under any of the federal antifraud provisions. Beck, *supra* note 43, at 166 n.13. SEC Rule 10b-5, which often serves as an avenue for fraud claims, requires a plaintiff to prove scienter, reliance, and causation. 17 C.F.R. § 240.10b-5; Beck, *supra* note

effect of the safe harbor provision is, as a theoretical matter, necessarily premised on the negation of one of these two distinct elements.<sup>209</sup> If the PSLRA's safe harbor provision is seen as operating within a falsity framework, cautionary language is deemed meaningful if it prevents a reasonable investor from drawing important, incorrect inferences from the publication of a forward-looking statement.<sup>210</sup> That is, under a falsity-based approach, cautionary language effectively makes a projection "not misleading."<sup>211</sup> In contrast, if the PSLRA's safe harbor provision is viewed as operating within a materiality framework, cautionary language is meaningful if it prevents a reasonable investor from unduly relying on an uncertain projection.<sup>212</sup> Under this approach, cautionary language thus immunizes a projection by rendering it immaterial.<sup>213</sup>

Determining which conceptual approach properly informs the PSLRA's safe harbor provision proves significant in interpreting the provision itself.<sup>214</sup> Specifically, the framework in which the cautionary language prong operates shapes the definition of meaningful cautionary language and the role of such language in immunizing projections.<sup>215</sup> To be meaningful under a falsity-based approach, cautionary language must meet a relatively demanding standard: it must prevent a reasonable investor from drawing any important, incorrect inference from the inaccurate projection.<sup>216</sup> In contrast, under a materiality-based approach, cautionary language is meaningful if it is substantive and tailored to the specific projection challenged by the plaintiff (be-

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43, at 166 n.13. Rule 10b-5's requirement of scienter distinguishes it from the antifraud provisions of the Securities Act, under which a plaintiff may recover by proving lesser degrees of culpability. *See, e.g.*, 15 U.S.C. § 77k (2006) (requiring that a plaintiff only show that the defendant failed to undertake a reasonable investigation of the truthfulness of a misstatement); *see Beck, supra* note 43, at 166 n.13.

<sup>209</sup> *See* 17 C.F.R. § 240.10b-5; *see also Beck, supra* note 43, at 166 n.13.

<sup>210</sup> *See Freeland*, 545 F. Supp. 2d at 73

<sup>211</sup> *See id.*

<sup>212</sup> *See Trump*, 7 F.3d at 371.

<sup>213</sup> *Id.*

<sup>214</sup> *Compare Harris*, 182 F.3d at 807 & n.10 (stating that, under a materiality-based approach, the cautionary language inquiry is independent from the actual knowledge inquiry), *with Freeland*, 545 F. Supp. 2d at 73, 74 (stating that, under a falsity-based approach, the determination of whether certain disclosures constitute meaningful cautionary language requires consideration of the issuer's state of mind).

<sup>215</sup> *Compare Harris*, 182 F.3d at 807 (holding that, under a materiality-based approach, cautionary language is sufficient if it allows the reasonable investor to make an intelligent decision about an investment by providing the investor with notice of its danger), *with Freeland*, 545 F. Supp. 2d at 73 (holding that, under a falsity-based approach, cautionary language is only sufficient if it prevents a reasonable investor from drawing important, incorrect inferences from the publication of the false forward-looking statement).

<sup>216</sup> *See Freeland*, 545 F. Supp. 2d at 73.

cause such disclaimers render projections immaterial by foreclosing reasonable reliance).<sup>217</sup>

The fact that the congressional record explicitly articulates a materiality-driven approach suggests that Congress, in constructing the safe harbor provision from the “bespeaks caution” doctrine, intended to incorporate this approach into the provision itself.<sup>218</sup> In fact, the record quotes extensively from *Trump*, the seminal materiality-based decision.<sup>219</sup>

Even absent the congressional record, however, the text of the PSLRA’s safe harbor provision, read literally, better comports with a materiality-driven approach.<sup>220</sup> Indeed, although most courts have conducted only a cursory analysis of the mechanics of cautionary language, the falsity-driven approach, articulated by Beck and officially adopted by the *Freeland* court, runs afoul of the plain language of the safe harbor provision.<sup>221</sup>

The disjunctive “or” that separates the two prongs of the provision indicates that the cautionary language and actual knowledge prongs act as independent, alternative means of immunizing a projection.<sup>222</sup> For courts adopting a conjunctive reading, however, a lack of actual knowledge is typically required for a projection to receive the protection of the safe harbor provision.<sup>223</sup>

In addition to undermining both the legislative intent and the text of the safe harbor provision, the falsity framework proves unsound as a theoretical matter.<sup>224</sup> As the U.S. Supreme Court has recognized, a statement of beliefs (here, a projection) is factual in two senses: as a statement that the speaker actually holds the belief stated and as a statement about the subject matter of that belief.<sup>225</sup> Because any projec-

<sup>217</sup> See *Trump*, 7 F.3d at 371.

<sup>218</sup> See S. REP. NO. 104-98, at 17 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 683 (quoting *Trump*, 7 F.3d at 371) (“[C]autionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.”).

<sup>219</sup> *Id.*

<sup>220</sup> See 15 U.S.C. § 78u-5(c)(1) (2006) (establishing the cautionary language and actual knowledge prongs as independent, alternative means of immunizing a projection).

<sup>221</sup> See *Freeland*, 545 F. Supp. 2d at 73; Beck, *supra* note 43, at 202 (articulating the falsity-driven approach).

<sup>222</sup> See 15 U.S.C. § 78u-5(c)(1) (separating the two prongs with an “or”); *Harris*, 182 F.3d at 803 (stating that the defendant’s knowledge of the falsity of a projection is only relevant if the projection is not accompanied with meaningful cautionary language).

<sup>223</sup> See, e.g., *Baron v. Smith*, 380 F.3d 49, 55 n.3 (1st Cir. 2004); *Schaffer v. Evolving Sys., Inc.*, 29 F. Supp. 2d 1213, 1224 (D. Colo. 1998).

<sup>224</sup> See *infra* notes 225–231 and accompanying text.

<sup>225</sup> See *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1092 (1991). Beck recognizes this problem and attempts to address it by asserting that the *Virginia Bankshares* Court

tion that is made with actual knowledge of its falsity invites an investor to incorrectly infer that the issuer actually held the belief stated, such projections, under a falsity-based approach, invariably fail both the first prong (because investors could have reasonably inferred that the issuer held the belief stated) and the third prong (because the projection was made with actual knowledge of its falsity) of the safe harbor provision.<sup>226</sup> As such, when a projection is knowingly false, the falsity-based approach effectively undermines the disjunctive nature of the safe harbor provision by preventing the prongs from acting as independent means of immunizing a projection.<sup>227</sup>

The materiality-based approach avoids this interpretive problem.<sup>228</sup> Under such an approach, cautionary language is meaningful if it is substantive and tailored to the specific projection challenged by the plaintiff.<sup>229</sup> Even if an issuer knew a projection was false, the projection would still receive protection if it were accompanied by substantive and tailored cautionary language.<sup>230</sup> The materiality framework thus maintains the disjunctive nature of the safe harbor by ensuring that either the presence of cautionary language or the lack of actual knowledge will immunize a challenged projection.<sup>231</sup>

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refused to rest liability solely on the inference that the speaker actually held the beliefs stated. Beck, *supra* note 43, at 202. There is no reason, however, for this limitation to be incorporated into the falsity-based approach. See *Virginia Bankshares*, 501 U.S. at 1096. The limitation articulated by the Court in *Virginia Bankshares* only prevents plaintiffs from basing a securities fraud claim solely on the incorrect inference that the speaker actually held the beliefs stated. See *id.* It does not, however, prevent a plaintiff from relying on such an inference simply to establish that the cautionary language was insufficient. See *id.* Because a knowingly false projection is necessarily inaccurate, evidence of the issuer's disbelief in these situations will presumably be used to attack the sufficiency of the cautionary language, not to discredit the projection's accuracy. See *id.* Accordingly, under a falsity-based approach, when an issuer makes a knowingly false projection, the safe harbor provision will be completely unavailable. See *id.* This unworkable result arises because the plaintiff could have reasonably believed that the defendant did hold the belief stated, thus failing both the cautionary language prong (because of this reasonable, incorrect inference) and, of course, the actual knowledge prong. See *id.*; Beck, *supra* note 43, at 202.

<sup>226</sup> See *Virginia Bankshares*, 501 U.S. at 1093; Beck, *supra* note 43, at 202.

<sup>227</sup> See *Freeland*, 545 F. Supp. 2d at 73 (adopting a falsity-based approach and a conjunctive reading).

<sup>228</sup> See *Trump*, 7 F.3d at 371.

<sup>229</sup> See *id.*

<sup>230</sup> See *Harris*, 182 F.3d at 803; *Trump*, 7 F.3d at 371. Although at least one commentator has argued that a materiality-driven approach to cautionary language provides issuers with a license to lie, this criticism both overlooks the policy concerns underlying the PSLRA and overstates the dispensation actually granted to issuers. See Beck, *supra* note 43, at 200 (arguing that a materiality-driven approach results in a license to lie); see also *infra* notes 272–287 and accompanying text (refuting this claim).

<sup>231</sup> See *Harris*, 182 F.3d at 803.

Not only is the broader materiality-based approach more consistent with the text of the safe harbor provision as a theoretical matter, but such an approach also more accurately reflects the jurisprudence that informed the construction of the statute.<sup>232</sup> As the Third Circuit has recognized, the courts, in applying the “bespeaks caution” doctrine, have effectively asserted that cautionary language “negate[s] the materiality of an alleged misrepresentation or omission.”<sup>233</sup> In the Second Circuit’s 1986 decision in *Luce v. Edelstein*, for example, the Second Circuit held that cautionary language is meaningful when it provides notice that the projections might not materialize.<sup>234</sup> Similarly, in 1991 in *Sinay v. Lamson & Sessions Co.*, the Sixth Circuit determined that the cautionary language was sufficient because the “language would alert a reasonable investor that [the defendant’s] future was uncertain.”<sup>235</sup> By asserting that sufficient cautionary language prevents reasonable investors from unduly relying on uncertain projections, these early cases utilized (often implicitly) a materiality-driven approach.<sup>236</sup>

Indeed, the *Trump* court would later make explicit the implicit materiality framework that informed these earlier cases.<sup>237</sup> Asserting that it was following the lead of a number other courts, the *Trump* court explicitly held that sufficient cautionary language renders a projection immaterial.<sup>238</sup> By explicating that the “bespeaks caution” doctrine is premised on materiality, the Third Circuit persuasively suggested the framework within which the doctrine operates.<sup>239</sup> Citing *Trump*, subsequent applications of the “bespeaks caution” doctrine continued to explicitly define the doctrine in terms of materiality.<sup>240</sup>

As the safe harbor’s construction and context suggest, the provision must be viewed as operating within a materiality framework.<sup>241</sup>

<sup>232</sup> See S. REP. NO. 104–98, at 16–17 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 683 (quoting extensively from the Third Circuit’s decision in *Trump*, 7 F.3d 357); *Trump*, 7 F.3d at 371.

<sup>233</sup> *Trump*, 7 F.3d at 371.

<sup>234</sup> 802 F.2d 49, 56 (2d Cir. 1986).

<sup>235</sup> 948 F.2d 1037, 1040 (6th Cir. 1991).

<sup>236</sup> See *Trump*, 7 F.3d at 371; *Sinay*, 948 F.2d at 1040; *Luce*, 929 F.2d at 56.

<sup>237</sup> See *Trump*, 7 F.3d at 371 (holding that cautionary language renders alleged misrepresentations immaterial).

<sup>238</sup> See *id.*

<sup>239</sup> See *id.*

<sup>240</sup> See, e.g., *Saltzberg v. TM Sterling/Austin Assocs.*, 45 F.3d 399, 400 (11th Cir. 1995) (stating that cautionary language renders predictive statements immaterial); *Rubenstein v. Collins*, 20 F.3d 160, 166–67, 167 n.24 (5th Cir. 1994).

<sup>241</sup> See *Trump*, 7 F.3d at 371 (asserting that the “bespeaks caution” doctrine is premised on materiality).

Such an approach comports better with both the text of the provision and the “bespeaks caution” jurisprudence that informed its construction.<sup>242</sup> Indeed, viewed together, these factors effectively demand a disjunctive reading of the safe harbor provision.<sup>243</sup>

B. *The Language and Legislative History of the Safe Harbor Provision  
Require a Disjunctive Reading*

The language of the safe harbor provision reinforces the disjunctive approach that results from conceptualizing the provision as operating within a materiality framework.<sup>244</sup> The PSLRA’s safe harbor explicitly states the two prongs disjunctively, ostensibly protecting either statements accompanied by cautionary language or statements made without actual knowledge of their falsity.<sup>245</sup> A plain meaning analysis of the safe harbor thus inevitably results in a disjunctive reading of the provision.<sup>246</sup> Alternatively, if primacy is given to the safe harbor provision’s legislative history rather than its text, the provision still demands disjunctive treatment because the Conference Committee Report clearly evinces such an understanding of the statute.<sup>247</sup> Viewed in any light, the safe harbor provision must therefore be read as immunizing either projections accompanied by meaningful cautionary language, or projections made without actual knowledge of their falsity.<sup>248</sup>

In the context of securities litigations, the U.S. Supreme Court has articulated an interpretive preference for the plain meaning of a statute’s language and has downplayed the import of the statute’s legislative history.<sup>249</sup> If a statute’s text presents no ambiguities and resolves the contested issue, the Court has deemed an inquiry into the statute’s

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<sup>242</sup> See *id.* (articulating the materiality-based approach). Compare *In re XM Satellite Radio Holdings Sec. Litig.*, 479 F. Supp. 2d 165, 177 (D.D.C. 2007) (holding that, under a materiality-based approach, an examination of the first prong requires no inquiry into the issuer’s state of mind), with *Freeland*, 545 F. Supp. 2d at 73 (holding that, under a falsity-based approach, an examination of the first prong of the safe harbor typically includes an analysis of the issuer’s state of mind).

<sup>243</sup> See 15 U.S.C. § 78u-5(c)(1) (2006).

<sup>244</sup> See *id.* For the full text of the safe harbor provision, see *supra* note 104.

<sup>245</sup> See 15 U.S.C. § 78u-5(c)(1).

<sup>246</sup> See *id.*; Spencer, *supra* note 130, at 118.

<sup>247</sup> See H.R. REP. NO. 104-369, at 44 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 730 (noting that the actual knowledge prong constitutes an alternative analysis).

<sup>248</sup> See 15 U.S.C. § 78u-5(c)(1); H.R. REP. NO. 104-369, at 44.

<sup>249</sup> See *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 178, 185 (1994) (“[W]e have observed on more than one occasion that the interpretation given by one Congress (or a committee or Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute.”).

legislative history unnecessary and its fruits irrelevant.<sup>250</sup> For misleading forward-looking statements, the PSLRA's safe harbor provision expressly exculpates such projections if they are either identified as forward-looking and "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially," or the plaintiff fails to prove that the statement "was made with actual knowledge . . . that the statement was false or misleading."<sup>251</sup> Under a plain meaning approach, the disjunctive "or" between the two clauses suggests that the cautionary language and actual knowledge prongs operate as independent, alternative means of immunizing a misleading projection.<sup>252</sup>

Although the plain meaning of the safe harbor provision clearly supports a disjunctive interpretation, the U.S. Supreme Court has demonstrated a willingness to look beyond statutory language if the language is facially absurd or unclear.<sup>253</sup> The two prongs of the safe harbor provision, however, present no such ambiguities.<sup>254</sup> The actual knowledge prong, by exculpating unknowingly false projections, proves exceedingly clear.<sup>255</sup> Moreover, the cautionary language prong's use of the words "meaningful" and "important," though admittedly less straightforward, is not inherently absurd or unclear.<sup>256</sup>

Rather, common dictionary definitions of these terms provide coherent meanings that prove consistent with the general tenor of the safe harbor provision.<sup>257</sup> The term "meaningful" indicates that, to be sufficient, cautionary language must "hav[e] . . . meaning or purpose."<sup>258</sup> As such, the term accords with the materiality framework of the safe harbor provision, which suggests that cautionary language, to be sufficient, must prevent the reasonable investor from relying on a misleading projection.<sup>259</sup> Indeed, if cautionary language is to prevent a

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<sup>250</sup> *See id.*

<sup>251</sup> 15 U.S.C. § 78u-5(c)(1).

<sup>252</sup> *See* Spencer, *supra* note 130, at 118.

<sup>253</sup> *See* Immigration & Naturalization Serv. v. Cardoza-Fonseca, 480 U.S. 421, 453 (1987) (Scalia, J., concurring); *see also* Richard J. Pierce, Jr., *The Supreme Court's New Hyper-textualism: An Invitation to Cacophony and Incoherence in the Administrative State*, 95 COLUM. L. REV. 749, 750 (1995) (noting the Court's adoption of this textualist approach).

<sup>254</sup> *See* 15 U.S.C. § 78u-5(c)(1).

<sup>255</sup> *See id.*

<sup>256</sup> *See id.*

<sup>257</sup> *See id.*

<sup>258</sup> WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 736 (9th ed. 1985).

<sup>259</sup> *See Trump*, 7 F.3d at 371 (holding that cautionary language is sufficient if it prevents the reasonable investor from relying on the allegedly misleading projection); *Sinay*, 948 F.2d at 1040 (same).

reasonable investor from relying on a misleading projection, the cautionary language must have significant meaning for the investor.<sup>260</sup> Moreover, the term “important,” which indicates that the factors identified by the meaningful cautionary language must be “marked by or indicative of significant worth or consequence,”<sup>261</sup> proves similarly consistent with the general tone of the safe harbor provision. Indeed, for cautionary language to render a projection immaterial, it must identify factors that are of such consequence as to determinatively influence the reasonable investor’s decision-making process.<sup>262</sup> Accordingly, because the language of the safe harbor provision clearly addresses the possibility of knowingly false projections, the provision’s plainly disjunctive language must prevail.<sup>263</sup>

Alternatively, if courts relied on the safe harbor provision’s legislative history instead of its plain meaning, the same disjunctive reading of the provision would result.<sup>264</sup> The Conference Committee Report in the House of Representatives clearly suggests that cautionary language and lack of actual knowledge serve as independent, alternative means of inoculating a misleading projection.<sup>265</sup> Furthermore, in sharp contrast to the reasoning of the conjunctive cases, the Report clearly asserts that, under the first prong, courts should disregard the state of mind of the issuer and instead focus solely on the cautionary language that accompanied the projection.<sup>266</sup> Moreover, the policy to protect issuers from abusive fraud claims, which was pronounced by the Conference Committee in support of the safe harbor provision, accords better with the broad, disjunctive reading of the majority courts than with the narrow, conjunctive reading of the minority courts.<sup>267</sup>

The safe harbor provision thus demands disjunctive treatment.<sup>268</sup> Because the safe harbor provision clearly addresses the possibility of knowingly false projections, effect must be given to the provision’s dis-

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<sup>260</sup> See *Trump*, 7 F.3d at 371; *Sinay*, 948 F.2d at 1040.

<sup>261</sup> WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY, *supra* note 258, at 605.

<sup>262</sup> See *Trump*, 7 F.3d at 371.

<sup>263</sup> See 15 U.S.C. § 78u-5(c)(1) (2006); *Cent. Bank of Denver*, 511 U.S. at 178, 185 (holding that the plain meaning of a statute governs its interpretation).

<sup>264</sup> See H.R. REP. NO. 104-369, at 44 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 730.

<sup>265</sup> See *id.* (“The [actual knowledge] prong of the safe harbor provides an alternative analysis.”).

<sup>266</sup> See *id.* (“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>267</sup> See *id.* at 32.

<sup>268</sup> See 15 U.S.C. § 78u-5(c)(1); H.R. REP. NO. 104-369, at 32, 44.

junctive nature under a plain meaning analysis.<sup>269</sup> Alternatively, if the provision's legislative history is examined, the Conference Committee Report unmistakably asserts that the two clauses should operate independently.<sup>270</sup> Accordingly, the language and legislative history of the PSLRA's safe harbor provision demand that its two prongs be read as alternative means of immunizing a projection.<sup>271</sup>

### C. *Overcoming the Claim that the Safe Harbor Provides a License to Lie*

When examined separately, the two clauses of the safe harbor provision clearly and coherently act as independent means of exculpating misleading projections.<sup>272</sup> Proponents of a conjunctive reading of the provision argue, however, that, examined together, the two clauses effectively grant issuers a license to lie.<sup>273</sup> That is, because the safe harbor protects issuers who knowingly make misleading projections as long as the projections are accompanied by meaningful cautionary language, it is argued that the provision allows issuers to mislead investors with impunity.<sup>274</sup> This argument, however, ignores the policy concerns that animate the safe harbor provision.<sup>275</sup> It also overstates the dispensation that the provision actually grants to issuers.<sup>276</sup> As a result, disregarding the language of the safe harbor provision to avoid providing issuers with a license to lie unnecessarily circumvents the plain meaning of the provision.<sup>277</sup>

A disjunctive interpretation of the safe harbor provision furthers the policies that animate the PSLRA; under such an interpretation, issuers can issue forward-looking information liberally because they are able to defeat meritless fraud claims at the early stages of litigation (and thereby thwart plaintiffs' attempts to use the prospect of an expensive discovery process to leverage undeserved settlements).<sup>278</sup> In contrast, a

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<sup>269</sup> See 15 U.S.C. § 78u-5(c)(1); *Cent. Bank of Denver*, 511 U.S. at 178, 185.

<sup>270</sup> See H.R. REP. NO. 104-369, at 44.

<sup>271</sup> See 15 U.S.C. § 78u-5(c)(1); H.R. REP. NO. 104-369, at 32, 44.

<sup>272</sup> See 15 U.S.C. § 78u-5(c)(1).

<sup>273</sup> See *Freeland*, 545 F. Supp. 2d at 73 (asserting that the materiality-based approach provides issuers with a license to lie); Beck, *supra* note 43, at 200 (same).

<sup>274</sup> See *Freeland*, 545 F. Supp. 2d at 73.

<sup>275</sup> See H.R. REP. NO. 104-369, at 32.

<sup>276</sup> See 15 U.S.C. § 78u-5(c)(1); *Harris*, 182 F.3d at 807 (stating that cautionary language is only sufficient if it puts investors on notice of the dangers of the investment so that they can make an informed decision).

<sup>277</sup> See *Cent. Bank of Denver*, 511 U.S. at 178, 185.

<sup>278</sup> See H.R. REP. NO. 104-369, at 32, 44. By immunizing all forward-looking statements accompanied by meaningful cautionary language, the safe harbor provision allows the courts to conduct a first prong inquiry simply by referencing the challenged projections

conjunctive interpretation of the safe harbor provision undermines the PSLRA's policy concerns: by requiring proof of state of mind under both prongs, it prevents issuers from resolving meritless fraud claims at an early stage.<sup>279</sup> A disjunctive interpretation of the provision more capably addresses the policy concerns underlying the PSLRA by encouraging the dissemination of forward-looking information and discouraging meritless fraud claims.<sup>280</sup>

Moreover, viewed in a materiality framework, a disjunctive reading of the safe harbor provision simply does not grant issuers an unrestricted license to make false statements to investors.<sup>281</sup> The safe harbor does immunize issuers who knowingly make false projections, but only if, given the cautionary language, a reasonable investor would not have been influenced by the misleading projection.<sup>282</sup> Thus, issuers may be granted a license to lie, but, by preventing issuers from unduly influencing investors, the PSLRA effectively strips issuers of any reason to exercise this license.<sup>283</sup> Moreover, according to Congress, as investors begin to associate deceitful behavior with certain issuers and avoid those issuers, "market discipline" will further discourage such behavior by effectively increasing the cost of raising capital.<sup>284</sup>

That a literal, disjunctive reading of the safe harbor provision does sometimes inoculate issuers who knowingly disclose false projections, does not, therefore, prove fatal to a disjunctive reading of the provision.<sup>285</sup> Indeed, a disjunctive reading of the provision, properly viewed in a materiality framework, strips issuers of any incentive to manipulate investors by conditioning the protection of the issuer on the immateri-

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(as opposed to requiring additional discovery). *See id.* at 44. As such, the provision empowers courts to resolve clearly meritless claims at an early stage of litigation. *See id.*

<sup>279</sup> *See id.* at 32. Because proof of state of mind almost always requires evidence not readily available to plaintiffs, a conjunctive approach necessitates discovery and thus effectively prevents courts from resolving meritless claims at an early stage of litigation. *See Alexander, supra* note 11, at 527.

<sup>280</sup> *See* H.R. REP. NO. 104-369, at 32.

<sup>281</sup> *See Trump*, 7 F.3d at 371 (holding that, to be sufficient, the cautionary language must prevent the reasonable investor from relying on the misleading projection).

<sup>282</sup> *See Harris*, 182 F.3d at 807; *Trump*, 7 F.3d at 371.

<sup>283</sup> *See Harris*, 182 F.3d at 807; *Trump*, 7 F.3d at 371. If an issuer's cautionary language must be capable of preventing the reasonable investor from relying on the false projection, the issuer lacks any motivation to attempt to manipulate investors by making knowingly false projections. *Trump*, 7 F.3d at 371.

<sup>284</sup> *See* S. REP. NO. 104-98, at 18 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683 (recognizing the license to lie problem, but summarily dismissing it).

<sup>285</sup> *See* 15 U.S.C. § 78u-5(c)(1) (2006); *Cent. Bank of Denver*, 511 U.S. at 178, 185 (holding that, when a statute addresses a given issue, the statute's plain meaning should prevail).

ality of the false projection.<sup>286</sup> As such, although a disjunctive reading of the safe harbor does occasionally immunize knowingly false projections, this result hardly requires courts to disregard the plain meaning of the statute.<sup>287</sup>

### CONCLUSION

Structural features of the legal system have effectively allowed plaintiffs' attorneys to hold corporations hostage by bringing frivolous class action securities litigations. In concluding that both prongs of the safe harbor provision contain a state of mind element, too many courts have interpreted the provision in a way that undermines a primary objective of the PSLRA, namely facilitating early-stage resolution of meritless claims. If, however, the provision is viewed as operating within a materiality framework in accordance with the statute's common-law precursor and legislative history, the policies underlying the PSLRA are ably achieved. Moreover, viewing the safe harbor in this conceptual framework gives effect both to the statute's plain language and the clear intent of Congress. Although critics claim that reading the statute disjunctively effectively grants issuers a license to lie, a materiality-based approach to the provision disincentivizes such behavior. Accordingly, to forestall the threat of continued class action securities abuses by ensuring that the two prongs of the safe harbor provision act as alternative means of immunizing a projection, the courts must adopt a materiality-driven approach to the provision.

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<sup>286</sup> See *Harris*, 182 F.3d at 807; *Trump*, 7 F.3d at 371.

<sup>287</sup> See *Cent. Bank of Denver*, 511 U.S. at 178, 185.